

# ACCOUNTING AND MONEY LAUNDERING

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## **Abstract**

This study sheds light on some aspects of money laundering and the role of accounting by examining how does money laundering persist and continue to increase or go undetected for extended periods of time given the institutional settings of increasing regulation, increasing monitoring and control systems at financial institutions, and increasing attention by accounting professionals. The study consists of three individual papers all connected to the common theme of accounting and money laundering. This area of research is important for several reasons. First, the problem of money laundering is a global problem, it occurs in both developed and developing countries, and in some cases, money is moved across borders to be laundered. The propagation of money laundering facilities furthers criminal activity. One of the aims of this research program is to help shed light on the mechanisms and practices used to facilitate money laundering, with a focus on accounting techniques. Second, the research seeks to understand what happens within financial institutions, and how their systems and processes, given the tight controls, allow money to be laundered. Third, does anti-money-laundering regulation deter money laundering activity? This research agenda has implications beyond the research community. By understanding how money laundering strategies work, how accounting is implicated, and the impact of regulators and regulation, the research can be used to help prevent and detect money being laundered—which can then lead to a reduction in the crimes that generate the proceeds to be laundered.

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## **1 Introduction**

Over the past few decades there has been a concerted effort to prevent and detect illicit financial flows on a global scale. Large institutional actors such as the United Nations Office on Drugs and Crime (UNODC), the World Bank and the IMF, and Transparency International, have all been engaged on the forefront of data collection and research in areas such as drug use and its supply chain, which generate large amounts of cash to be laundered. The data collection and research assist and support international cooperation, and inform policy choices (UNODC, 2017), particularly in developing nations.

It is estimated that the amount of money laundered annually ranges anywhere from two to five percent of global GDP, or \$800 billion to \$2 trillion US dollars (UNODC, 2018). Even at the low end of the estimate, these numbers present a serious problem. Laundered money in large volumes not only skews economic growth but also erodes the rule of law, creating a cycle of continuous corruption and money laundering. Being able to successfully launder the proceeds from criminal activity in many cases requires an in-depth knowledge of accounting instruments and technologies, accounting control systems, and a network of professionals who understand the rules and have the skill sets to work around the rules.

Prior research has pointed out that accountants have joined the fight against corruption (Everett, Neu, & Rahaman, 2007), and institutional actors such as the International Federation of Accountants and the Association of Chartered Certified Accountants, have also made this claim (ICAEW, 2002; IFAC, 2015; Kirtley, 2016; Tomlinson, 2017). There is also a growing body of research in fraud and corruption that recognizes the importance of context-specific work dealing with professionals and their influence on corrupt practices (Cooper, Dacin, & Palmer, 2013).



Although there has been some research focused on context (Mitchell, Sikka, & Willmott, 1998; Arnold & Sikka, 2001; Cooper, Neu, & Lehman, 2003; Barrett, 2004; Lehman & Okcabol, 2005; Neu, Gomez, Graham, & Heincke, 2006; Everett, Neu, Rahaman, 2007; Compin, 2008; Clikeman, 2009; Neu, Everett, Rahaman, 2012; Neu, Everett, Rahaman, & Martinez, 2013; Neu, Rahaman, & Everett, 2013; Power, 2007; Power, 1999;2010;2013), there is still a significant amount of work to be done to understand how accounting and its associated technologies, instruments, and control systems either constrain or enable business activities and corrupt practices.

Criminal activity such as the illegal drug trade, human trafficking, fraud, and government corruption all have detrimental effects on human life and society. These global problems should not be underestimated; their activities generate proceeds for criminal groups whose goal is to be able to utilize the funds legally or launder the proceeds. The United Nations Office on Drug and Crime reports that the amount of money laundered annually continues to increase (UNODC, 2011). This leads us to the primary question of this research program:

*How does money laundering persist and continue to increase or go undetected for extended periods of time given the institutional settings of increasing regulation, increasing monitoring and control systems at financial institutions, and increasing attention by accounting professionals?*

This area of research is important for several reasons. First, the problem of money laundering is a global problem, it occurs in both developed and developing countries, and in some cases, money is moved across borders to be laundered. The propagation of money laundering facilities furthers criminal activity. One of the aims of this research program is to help shed light on the mechanisms and practices used to facilitate money laundering, with a focus on accounting techniques. Second, the research seeks to understand what happens within financial institutions,

and how their systems and processes, given the tight controls, allow money to be laundered. Third, does anti-money-laundering regulation actually deter money laundering activity?

This research agenda has implications beyond the research community. By understanding how money laundering strategies work, how accounting is implicated, and the impact of regulators and regulation, the research can be used to help prevent and detect money being laundered—which can then lead to a reduction in the crimes that generate the proceeds to be laundered. Our teaching can also be enhanced in a manner that produces accountants with a greater scope of knowledge and skills. The fight against corruption partially depends on accountants who can have a significant impact on the social relations of power (Everett, 2015) with the ability to put systems in place that prevent and detect negative practices from being propagated.

This research program also has a more personal dimension: I grew up in Trinidad, the most southerly island in the Caribbean, a country whose prosperity is highly dependent on the price of oil. Trinidad is also a short boat trip away from Venezuela. Over the years I have seen corrupt governments siphon funds from the country with no action taken, witnessed the drug trade taking over street corners, and watched as young women have turned to crude lifestyles—just to mention a few of the negative impacts of corruption and drugs.

Given that the research question is quite broad in scope, with many social actors involved, the social praxeology of Bourdieu (Bourdieu & Wacquant, 1992) is introduced as a starting point to outline a field of focus, with the major players shown below. Tensions or conflict can occur between any pair of social actors in

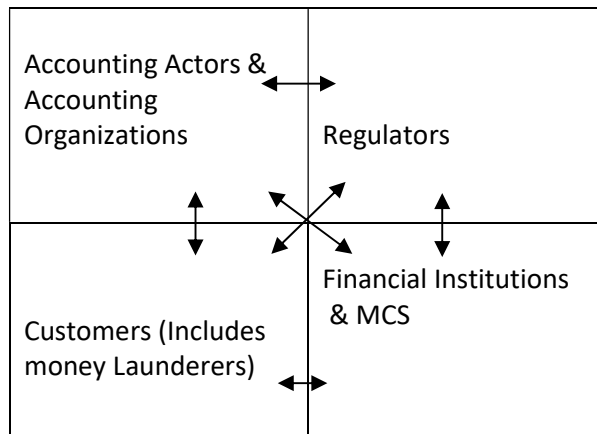


Figure 1. 1 Diagram showing relations of tension in the field.

either a horizontal or vertical direction, but tensions may not always exist between pairs. For tension or conflict to occur between any pair, the groups must have different motivations and different views about financial transactions or how the money is moved. In one sense we can say their values are different and oppose each other on the same subject. Although researchers and institutional investors can influence the field, they are viewed as situated on the periphery of this field acting as information agents, both supplying information to their peers and to the public.

Accounting actors can be seen in many ways and have been seen differently over time, but regardless of the different views, we cannot discount the role of accounting actors in helping to maintain social order. Prior research has highlighted some of these, such as, to name a few, Everett et al. (2015), Neu, Cooper, & Everett (2001), Cooper (2002), Sikka & Willmott (1995a,1995b, 1997a, 1997b, 2010).

This research aims to highlight some of the tensions that may exist among different groups in the field associated with money laundering, and how these tensions may lead to spaces that permit money laundering and other negative practices to fester and grow, going undetected for extensive periods of time. The research program also focuses on the adaptive nature of accounting

practices and management control systems in the fields where corruption and money laundering occur. The research shows how skillful accounting and auditing practices are used, and how they can be propagated within the financial sector to facilitate business transactions with stakeholders, while simultaneously adapting to the changing regulatory environment.

The dissertation consists of three separate but related studies based on the original diagram of tensions as follows: The first study, intended to set the stage for the practices of accounting and auditing research examines how accounting researchers situate “accounting” and “auditing” in the academic field of journal publications, and how accountants and auditors are viewed through the research lens as they operate in the practical field. In other words, the paper looks at “What are researchers observing about accountants and auditors and how they practice?” This paper highlights some of the tensions researchers face in crafting publications, while simultaneously being objective about how accounting professionals perform. The second paper focuses on how networks utilize the accounting technologies and instruments to facilitate the money laundering process. Paper three focuses specifically on the adaptive nature of accounting control systems within the banking sector and shows how accounting control system and MCS are used to facilitate the money laundering process. Building on this body of research, as internal control system failures become public knowledge, future research will take the process one step further, looking at the role of regulatory action and the impact it has on investors’ responses the choice of theory is presented next, followed by a summary of the three main papers and their contributions. The thesis is summed up at the end of the introduction.

## 1.1 General Theory

First, theory provides us with a lens to help us understand the world and a set of conceptual tools to challenge the practices we observe. Our research begins with the ‘common sense’ notion that increasing regulation, with more and better banking control systems, tighter controls, more accountants, and even more elaborate ethical codes of conduct, should lead to better prevention and detection of money laundering practices. Yet contrary to this ‘common sense’ view, we observe that, despite these changes in the institutional settings of more regulation, tighter control systems and so on, money laundering continues to persist and increase. These conflicting views present some challenges to our understanding of money laundering, how it works, and what the mechanisms are that allows it to continue to thrive under these conditions.

To help us think through these issues in a productive way, our research employs Bourdieu’s conceptual tools and theory of practice. Bourdieu emphasizes that theory is a means of not only viewing and understanding existing practice but is also a means of challenging practice (Bourdieu, 1996a). Bourdieu’s theoretical conceptual of *field, capital, and habitus* have been in organizational studies and in the accounting literature for some time. These three concepts, according to Bourdieu, cannot be considered or used independently of each other (Bourdieu & Wacquant, 1992). Field and the accompanying habitus and capital are used to make sense of social space in societies, and the practical action within it (Bourdieu, 1985) along with changing social conditions (Bourdieu, 1996a).

“A field consists of a set of objective, historical relations between positions anchored in certain forms of power (or capital), while habitus consists of a set of historical relations deposited

within individual bodies in the form of mental and corporeal schemata of perception, appreciation, and action” (Bourdieu & Wacquant, 1992).

Social actors are positioned within a field based on their possession of capital or power that is relevant or valued to the purpose of the field. Over time, these positions produce in agents and institutions particular ways of acting, speaking, and thinking (Bathmaker, 2015). Habitus also links past fields to present fields through individual actors who move from one field to the next (Emirbayer & Johnson, 2007) and the concept of habitus offers a powerful means of linking macro-level and micro-level processes together in organizational theory.

Although this research thesis utilizes Bourdieu’s concepts, the research does not advocate that these concepts are the only useful way to theorize or view this work; however, Bourdieu’s concepts do provide a good starting point for analysis and provide an opportunity to raise questions and to identify the tensions that may exist in the field of money laundering.

## **1.2 Summary #1 – Illicit Financial Flows, Accounting and Auditing: A View from Practice**

This study examines how accounting and auditing is situated in the field of money laundering as seen by the researchers in the field. Through a content analysis of over 475 articles published from 2001 to 2016 in the *Journal of Money Laundering Control* the study looks at the how accounting and auditing practices are viewed to play a role in illicit financial flows, and how detailed the role is documented.

The paper's analysis identifies five primary themes through the analysis, namely: (1) Accounting professionals and a failure to perform, (2) Independence and ethical dilemmas, (3) Legislation and accountancy, (4) A few good accountants required, and (5) Forging an auditor. This thematic analysis contributes to the literature in several ways:

First, it looks specifically at the research published in a specific journal of practice and draws attention to how accounting and auditing is situated within the literature. This focus is important to researchers as it pin-points the specific ways accounting is being used in corruption and money laundering, while pointing to where opportunities exist for further accounting research. The paper builds on the recent body of research on fraud and corruption, be it the fight against corruption by large institutional organizations (Uddin & Hopper, 2001; 2003; Loft & Aggestam-Pontoppidan, 2007; Annisette, 2004; Neu, Gomez, Graham, & Heincke, 2006) or fraud with a specific focus on individual wrong-doing such as in Albrecht, Albrecht, Albrecht, & Zimbelman (2011), Brody, Melendy, & Perri (2012), and Hoffman & Zimbelman (2009).

Second, the paper shows how accountants and auditors are viewed through the lens of researchers in the field and highlights some of the biases faced by researchers in the production of

accounting research. This is important since it helps to identify how the information content of research is valued differently in different fields, the perceived value of research in academia is different than its value to practice. And third, the paper highlights themes that show a view from academic research almost contrary to what the accounting bodies and transnational organizations portray, and the research sometimes calls into question the high ethical standards that professional accountancy bodies espouse.



### **1.3 Summary #2 – Money laundering and Accounting**

This study focuses on accounting and the accountant's role in the complex relationships between organized crime and the mechanisms for moving illicit financial flows into legal financial systems. Recognizing that being able to launder criminal proceeds helps to propagate criminal activities, the paper contributes to the body of research on corruption (Mitchell, Sikka & Willmott, 1998; Everett, Neu & Rahaman, 2007; Compin, 2008; Neu, Everett, Rahaman & Martinez, 2012; Cooper, Dacin, Palmer, 2013 ) by providing supporting evidence highlighting why such negative behaviors persist despite regulation and strong anti-corruption barriers (Neu et al, 2012).

First, we highlight some of the major areas of the production of money to be laundered: fraud, organized crime and drugs, the drug supply chain, corruption along the supply chain, and politically exposed persons and public corruption. Then the paper shows some methods of moving bulk cash into the financial system and highlights the financial system's vulnerability to money laundering. The case studies on two banks— Ocean Bank and Zions Bank—highlight how a bank's internal controls provide opportunities to money launderers; the case studies also contribute to the existing literature by discussing several factors that ultimately lead to money laundering.

The paper discusses how banks' responses to regulators' allegations regarding issues of internal control deficiencies have become standardized, with banks neither admitting nor denying the issue of internal control problems, which leads to propagating internal control practices ultimately leading to money laundering. The paper also discusses how the response by regulators have become routine, with a lack of urgency. Regulators have become accepting of the shortfalls of banks and there is no real penalty for banks with deficient internal controls. The paper then discusses crime networks and accounting, with a focus on the capital needed in the field to (i) be

able to structure the transactions and (ii) to become recognized as someone who can perform the tasks of money laundering. And lastly, the paper discusses crime network adaptability from the perspective of the value of the accountant and how accountants, either from within the crime network or as a contract firm, position themselves with the capital necessary to sustain the crime network and money laundering.

The paper also adds to the practice literature by highlighting some of the standard transactions and accounting techniques used by money launderers, with the hope that these can be used to detect money laundering activities at an early stage. There are many other areas where corruption and crime networks operate which are specific to different contexts and these must be studied to ultimately uncover more reasons for money laundering to persist. Technological advancement has created new opportunities for money laundering and the crime networks. This is an important area for future research, as technology will more and more be accessed to propagate crime activity and money laundering. The paper also proposes that by understanding how new crime networks come into existence, and how networks specifically focused on money laundering strategies gain the capital necessary for survival, we can be a step closer to preventing such networks from operating.

### **1.4 Summary #3 – Facilitating Money laundering: The Role of banks**

The current study examines the adaptive nature of Management Control System (MCS) practices within the banking industry; more specifically how control practices respond to changed money laundering regulations, but in ways that attempt to maintain a client-friendly focus. This study examines how the HSBC Group utilized the information from the external environment in developing parts of its internal control system and how internal control systems are used to create a system of visibility of its processes while facilitating business practices. The paper has also shown how in this particular situation, the illusion of objectivity was created by providing a paper trail supporting particular issues that were raised. Starting from the premise that success in this industry partially depends on (i) the treatment or classification of the monies based on the rules and regulations of the industry, and partially on (ii) the in-depth knowledge and skills possessed by the actors involved, pertaining to the MCS within the financial institution. We have looked at both MCS design and practices as a second-order response to regulation.

Although we attempt to isolate three key areas—i.e. designing internal controls, process visibility, and skillful practices—these are not isolated from each other but are in fact closely intertwined with one another. Skillful practices, both emergent and conscious, affect the design of MCS and create process visibility. The evidence from our analysis shows how MCS practices both respond to regulations and are learned through practice and memos.

By analyzing internal control design from an environment risk perspective, we have shown how HSBC selectively utilizes the environment risk information produced by third parties. For many years it has been known that Mexico is a high-risk jurisdiction pertaining to drug trafficking and money laundering, yet this information was accidentally omitted from the country's risk rating. But

we also see how omitting the information has put HSBC in a position of advantage in two ways: First, this accidental omission coupled with unexplained discretion has reduced the risk rating sufficiently to allow all existing clients of the Mexican affiliate to have access to US dollar correspondent accounts, thus increasing the potential for cash flow between the two affiliates and ultimately between the two countries. And second, this process created a visible system for the regulators showing that HSBC has performed its due diligence and that the operating practices are legitimate. We show how different control systems, which would normally be expected to work as a disadvantage, was turned into an advantage by HSBC's policy treatment, allowing its employees to treat all affiliates as if they met the standard of the US affiliate. This analysis shows how the perceptions of a field changes given different rules. Prior to the merger, Mexico was seen as a high-risk environment, but once assimilated into HSBC, the business practices continue as if, by the mere act of acquisition, the Mexican affiliate became the same as the other affiliates. Internal policies are a part of structures and this process shows how closely policy and practice are linked within this context. Knowing the policy was accepted, the practices simply followed. The policies are part of the material arrangements within the system (Schatzki, 2005; Ahrens & Chapman, 2007, Neu et al, 2012) and have restructured how the field is seen by the employees. The internal control was shaped by the risk assessment information and in turn, the internal controls are shaping practice.

On one hand, the analysis of the Mexican affiliate highlights the role of discretion in offering decision-making flexibility, s given the information presented; n the other hand, our analysis of the Iranian transactions shows that they strived toward a point of no discretion. These differences demonstrate that creating a system of visibility is dependent on the consumers of the information. The HSBC case has also shown that the use of information and discretion can be used

to shape strategy. Simon (1995) argued that strategy is both planned and emergent, a notion supported by our analysis of the Mexican and Iranian transactions.

The analysis highlights the use of form-based transactions and its role in instituting a practice. The form-based process creates process visibility, but only on the part of the process highlighted by the information present on the form. In other words, parts of the process and information are also hidden or made invisible by the use of forms. HSBC created a system of visibility by using standardized forms from an established and institutionalized practice. The Society for Worldwide Interbank Financial Telecommunication code also known as the SWIFT information processing system is used by most financial institutions. Forms only allow specific fields to be filled out, and the training HSBC provided to its client not only guaranteed a fixed process, it also determined the language to be used and specifically shows what information should not be provided. This is another example of using artifacts to structure and organize the field. The form helps to organize the field in several ways. First, the form determines what information is collected and placed on the form and also what information is omitted. Second, the form becomes digital archival records that are auditable. This provides a permanent system of visibility, giving the appearance of a transparent system. Training on the use of the forms restructures the capital in the field by changing the knowledge required for specific roles. And finally, the use of the form is geared towards eliminating human interaction—which would involve discretion—and replacing it with a preference for straight-through processing.

This analysis also shows that knowledge of control system design facilitates business processes by allowing those with the specific knowledge the ability to work within and around the rules of the system. Using Bourdieu's notion of the field and power, we observe that individual actors with this knowledge (capital) are able to work with internal control systems to change the

field, resulting in a position of power or advantage. The increased position of power occurred on two levels: First, although there was the constant tension between the Group affiliates pertaining to the treatment of Iranian transactions, the European affiliate proceeded without being challenged. And second, the analysis also showed that being able to work within and around the Office of Foreign Assets Control (OFAC) regulations placed HSBC in a position of competitive advantage with the Iranian banks.

In this instance, the MCS was built around the artifacts and interpretations of particular forms, records, policies, and processes which were not only used to create a system of visibility, but also used in some cases, to create a sense of illusion. While a system of visibility was being created among banking affiliates, using processes such as U-turn transactions and straight-through processing, a sense of illusion was being created for the OFAC and regulators by documenting issues, and using external law firms for legal verification of processes. In addition to highlighting the role of MCS practices in facilitating these negative practices, the line of research touches upon the broader practices of visibility and illusion. Inherently, as particular aspects of a process are illuminated, other aspects become less visible and, in some cases, a more visible process may not allow actors to focus attention on the important aspects. We have shown how the use of form-based transactions cause attention to be focused on fields for correctness while eliminating other aspects of the transaction that could cause a flag to be raised and the transaction halted.

## **1.5 Discussion Summary Points**

*How does money laundering persist and continue to increase or go undetected for extended periods of time given the institutional settings of increasing regulation, increasing monitoring and control systems at financial institutions, and increasing attention by accounting professionals?*

The research question as stated above has generated additional questions of focus for the individual research papers. The papers examined different aspects of the field of money laundering from multiple means of production through: the accounting techniques and networks set up; regulation and reporting requirements and practices; influence of customers and regulators on the banking process; and how banks work around the rules in an attempt to satisfy customer needs.

The research started from the premise that when tensions exist within the field, pockets or spaces are created which allow money laundering to fester and grow undetected for extended periods of time and has further considered how accounting practices become standardized and embedded as part of the money laundering process. Although each paper has its individual contributions, there are a few points worth discussing as part of the overall thesis. The research has also looked at management control systems and its use in identifying “red flags”, and has shown how these very systems, set up to identify routine suspicious activity, can be used to by-pass these identifications and allow negative or corrupt activities to persist. In one sense, this can be seen as enabling practices (Neu et al., 2006; Miller & Rose, 1990) that banks perform to facilitate “normal business transactions”.

While paper one has helped us to better understand how accountants and auditors are viewed through the lens of researchers, it is somewhat surprising to find that tensions exist within this sub-field. What is being said in the practice journal is different than what is being said by the professional accounting bodies. This analysis encourages us to think more carefully about how we

utilize the information we acquire through research and how we inform practicing accountants of the research findings. To help in the fight against corruption and money laundering, researchers must join the fight with practicing accountants and share the findings in a positive light. While the research has shown how skillful practice is being used to propagate negative practices, we can utilize the research to strengthen the institutional training programs in accountancy. We should also consider highlighting more of the positive work accountants are currently doing in the fight against corruption.

Although it may be clear that context matters—as shown in paper two and paper three using the HSBC case study—paper three brought to light a struggle for position within the regulatory bodies themselves. The regulatory structure is a field on its own and I believe this research has only touched the surface of how the battle for position, and complacency within the regulatory bodies, help to create the spaces that allow negative practices to persist. This research is not advocating that this is intentional by any means; however more research in this area may help to reduce the negative behaviors. One of the future studies proposed is the work on “red flags”—how they are generated and how the information is used. The HSBC case study also encourages us to reconsider the process of moving money itself, and how human intervention in the process at a high level can make negative practices routine, in a manner that allows the transactions to occur in plain sight. For example, the research showed how customers and bank employees are trained to fill out forms to by-pass the checks put in place to create red flags. In other words, fabrication of information became the institutionalized practice for working around the regulatory rules and reporting systems.

Future research intends to analyze the impact of regulatory actions on banks and how the penalty and future earnings potential of the bank is seen by investors; and how investors’



perceptions of banks have changed over time, with respect to money laundering and other negative practices that affect society.

In sum, the research has identified some areas that help propagate negative practices and money laundering. The diagram of the field and the possible tensions have helped to focus the research, but like all research endeavors, there are limitations to the findings. This research is based on archival data only. Interviewing regulatory personnel as well as bank personnel dealing with AML represents another future research opportunity. The research methods used in the individual studies were selected based on the information available and the type of analysis the data lends itself to. The first study uses a mix of quantitative word count analysis coupled with qualitative research; papers two and three are primarily qualitative based.

Among the benefits of this research thesis is the ability to take some of the findings to practice and have a direct impact on the way we teach and engage in the fight against corruption and money laundering. Some areas of future research have been identified and hence this thesis provides a good spring-board to future work.

## **2 Illicit Financial Flows, Accounting and Auditing: A View from Practice**

### **2.1 Abstract**

This study examines how accounting and auditing is situated in the field of money laundering as seen by the researchers in the field. Through a content analysis of over 475 articles published from 2001 to 2016, the study looks at the how accounting and auditing practices play a role in illicit financial flows, and how detailed the role is documented. The paper shows how accountants and auditors are viewed through the lens of researchers in the field, and highlights some of the biases faced by researchers in the production of accounting research for the purpose of journal publication.

### **2.2 Introduction**

*“Always follow the money” has been sound advice in law enforcement and political circles for decades. Nevertheless, tracking the flows of illicit funds generated by drug trafficking and organized crime and analyzing the magnitude and the extent to which these are laundered through the world’s financial systems remains a daunting task (UNOCD, 2011) .*

Money laundering facilitates a broad range of serious underlying criminal offences and ultimately threatens the integrity of the financial system (U.S. Department of Treasury, 2013) while propagating negative behaviors that further erode social structures. Although the true amount of laundered funds cannot be known, the UNODC estimates laundered money to be between two and five percent of global GDP, which amounts to somewhere between USD 1.51 and 3.78 Trillion annually.

The phrase “money laundering” is used to describe the process by which the sources of the funds are concealed for the purpose of introducing the funds into the legal financial system and out of the reach of anyone who may have a claim on the funds. Tax evasion is often coupled with money laundering since the process often involves moving and investing funds outside the reach of governments and tax authorities.

The process of money laundering can be quite complex and may involve several professional groups (e.g. lawyers, accountants, real estate professionals, businesses, and financial institutions) working together to achieve the goal. It has been argued that—similar to the larger field of corruption—skillful accounting practice and social networks are utilized to achieve a particular goal (Neu et al, 2012). The money laundering process can be viewed as situated in a field where success demands accounting capital (Bourdieu, 1989a), technical accounting expertise, and the practical skills needed to facilitate the process.

Professional accountants and auditors are perceived as possessing, among other qualities, a high level of rigorous educational training and accounting-specific knowledge, high ethical standards, and a strict code of ethics (AICPA, 2018), primarily acquired by participating in institutions that possess the authority to deliver a particular level of educational qualifications, and hence can be recognized by others as possessing the powers to officially accredit the individuals with an accounting professional designation. Another group of professionals possessing the skill-sets and technical abilities similar to professional accountants are those performing or occupying accounting positions but do not have the professional designation. Not possessing the designation does not make the individuals less skillful or less knowledgeable about accounting practices, but the designation itself can be used as a barrier and it may, in some ways act to exclude these individuals without the designation from certain social or economic benefits (Chua & Poullaos, 1998),

particularly if the existing members of the institution subscribe to the notion that the designation makes them part of a somewhat elite group with access to certain social and economic privileges. In one way we can look at the designation being used as an exclusionary device, such as setting up a monopoly over the field and only giving access to those possessing the accounting designation (Macdonald, 1985; Walker, 1991). Not only does the profession seek to restrict access to resources to those possessing the designation but they also attempt to keep out individuals possessing the designation but who are from other groups or jurisdictions (Annisette, 2017).

The topic and methods of restricting access to accounting resources or the field of accounting in general is important as it sets a tone for whose voice is being heard. One way of restricting access to the field of accounting practice is to limit the voice of individuals, or to limit the conversations individuals can participate in, or by restricting speakers only to those authorized or possessing the capital demanded by the field to allow participation. These social conditions of communication first restrict access to the conversations, then act to sustain the institutions which originally endowed individuals with the power, capital, and credentials to participate in the conversations, and to possibly change the conversations.

As mentioned earlier, money laundering and the illicit flow of funds is a major problem and can have serious and devastating effects on communities. The focus on anti-money laundering (AML) and combating the financing of terrorism (CFT) has seen a global response: Transparency International and its work with the National Integrity System (Doig & McIvor, 2003), the IMF, the World Bank, and United Nations Office on Drug and Crime have all set up programs to provide technical assistance to countries by working with governments, central banks and finance ministries to help stem the illicit financial flows. These programs are geared towards increasing or

changing the knowledge or capital in the field<sup>1</sup>, and accounting and auditing techniques are used for setting up controls in AML programs. These accounting and auditing techniques change the knowledge and practices in the field and hence change the capital in the field.

The sources of money to be laundered are vast but on a very basic level it includes some form of controls weakness or deficiency, or a level of corruption that helps to facilitate the process. This intrinsic nature of corruption and money laundering has been recognized by several institutional actors over the years (Everett et al., 2007) leading to several major changes; the International Monetary Fund has, for example, adopted a new governance framework with four major elements, the first of which assesses a country's governance structure pertaining to corruption, anti-money laundering, and the threat of terrorist financing (IMF, 2018). The OECD has also worked with the Financial Action Task Force (FATF) to publish documentation as a guidance to tax and anti-money laundering authorities (OECD, 2015), and the International Organization of Supreme Audit Institutions (INTOSAI) Working Group on the Fight Against Corruption and Money Laundering (WGFACML) began working on "Social control" and how to engage citizens in the fight against corruption (INTOSAI, 2018). Other organizations such as the United Nations, and the World Bank have been part of the fight for decades (Everett et al., 2007).

While the focus by large institutional actors in the field of money laundering and the fight against corruption has increased significantly (Zamorano, 2000; Everette et al., 2007), and although individual accounting organizations may have reasons to limit participation in their conversations, there appears to be a united front, at least on a high level, that accounting bodies and

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<sup>1</sup> Capital and field relates to the praxeology of Pierre Bourdieu. Bourdieu's concepts of field, capital, habitus, doxa, and symbolic violence, and his understanding of language are linked to current organizational literature and theory (Everett, 2002)

their associated actors must stand at the forefront of this fight against corruption (ICAEW, 2002; Everette et al., 2007). And as the fight has changed over time, in part due to enhanced technology, financial instruments, education and methodological know-how, so too has the academic research into the field of corruption and money laundering changed

The role of International Organizations (IOs) in standard setting and policy making has been recognized in the academic literature by authors such as Pollack (2003), Barrett (2007) and many others. It has been suggested that, among other things, IOs help to improve governance, reduce transaction costs, improve information sharing, and provide for neutral monitoring of existing contracts, commitments and policies (Pollack, 2003; Hawkins et al., 2006). The OECD challenged International Organizations to join the fight against corruption by first stating that some of the greatest challenges faced today transcend national boundaries; among these challenges are tax evasion, terrorism, and illicit financial flows (OECD, 2015). The OECD then facilitated a process for international organizations to participate in the development of standards and policies that would help to address these global challenges. Among the fifty IO respondents were the UN, IMF, and the IFAC. Twenty-two IOs were related to the UN and fourteen of those respondents belong to the system of UN Organizations. The IFAC is the only accounting body to participate (OECD, 2016). This process of simultaneous privatization and internationalization of governance (Buthe & Mattli, 2012) allows the participating IOs to assist with standards and policies that would be recommended for adoption by all OECD members.

Speaking to the World Congress of Accountants at the Vatican in November 2014, Pope Francis encouraged accountants and other professionals to find solutions to issues facing communities, by going beyond the numbers to assist businesses and families, alluding to the notion

that accountants are well positioned in their work and practice to make a significant difference to the major issues facing communities.

*“Economy and finance are dimensions of human activity and can be occasions of encounter, of dialogue, of cooperation, of recognized rights and of services rendered, of dignity affirmed in work. But in order for this it is necessary to always place man with his dignity at the centre, countering the dynamics that tend to homologize everything and place money at the apex. When money becomes the end and the motive of every activity and of every venture, then the utilitarian perspective and brute logic — which do not respect people — prevail, resulting in the widespread collapse of the values of solidarity and respect for the human being”. (Francis, 2014)*

In November 2016, the out-going president of IFAC issued an open letter to Pope Francis outlining some details on how the accounting profession continues to assist with the fight against financial fraud and corruption, along with some of the improvements the profession has made. The outgoing IFAC president Olivia Kirtley, a former chair of the American Institute of CPAs wrote: *“Serving the public interest is at the very heart of IFAC’s mission—and combatting fraud and corruption is clearly a public interest issue where our profession can provide valuable skills and expertise”. (Kirtley, 2016)*

The letter explains that the analytical and forensic skills of professional accountants, along with knowledge of how to implement strong internal control processes, can make a real difference in combatting corruption activities and temptations, and in increasing the flow of resources to support economic growth (Kirtley, 2016). Given these skills, one of the major areas of improvement is to accelerate the capacity-building process of developing countries. The strong code of ethics is also highlighted as a key to implementing strong governance practices. Another key area in which the IFAC’s efforts have intensified to combat fraud and corruption is in their campaigning for

governments to develop more transparent and complete information, including use of International Public Sector Accounting Standards (IPSAS) (Kirtley, 2016). The desire to serve the common good is also highlighted, and there is a request to the Pope to assist in supporting two major reforms the IFAC believes would have a tremendous positive impact on fraud and corruption:

1. More rigorous, transparent accounting by all governments worldwide; and
2. Coordinated international action to implement stronger whistleblower protections for all citizens.

According to the IFAC, accountants have been actively involved in the fight against corruption for more than a century (Tomlinson, 2017). In 2014, the IFAC commissioned an independent study by the Centre for Economics and Business Research (CEBR). The three-part report highlights the role of the IFAC and the importance of the accountancy profession and its contribution to the global economy. The studies highlight the role of professional accountants as part of the governance architecture that tackles corruption and correlates accountants' positive impact with the number of qualified accountants in the workforce. The study also points to the robust international Code of Ethics, comprehensive educational requirements, and ongoing monitoring and oversight mechanisms, saying these aspects of the profession act in the public interest to reduce corruption and fraud (IFAC, 2015).

The academic research in the area of corruption and fraud, as demonstrated through the publications, plays a highly significant role as it informs and is informed by practice in the field. More specifically, one of the ways accounting actors have engaged in the fight against corruption is through academic research. Accounting researchers are embedded in this field of research, as it has become more evident that corruption and, in many cases, the associated fraud is context-specific (Everett et al., 2007; Neu et al., 2013; Cooper et al., 2013). Hence universal or over-



arching rules more often than not fail to get to the root of the problems. Through current research, accounting researchers attempt to add to the fight against corruption such as the works of Transparency International with the NIS (Doig & McIvor, 1999; 2003), the Contraloria General de la Republica and the project of introducing new auditing practices (Espejo, Bula, & Zarama, 2001), and Kimbro (2002), who examined the quality of legal and accounting systems using macro economic data, just to name a few. This paper adds to the research on the fight against corruption and money laundering by shedding light on the practices that help to propagate corruption and money laundering; it also looks at the use of accounting and auditing as seen by academic researchers, and in doing so makes recommendations for future research and the possibility of changes to practice that will help prevent and detect money laundering and corrupt activities. Although the field of corruption can be seen to encompass the academic research being performed, this study views academic research as a specific subset to the larger field of corruption—particularly since access to each field, and what is at stake in the field of academic research, is different than what is at stake in the practical field of corruption.

This study is motivated to better understand how accounting and auditing are situated within the field of research and practice by analyzing publications within the field. In other words, “where is the accounting” within the literature and how its use has changed over time when looking at money laundering and the prevention or fight against money laundering. The paper looks specifically at how accountability, accounting and auditing are used to depict what is occurring in practice, and how this depiction of accounting and auditing has changed over time. The changing accounting and auditing capital help to create the visibility (Miller 1990, P 317) or shed light (Neu et al, 2015) on the processes and structures that allow the money laundering process to occur. To understand how accounting and auditing is situated within the field, and how

this has changed over time, the present study looks at prior research papers from the perspective of researchers and practitioners in the field of money laundering control. The present study attempts to map out a portion of the field of accounting research by examining how various groups of researchers use “accountability, accounting, accountancy, auditing, auditor” and other roughly synonymous terms to show how accounting and auditing is situated or located within the field. Hence, the study attempts to analyze the field of accounting research that deals specifically with money laundering control with the goal of showing structural changes over time. Drawing on Bourdieu’s notions of field, habitus, and capital (Bourdieu, 1990; Bourdieu & Wacquant, 1992), the study utilizes the idea that academic journals carry on a conversation, one that changes when there is a crisis or rupture in the larger or more widespread field (Cooper et al., 2005). The study also looks at the various sub-fields in the academic accounting literature that pertains to money laundering and anti-money laundering, with the view that various categories of research exists within the larger body of research on corruption and money laundering. This is an attempt to depict how the accounting researchers disentangle or shed light on changes in practice that have occurred, and is continuously occurring, as the capital in the field changes.

This study follows many previous works that have looked at how accounting researchers view and analyze a particular field. Cooper et al (2005) challenged the views and interpretations by accounting researchers on their responses to the vast amount of corporate financial scandals in the prior years. Cooper et al (2005) utilizes Bourdieu’s institutional framework for their argument and encourages researchers to place the subject of research within the broader field, instead of simply placing the subject as an isolated incident. In their discussion of business ethics and the field of corruption, Everett et al. (2007) examines the anti-corruption field by reviewing academic and think tank reports, books, and papers dealing with the topic of corruption. By using a Foucaultian

and virtue ethics framing, Everett et al. (2007) points out the problem of corruption is not at all clear in part due to the field's actors having different ways of seeing the problem. Money laundering and the practices that go along with it belong to the larger group of corruption and the practices that sustain these negative behaviors. Neu et al. (2001) draws on the prior research on intellectual's efficiency and utilizes case studies to look at accounting within public policy struggles. Their paper shows the importance of having a network of allies to overcome the producer/consumer dichotomy that typically exists in the field of research. Neu et al. (2001) also highlight the importance of adding a temporal dimension to our research. In a review of white-collar crime and the role of accounting and accountants, Compin (2008) compiles a typology of varying illegal activities along with the level of accounting knowledge required in each category. By using agency theory to foreground his argument, Compin (2008) also shows how accounting knowledge can be used in both the fight against crime by providing information with clarity, and how the use of accounting knowledge may prevent crime and, on the other hand, how accounting skills and knowledge can be successfully incorporated into financial crime networks to facilitate the money laundering process.

This paper looks at publication in *The Journal of Money Laundering Control*<sup>2</sup> over time. The publisher Emerald publishing states “*The Journal of Money Laundering Control is the only quarterly, peer-reviewed journal designed to provide detailed analysis and insight on the latest issues in the law, regulation and control of money laundering and related matters*”<sup>3</sup>. This journal

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<sup>2</sup> <http://emeraldgroupublishing.com/products/journals/journals.htm?id=jmlc>

<sup>3</sup> *The Journal of Money Laundering Control* is the only quarterly, peer-reviewed journal designed to provide detailed analysis and insight on the latest issues in the law, regulation and control of money laundering and related matters.

provides access to a fair mix of researchers who are close to the topic and area of money laundering. While some researchers such as Cooper et al (2006) and Tinker (1984) and others are critical of how accounting research should be conducted and interpreted, others such as Parker (1994) has been more accepting or less critical in that respect.

This paper's analysis contributes to the literature in several ways. First, it looks specifically at the research published in a specific journal of practice and draws attention to how accounting and auditing is situated within the literature. This focus is important to researchers as it pin-points the specific ways accounting is being used in corruption and money laundering and shows where further accounting research has to be done. Second, the paper builds on the recent body of research on fraud and corruption, be it the fight against corruption by large institutional organizations (Uddin & Hopper, 2001; 2003; Loft & Aggestam-Pontoppidan, 2007; Annisette, 2004; Neu, Gomez, Graham, & Heincke, 2006), and fraud with a specific focus on individual wrong-doing, such as Albrecht, Albrecht, Albrecht, & Zimbelman (2011), Brody, Melendy, & Perri (2012), and Hoffman & Zimbelman (2009). Other research primarily focused on fraudulent activity as seen through the eyes of economic theories (e.g. agency theory) such as Peroz, Park, & Pastena (1991)

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The journal's authors include not only leading scholars, but those directly involved at policy and operational levels in fighting money laundering.

Coverage includes, but is not restricted to:

- The legal risks faced by banks and other intermediaries in complying with the law
- Disrupting organised crime and terrorist organisations
- New trends and techniques
- Underground banking systems
- Laundering with virtual money
- The World Bank's Stolen Assets Recovery Programme
- The use of financial intelligence
- Effective compliance management

Dechow, Sloan, & Sweeney (1996) and Compin (2008). And after the corporate accounting scandals of 2002 (e.g. Enron, WorldCom, Parmalat), auditing research and auditing linked to the fraud triangle such as Wolfe & Hermanson (2004), Norman, Rose, & Rose (2010) and Morales, Gendron, and Guénin-Paracini (2013), and the context-specific research that looks at the mechanisms, knowledge, and tools that accountants and auditors enlist to either engage in corrupt activities or utilize to prevent corrupt activities (Mitchell, Sikka, & Willmott, 1998; Arnold & Sikka, 2001; Cooper, Neu, & Lehman, 2003; Barrett, 2004; Lehman & Okcabol, 2005; Neu, Gomez, Graham, & Heincke, 2006; Everett, Neu, Rahaman, 2007; Compin, 2008; Clikeman, 2009; ; Neu, Everett, Rahaman, 2012; Neu, Everett, Rahaman, & Martinez, 2013 Neu, Rahaman, & Everett, 2013; Power, 2007; Power, 1999;2010;2013). Finally, this research contributes to our understanding of how the accounting conversations occur within a journal and how researchers can join the conversation, with an eventual impact on accounting in practice.

The paper proceeds as follows: The next section discusses the theoretical framing and the field within which this research is situated. Following this the paper discusses the method and data used and then the analysis of the data highlighting key findings. The paper then concludes with a discussion of the findings, applicable theory, and comments on future research.

### **2.3 Theoretical Framing**

The area of corruption and money laundering can be viewed in many ways with multiple sub-fields where money laundering occurs, depending on one's interest in the field. For example, we can separate the field where money laundering occurs into the sub-fields defined by major groups performing the actions to launder money as well as those engaged in attempting to prevent money laundering. Another sub-field can be defined by the physical activities and processes of

money laundering and anti-money laundering as the core, and the associated or periphery sub-field containing the processes and activities leading to the conversations, documentation, articles, journals, and associated literature that is written to help change the core field. This sub field, although acting in ways to change the core field, is also changed by the processes and actions within the core field. This paper views the field as the latter case for two primary reasons. First, the data used in this analysis consists primarily of articles published by academics working in the field of research on money laundering and corruption. The research tends to focus on what is actually occurring in the core field and hence the research is changed by the events in the core field, while simultaneously the researchers are attempting to change the core field by making recommendations. Second, the sub-field also holds specific capital which does not extend to the core field, but which is valued in the academia.

The paper begins with the theoretical concepts of Bourdieu who sets out a field as a network of social relations. The field is the arena in which the social actors compete for capital (Everett, 2002). The capital in a field is not just economic or material. Economic capital is only one form of the capital in the field of money laundering. Actors within the field of money laundering continuously strive to retain their economic capital or gain control of economic capital, but there are other forms of capital needed in this field. Bourdieu (1991) emphasizes the less tangible but highly valued skills, knowledge, and qualifications known as cultural capital. It is our belief that within a field, those with the superior cultural capital will be in demand and may become “known”, or at minimum will be sought out by those requiring the service. Both the areas of money laundering and anti-money-laundering possesses these forms of cultural capital.

Institutionalized or certified capital, a form of cultural capital refers to the actual certificate. Those who are officially certified in a process or possesses a document stating the qualification are

viewed as possessing this institutional capital. This form of capital is important in the field of anti-money-laundering and counter terrorist financing primarily due to the requirements of the institutions employing the persons for the roles. The gate keepers of these organizations, such as financial institutions and regulatory bodies, have minimum requirements for career postings, which usually contain a clause for a certificate, i.e. a specific form of institutionalized capital. The flipside of this process is the view from the money launderer's point. Does the launderer require the person performing the tasks to possess a certificate or is the possession of the knowledge more important? In this particular process it may be much more important that the goal of the money launderer is to retain the economic capital and other benefits associated with the wealth, and hence the launderer is not necessarily concerned with certificates.

The theoretical concepts of Bourdieu as applied to organizational and accounting research is not new. Accounting researchers have successfully applied the concepts of field, capital, and habitus in various settings to help explain why particular fields operate, sustain, or change in particular ways. For example, Bourdieu's concepts have been applied to the diverse roles of accounting actors, organizations, and institutions in the following ways: the actors involved in financing, production, and consumption of services in the field of health care where relative power and access to resources vary among actors (Kurunmäki, 1999); the social project to institutionalize the accounting profession in France (Ramirez, 2001); professional accountancy and institutionalization (Edwards & Walker, 2010; Annisette, 2017; Poullaos, 2016; Annisette & Trivedi, 2013; Hammond, Clayton & Arnold, 2009); tracking and classifying consumer behavior (Fourcade & Healy, 2013); and tax audit process, tax regulation, and tax accountants (Louise & Oats, 2012; Boll, 2014; Radcliffe, Spence, Stein & Wilkinson, 2018).

While some researchers have also applied Bourdieu's theory of practice to Government settings (Neu, 2006; Neu et al., 2013; Joyce, 2014; Killian, 2015), others have focused on inter-firm alliances (Mahama & Chua, 2016), the role of inscriptions (Qu & Cooper, 2011), visual images (Davidson, 2010), and corporate social responsibility (Archel, Husillos & Spence, 2011; Malsch, 2013). And there is a growing body of research on organizational works such as management control systems (Chenhall, Hall & Smith, 2010), budgeting (Bryer, 2014), organizational practices of the management accountant (Lambert & Pezet, 2010), and organizational applications (Kornberger & Mourtisen, 2011; Boedker & Chua, 2013) where Bourdieu's theory of practice has strong explanatory powers.

One other main area where Bourdieu's theories have been applied is in the production of legitimacy. Studies have focused on how social accounting legitimizes the company (Killian & O'Regan, 2016) and the production of such legitimacy (Oakes, Townley & Cooper, 1998) in auditing (Power, 2003) and assurance (Andon, Free & Sivabalan, 2014); and in academic research (Edwards, Dean, Clarke & Wolnizer, 2013; Lukka & Granlund, 2002; Whittington, 2011). This paper aims to add to the body of literature on the application of Bourdieu's practice theory to research; more specifically it builds on the legitimizing process and academic research.

The researchers in the field of anti-money-laundering and corruption are the ones directly engaged in the field described above. This paper looks at the field created by *The Journal of Money Laundering Control*. This is a separate field where the struggles are not only about the interpretation of field concepts, nor only about access to the field of money laundering itself. Researchers are also faced with the struggle for access to the journal. Generally, to be published, researchers join a conversation occurring in the journal at the time. This could be an ongoing conversation or a change in conversation as set by the language or tone of an editor. If a researcher



attempts to shift a conversation and that shift is not recognized by her peers, then the conversation may not change, preventing access to the field. Equally important is the notion that researchers in this field get to name what is important (Cooper, 2005) in this field. In other words, these researchers shed light or illuminate what is important, their decisions on research topics help to decide what practices are focused on, and the researchers have the opportunity to suggest what the main areas are that should be worked on in the core field of anti-money-laundering and corruption.

Journal publications are a form of currency in the academic field in the sense that publications are often a requirement of university researchers; the volume and location of publications may also be a significant factor. The journal in which the publication resides helps to define the agent's capital portfolio, which ultimately gets compared to some set standard or to the portfolio of other agents in the same field. This objectified form of cultural capital can then be exchanged or helps to build other forms of capital (Bourdieu, 1986). In this case publications can eventually be used to change one's position in the field—such as a promotion—which can then be parlayed into economic capital. The type of journal and its ranking may also dictate the mobility of agents within the field (Bourdieu, 1972) and may also dictate the authority with which the agent is given to speak to a particular topic. The greater the number of publications and higher the status of the journal, the more authority and mobility allowed within the field.

The authors and researchers in the academic field, through their publications and the conversations they joined in the journals, are given the power and authority in the field, but according to Bourdieu, he or she does not create that power and authority; instead, that power and authority is part of the social institution (Bourdieu, Thompson, Raymond, & Adamson, 1994); it is not only the publication itself that has made the difference but also the current position of the agent within the field, as well the social relations or networks that the agent or actor is involved with.

In the field of linguistics, Austin has argued that utterances such as “I do” at a wedding ceremony spoken in the presence of the granting powers, or “I name this ship...” while smashing a bottle of Champaign on some part of the ship, can be viewed as more than simply the state of affairs. Viewed as ways of acting and participating in the ritual (Austin & Urmson, 1965) these uttered words are often accepted as a result of the institutional structure in which they are embedded—giving the utterances more power, authority and meaning without which they would not have the same power, authority, and meaning. According to Bourdieu, we cannot separate the institution which defines the conditions from the utterances themselves, as this separation would render the words almost meaningless. In the field of the production of academic literature for journal publication, the existing institutional setting matters. The journal, ensuing conversation, other researchers who have participated in the conversation, and access to resources, are just a few of the things that are a part of the context and would help to give authority to the authors or researchers.

Academic research in the field of money laundering and corruption brings together theory, prior research, and some activities or relations in practice. It attempts to elucidate the practical world by drawing on past research and theories. Practice is key to this particular body of research, as it is the relations between practice and the institutions within which these practices are embedded that form the situational context to be analyzed. The production of research publications in the field of money laundering and corruption are always produced in particular contexts, for particular markets. Journals can be viewed as markets. The properties of these markets, such as the conversations within the journal, the consumers, and the products that are valued within the specific journal, vary within journals or markets. In any given market or journal, the value of some products is weighted more highly than in others, and part of the skill-sets of academic researchers

and authors are the ability to produce submissions which would be considered by the particular market or journal as highly valued. This aspect of the practical skill-sets or competence of the academic researchers and authors within the field, like most forms of capital, are not equally distributed across the field (Bourdieu et al., 1994). This skill-set is important for joining or starting a conversation within a journal, and the more capital the researcher possesses, the more one can exploit these abilities and differences in the markets for position within the field. Bourdieu (1994) suggests that, when speaking on the linguistic field, what is praised as good quality by someone with a particular position, can be seen as useless or negative if attempted by someone without that position. The same may hold for the field of academic research.

The researcher's assessment of the conversations occurring within a journal, other market conditions, and the likely reception of the research by the market, all become part of the boundaries of the field for the particular research paper, and these limits operate as internalized boundaries in the process of production (Bourdieu et al., 1994). Since the primary objective is obtaining a publication, theoretically, researchers could modify these styles of writing to create the greatest chances of success—which means that during the production process a certain level of censorship is inherent due to the internalized process of one's expectation of what the market and its institutions will accept. Hence, to be able to produce and publish academic research in a field, the researchers must follow the forms and formalities of the field (Bourdieu et al., 1994).

This paper looks at the how the researchers interpret the ways accounting and auditing practices are used in the field of money laundering and corruption and how this interpretation has changed over time. Recognizing that the use of accounting and auditing practices would appear in different journals or markets, and based on Bourdieu's theory of practice, different institutionalized mechanisms typically emerge to "fix a value" accorded to different types of research or products.

This value would in turn help to differentiate the products and hence allocate the product of the research to a receptive market. The *Journal of Money Laundering Control*, as noted earlier, has emerged as a dominant practice journal in its field and allows this research to look at the changes to the use of accounting and auditing practices over time. The next section describes the data and method used in this analysis.

## **2.4 Methodology and Data**

In order to establish the connection between the field of research on Money laundering where researchers depict how accounting and auditing practices are being used and the field of money laundering where the accounting and auditing practices are actually used, the present study analyses a large portion of the published journal articles from the *Journal of Money Laundering Control*. This journal was selected because the journal is already specific to money laundering while providing insights from both the academic research world and the world of practice. The journal started as a publication that brought academia and practice together and has continued to do so from 1997 to the present. The study includes articles starting from 2001, volume 5, issue 1 and spans 16 years to 2016, volume 19, issue 4. The data set is comprised of a total of 476 articles and eight editorials, totaling 484 cases for analysis. Figure 1 shows the list of the number of articles by year, volume and issue number. The table shows Journal of Money Laundering Control – Articles selected by Year, Volume and Issue Number.

Table 2. 1 Journal of Money Laundering Control: Selected Articles-Year, Volume and Issue

<i>YEAR</i>	<i>VOLUME</i>	<i>ISSUE</i>	<i>NUMBER OF ARTICLES</i>	<i>YEAR</i>	<i>VOLUME</i>	<i>ISSUE</i>	<i>NUMBER OF ARTICLES</i>
2001	5	1	7	2009	12	3	7
2001	5	2	8	2009	12	4	7
2002	5	3	7	2010	13	1	7
2002	5	4	14	2010	13	2	7
2002	6	1	11	2010	13	3	7
2002	6	2	7	2010	13	4	6
2003	6	3	7	2011	14	1	7
2003	6	4	11	2011	14	2	6
2003	7	1	10	2011	14	3	7
2003	7	2	10	2011	14	4	8
2004	7	3	12	2012	15	1	6
2004	7	4	9	2012	15	2	7
2004	8	1	8	2012	15	3	8
2004	8	2	10	2012	15	4	8
2005	8	3	10	2013	16	1	6
2005	8	4	10	2013	16	2	7
2006	9	1	9	2013	16	3	6
2006	9	2	10	2013	16	4	6
2006	9	3	8	2014	17	1	7
2006	9	4	7	2014	17	2	7
2007	10	1	7	2014	17	3	8
2007	10	2	5	2014	17	4	7
2007	10	3	7	2015	18	1	8
2007	10	4	6	2015	18	2	7
2008	11	1	8	2015	18	3	8
2008	11	2	6	2015	18	4	11
2008	11	3	7	2016	19	1	7
2008	11	4	7	2016	19	2	9
2009	12	1	7	2016	19	3	8
2009	12	2	7	2016	19	4	14

Total **476**

These articles from the journals were downloaded in full text versions with all references and cover page intact. A database was created in QDA Miner and the analysis was performed using SimStat and WordStat.

Following along the lines of prior researchers using topic modelling to analyze large data sets, such as DiMaggio et al. (2013) and Jockers & Mimno (2013), the linguistic content of the data set is analyzed by extracting modelling themes using hierarchical clustering techniques to extract the themes. Other machine learning tools and text analysis methods are then used for analysis. This research builds on prior accounting research such as Neu et al (2006) where textual analysis was used to measure environmental disclosure in the mining industry. Dyer et al (2017) uses a broad set of textual attributes to measure changes in SEC 10K reporting, and Li (2010) uses textual analysis to look at the information content of forward-looking statements in the MD & A of 10K and 10Q statements.

## **2.5 Analysis**

This paper's analysis begins with the creation of a search dictionary which places key words such as *accounting*, *accountancy*, *accounting practices*, *audit*, *auditing*, *auditing practices*, *accountability*, *regulation*, and *taxes* into specific categories. These categories are then analyzed over the period considered.

The process began by first reading through many of the articles to understand the terms and to have a fair expectation of the type of words that would be in the analysis. The next step involved subjecting the full corpus to an analysis which eliminates 'stop' words by applying a dictionary containing words such as: ABOUT, ALSO, ALL, AND, COULD. The terms were then rank-ordered, and the full list examined. This examination led to identifying the major areas or regions that researchers focused on and identified the key words used in accounting and auditing.

The list of countries / regions most frequently researched are listed below in the table. The Caribbean is shown separate from Bahamas and Jamaica because these have much higher listings

as compared to the rest of the Caribbean. It is interesting to observe the high volume of papers and references to Iran.

The analysis over the full-time period for the researched countries is shown in Table 3 and Table 4. Table 3 shows the four highest countries and Table 4 shows the remaining four countries. Iran, Nigeria, and China have remained the highest referenced countries for the full sixteen-year period.

Figure 2. 1 Keyword distribution by Country

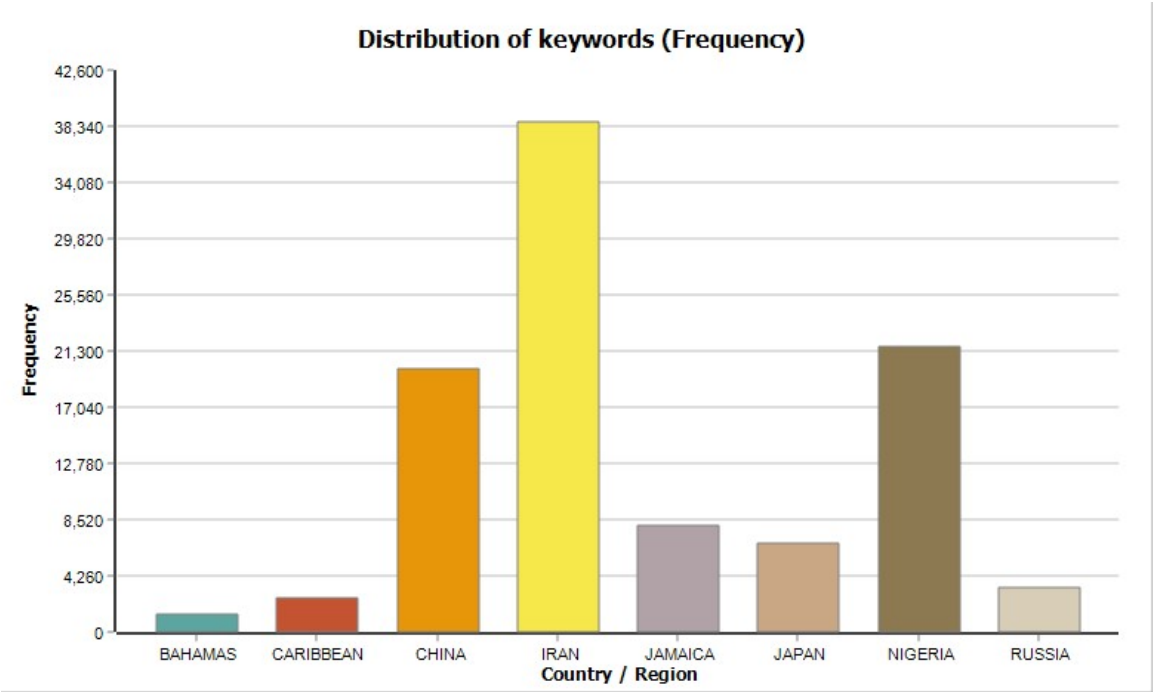


Figure 2. 2 Keyword % distribution over time by country

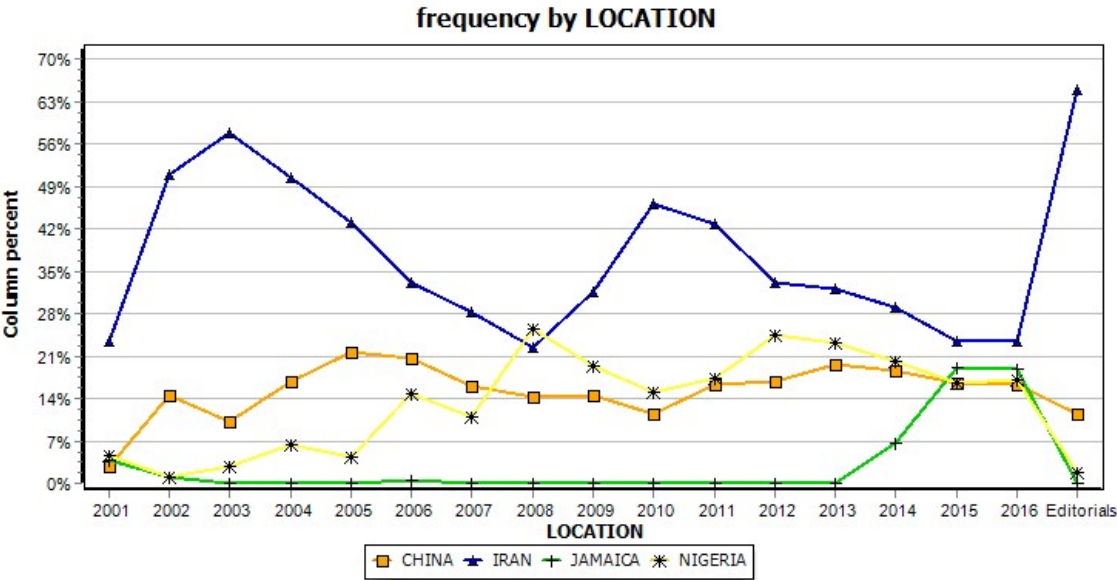
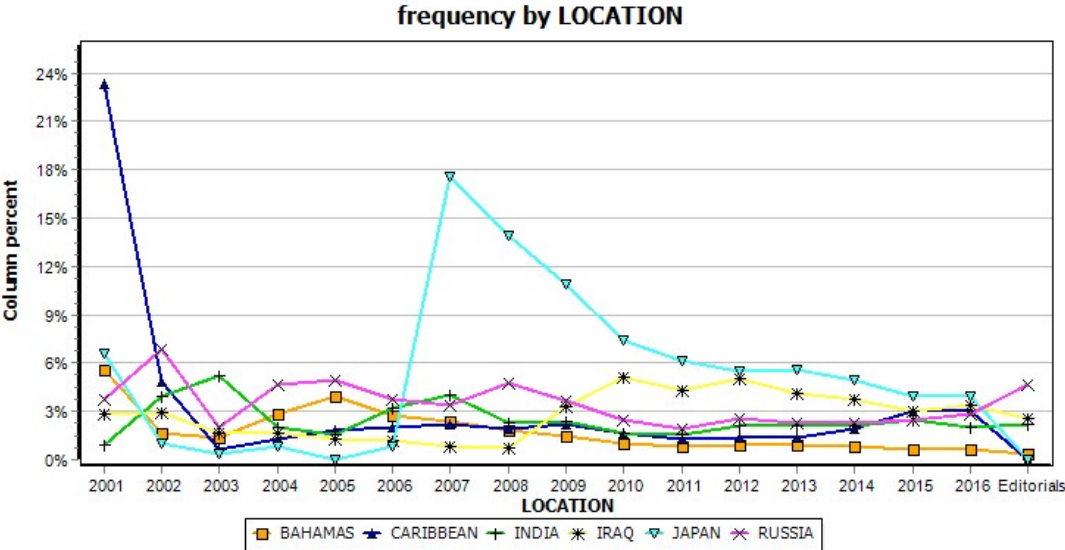


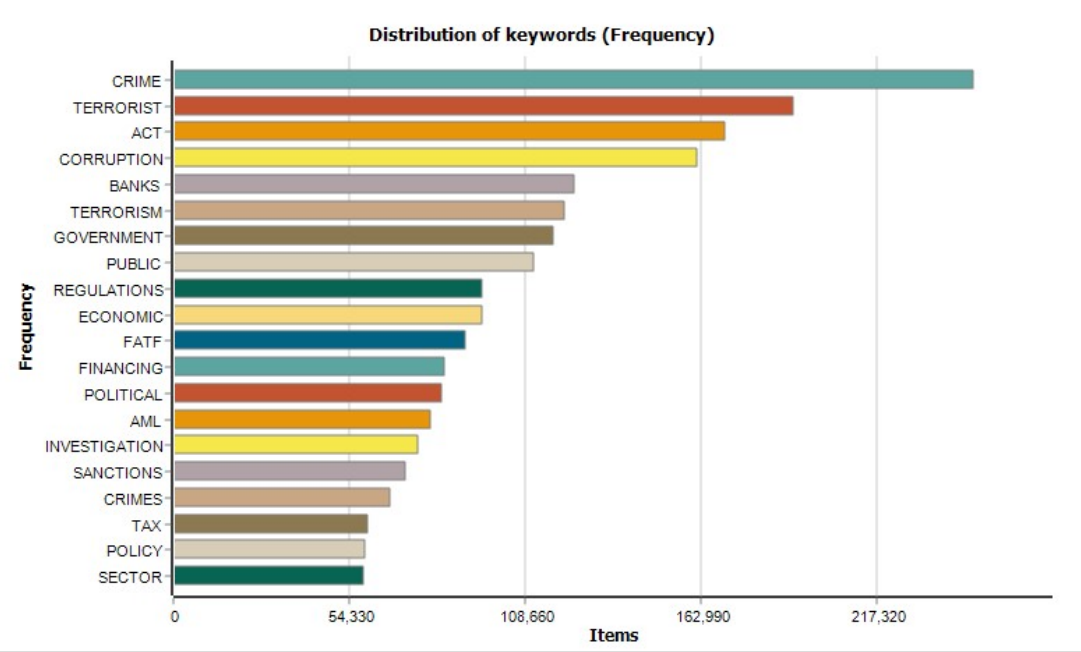


Figure 2. 3 Most frequently used terms by country over time



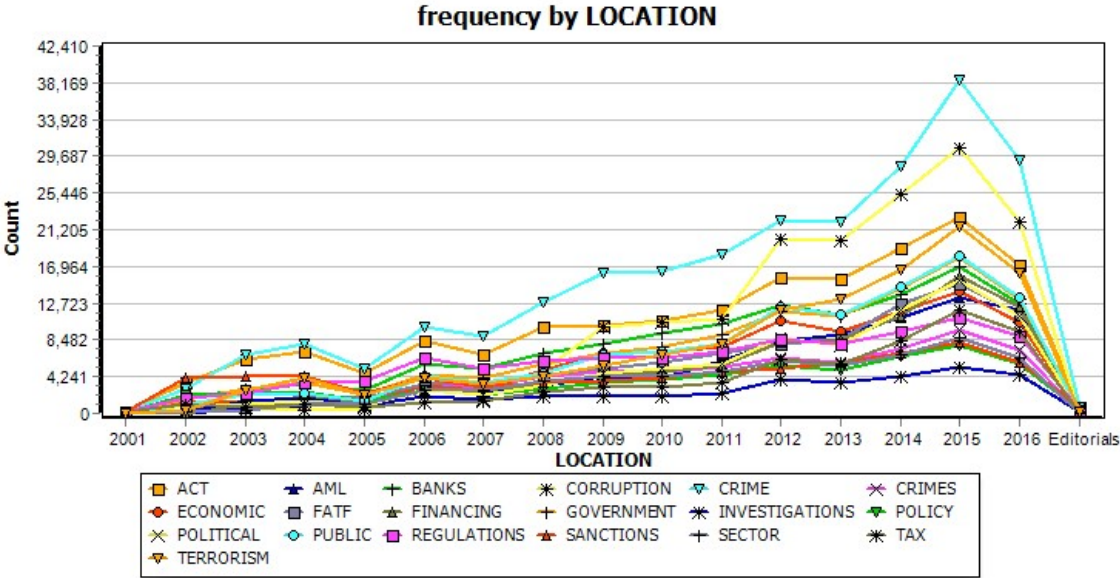
The most frequently used terms and the terms used for identifying how accounting and auditing are situated in the current literature are shown in the next table.

Figure 2. 4 Most frequently used keywords



The list of the most frequently used words over time is shown in Figure 6.

Figure 2. 5 Frequency of keywords over time in the Journal of ML



The most referenced word list is not surprising given the mandate of the journal. As mentioned earlier, The Journal of Money Laundering Control mandate is to highlight the latest issues in the law, regulation and control of money laundering and related matters.

Figure 2. 6 Frequency of “Accountability” over time

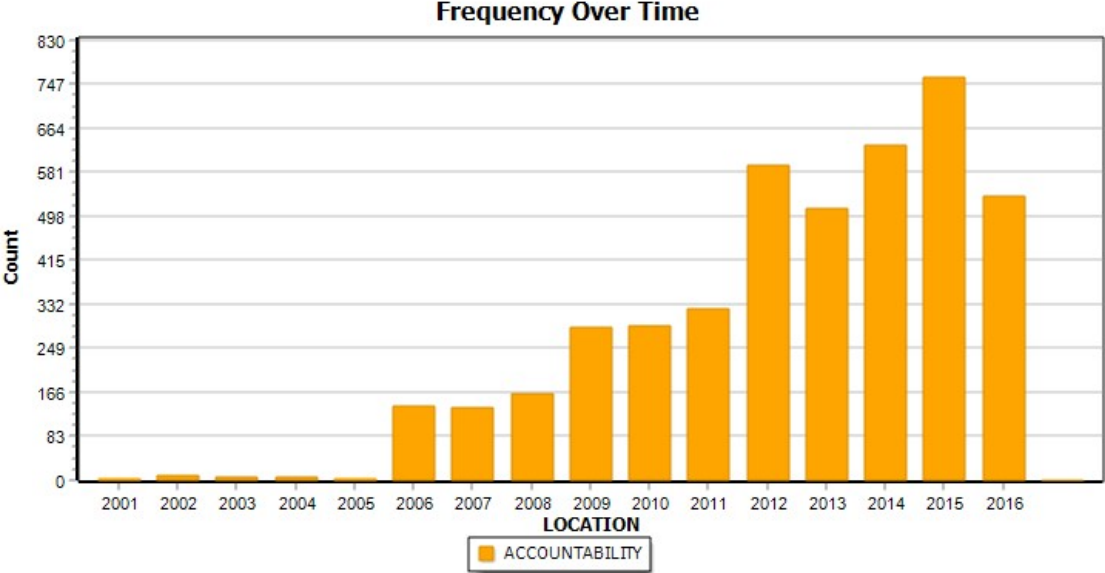


Figure 2. 7 Frequency of “Accountancy” over time

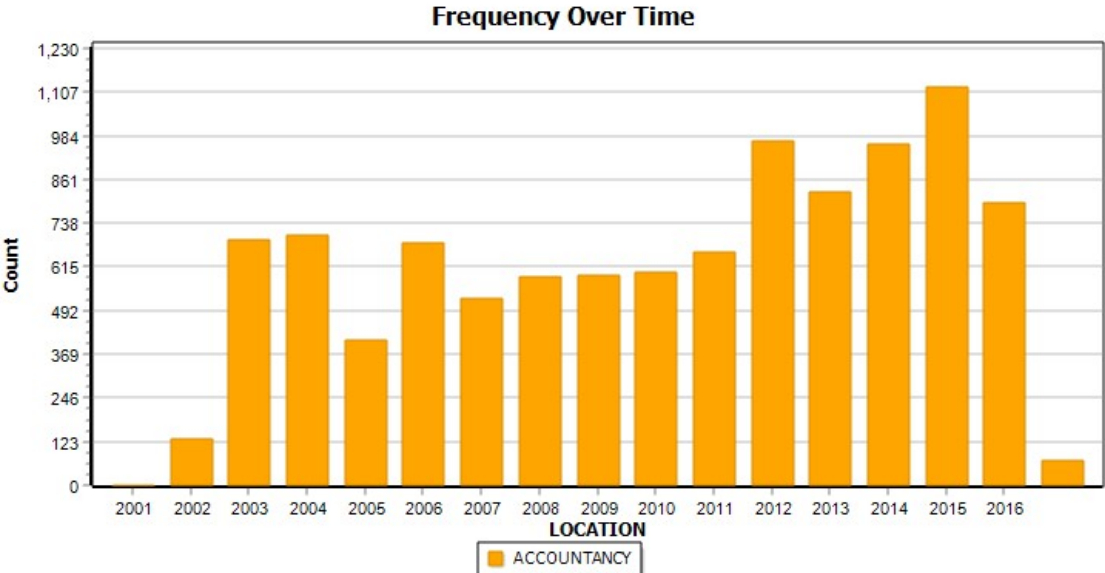
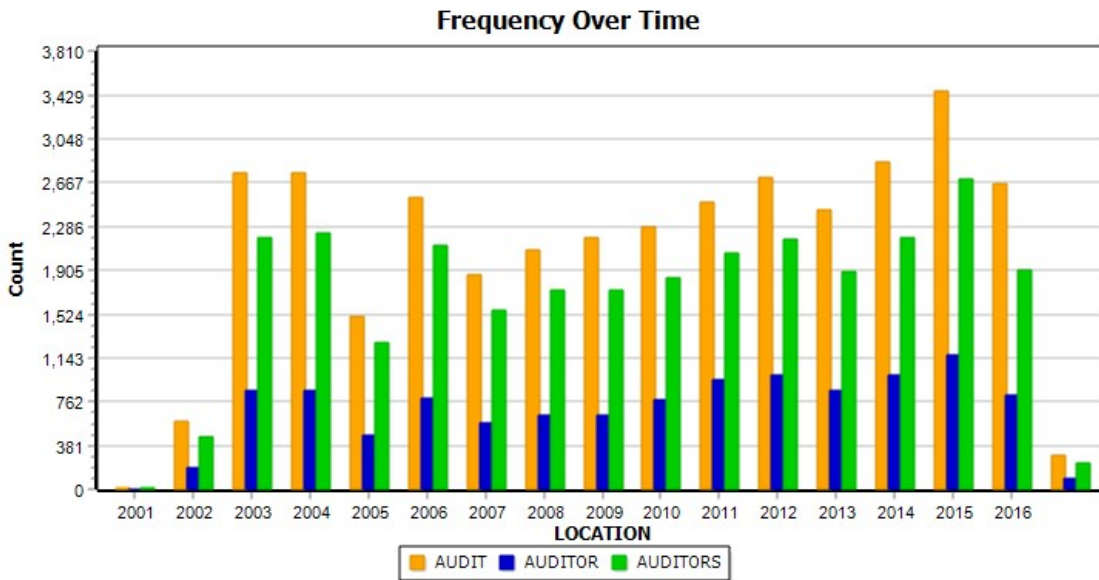


Figure 2. 8 Frequency of “Audit”, “Auditor”, & “ Auditors” over time



The term “Audit” appears with “Accountancy” in all issues of the journal from 2002 to 2016. Beginning with the editorial in Volume 5, Issue 1, *accountancy* is linked with *audit* and *auditor*. Johnson (2001) discusses the importance of the role of auditors and stresses the need for auditor independence. The trend of the terms Accountancy, Audit, and Auditor, continues over the years, as can be seen in the above chart.

The proximity plots for the terms Audit, Auditor & Auditors, and Accountancy, tie the information together even further, showing each time the word occurs and which terms are used with the key word. These plots show that, as each of these words is used in the journal, the frequency of occurrence together is much more than with any other word or phrase.

Figure 2. 9 Proximity of “Accountancy” to keywords

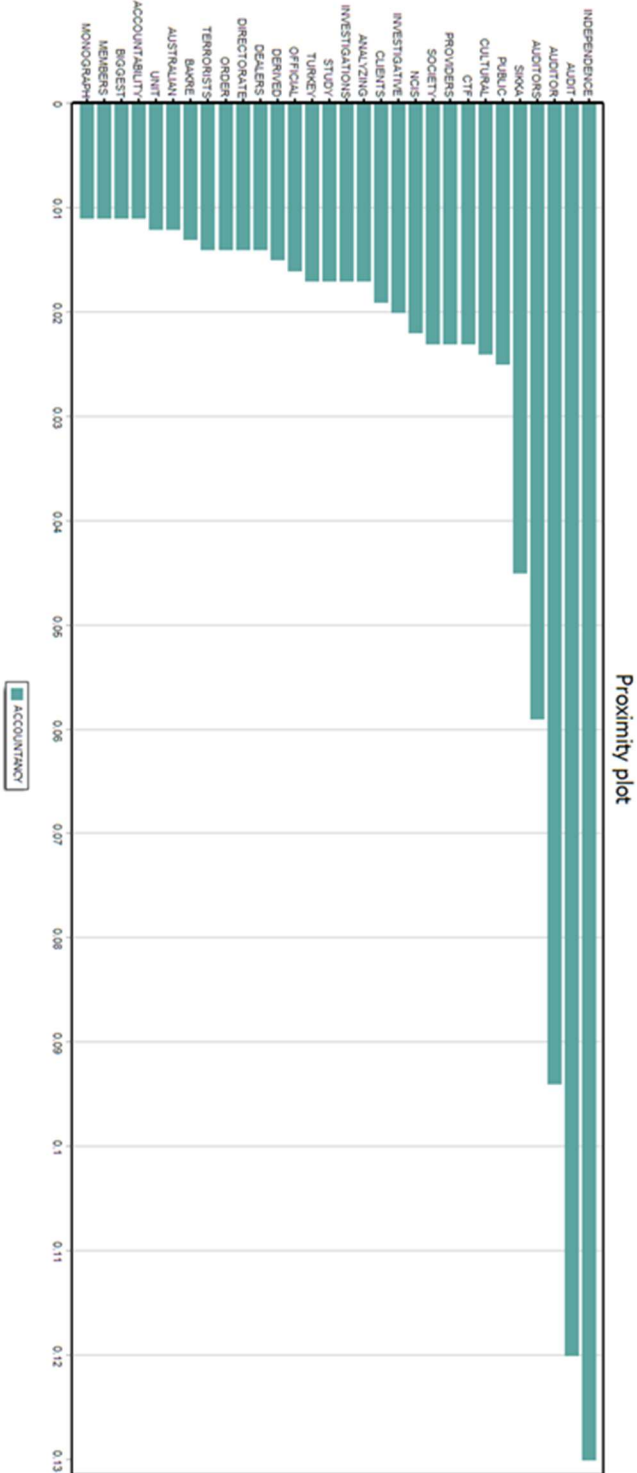


Figure 2. 10 Proximity of “Audit” to keywords

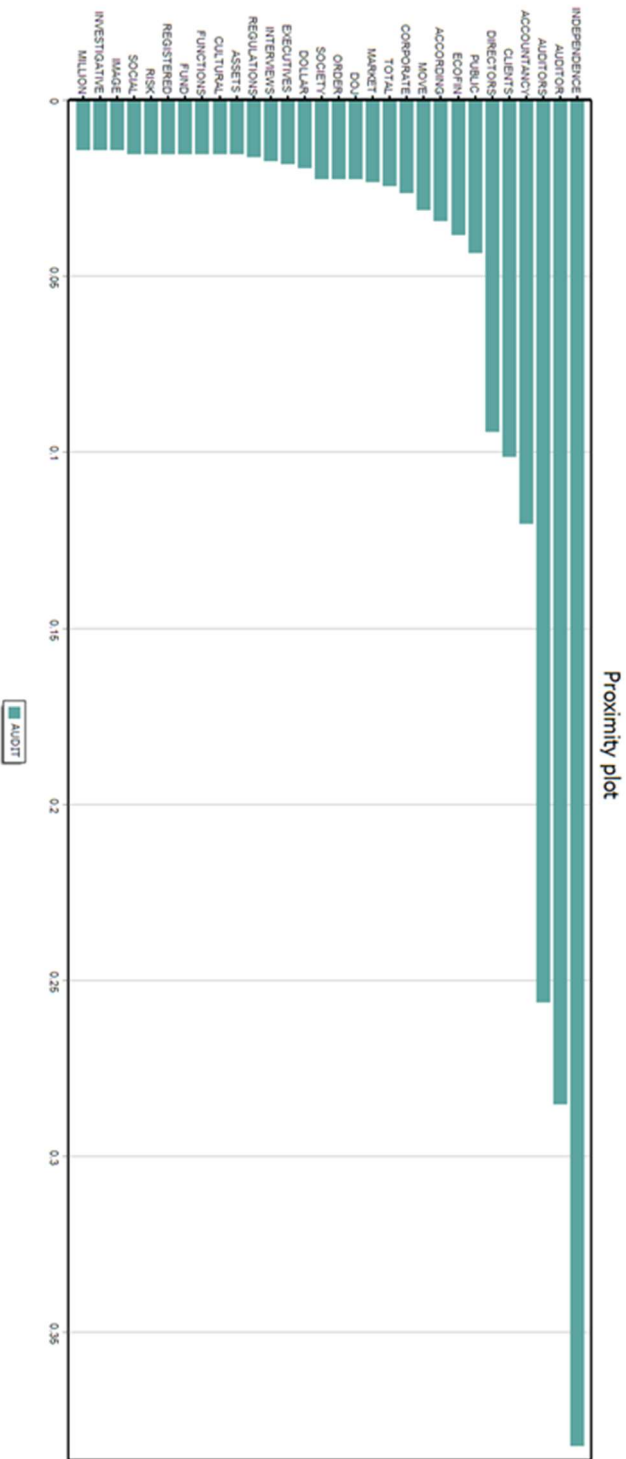
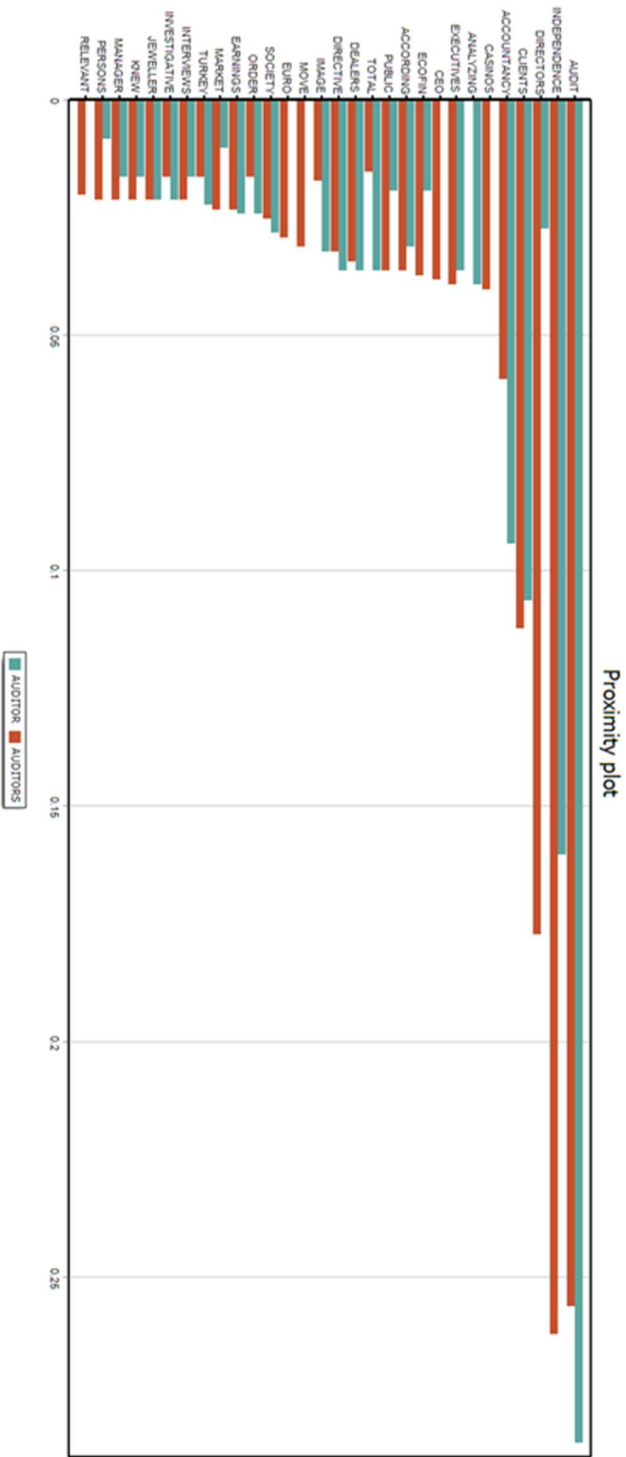


Figure 2. 11 Proximity of “Audit” and “Auditors” to keywords



With the most frequently used words and the groups established, the preliminary results were further sorted by reading through the analysis and identifying the themes of how Accountancy, Audit, and Auditor/Auditors are used together. This thematic analysis led to the identification of five different themes where accounting and auditing are situated within the journal as follows: (1) Accounting professionals and a failure to perform, (2) Independence and ethical delimas, (3) Legislation and accountancy, (4) A few good accountants required, and (5) Forging an auditor. The field of academic research is then discussed specifically looking at how production of journal publications can be constrained or enabled through a Bourdieuan lens.

### ***2.5.1 Accounting Professionals and a Failure to Perform***

Accounting professionals hold a particular social position in the field, a position that is not only based on the institutionalized capital they possess, but also based on the cultural capital or knowledge they possess and how they uphold that social position. Hence the accountant's social position changes depending on how other social actors view their cultural capital. To be more specific, in large part an accountant's social position is based on judgments of their ability to perform the perceived tasks and responsibilities, judgments made by other social actors such as regulating authorities, professionals, researchers, and the public, to name a few. Within the body of research there is a theme that shows the accountants as failing to perform their duty or failing to uphold the law. In the article: *Australia: Attitudes to Extending the Scope of Anti-Money Laundering Legislation. Journal of Money Laundering Control*, 5(1), 16-24, 2001 (doi:10.1108/eb027290), Johnson discusses the issue as follows:

A current problem is the increasing participation, in money laundering activities, of the non-financial sector: accountants; auditors; lawyers; and real estate agents. In



1997-98 the Financial Action Task Force (FATF) made, for the first time, an in-depth study of the involvement of the non-financial sector in money laundering, giving examples of real estate agents, lawyers and accountants either directly involved in laundering funds or setting up company structures to facilitate money laundering, indicating an unacceptable level of involvement by professional groups that would be expected to uphold the law. (Johnson, 2001)

This statement points to accountants possessing the skills to perform the work, but more specifically using their skills to assist in money laundering. Although the methods are not fully described here, the information, apparent in the way it is written, is sufficient to see a difference in relative social power.

In discussing the number of prosecutions for money laundering in the UK, Bell (2001) points out that during the prior twelve years that there had been over 2000 prosecutions in the USA, and only just over 350 in the UK. These researchers point to a number of reports made by professionals such as lawyers and accountants. According to Bell, in *Discretion and Decision Making in Money Laundering Prosecutions. Journal of Money Laundering Control, 5(1), 42-51.* (doi:10.1108/eb027292):

In respect of money laundering, such reporting principally occurs by financial institutions making disclosures of suspicious transactions to the National Criminal Intelligence Service, which acts as the intelligence clearing house for law enforcement agencies in the UK. It is mainly through such disclosures that money laundering in the UK is detected by the authorities. The NCIS has reported that there were 14,500 such disclosures received in 1999. However there has been frequent criticism by the law enforcement community that the number of disclosures is consistently low, and that certain sectors, particularly the legal and accountancy professions, are failing in their legal and moral duties to make

disclosures (Bell, 2001).

Bell (2001), in other words, portrays the accountants in one of two ways. First, the accountants can be perceived as not caring sufficiently to perform the reporting, given that cases to be reported are identified; or second, the accountants are not recognizing cases that have to be reported. Both of these situations possess a damaging impact on the social standing of the accountants. The first case can easily be tied to collusion or, in the simplest case, a lack of ethical standards. And if accountants are not recognizing the process of money laundering, then this speaks to their level of competence in the profession. In other words, the accounts do not possess the cultural capital necessary, and at the same time the value of the institutionalized capital is eroded.

Another aspect of accountants failing to perform their duty is shown in accountants' indecisiveness pertaining to a particular firm and its accounts. The ultimate judgment for the accounting auditor is to professionally decide whether or not to issue an unqualified or *qualified* rating. Here the perception is that auditors are failing in this category as well. According to *The utility of independence in preventing audit failure. Journal of Money Laundering Control*, 6(1), 88-93. doi:10.1108/13685200310809464, Hemraj (2002)) London's City University Business School reported in 'Auditors afraid to qualify accounts', *Accountancy* (10th December 1992, p. 3), that "this has been proved from a sample of companies, which when statistically tested, showed a significant higher rate of auditor switching." (Hemraj, 2002)

It is further explained by Hemraj, (2002) that auditors may possess some fear pertaining to giving a qualified rating. Although the fear may be genuinely founded, the reputational damage

and loss of social capital continues to occur primarily due to the fact that these things are all portrayed in a negative light.

...fear of losing the client's business makes auditors unwilling, even where the situation merits it, to issue a going concern regarding any qualification on its accounts. This calls into question auditors' competence and independence. Auditors generally fear qualifying accounts for two main reasons, which are (a) if the company survives after the qualified report, it will most surely hire new auditors and (b) a qualified report will lead to the collapse of a fragile company (Hemraj, 2002).

The way accounting auditors are seen as not performing is not restricted to Europe or the UK. Even American auditors are portrayed as failing to perform their duty as discussed by *Silets, H. M., & Drew, M. C. (2001), In Offshore Asset Protection Trusts: Tax Planning or Tax Fraud? Journal of Money Laundering Control, 5(1), 9-15. doi:10.1108/eb027289*. Their paper focuses on a case where the setting up of offshore accounts is the primary conversation. The research shows that accountants and auditors should be able to detect the use of such accounts:

If American auditors cannot trace transactions between offshore banks and their clients, the offshore trust becomes an attractive way to launder money.'(14) The Mathewson cases. (Silets & Drew, 2001).

### ***2.5.2 Independence & Ethical Dilemmas***

*Cottell, P. G., & Perlin, T. M. (1990), Accounting ethics: A practical guide for professionals. New York: Quorum Books*, is cited quite often in the journal to show the standard that accountants and auditors are held to, but more often than not the reference is used to point out what ought to be in the accounting and auditing field.

The accounting scandals which started around 2001 and continued over a few years, including companies such as Parmalat, Enron, and WorldCom, to name a few, prompted a wave of responses from the academic and research world attempting to explain “what went wrong”. This body of research followed a particular theme in describing the events which pointed to the auditor’s ethical dilemmas and the independence of the auditor as noted by Hemraj (2002):

Independence is a part of the ethical rules. Ethical rules are minute and arbitrary (either comply or fail to comply), and unless the underpinning of accepted rationale is known, they are hollow rituals. What the problem is and how the rules tackle the problem needs to be clearly stated as a prelude in order to "instill and nurture in each auditor a state of mind that makes independence in fact virtually automatic"(41). In other words, the reason why the profession is barred from doing certain things needs to be clearly spelled out. The teaching of business and professional ethics should be a part of the university curriculum(42). The creed of ethical independence should form part of the professional qualification, when accountancy firms conduct training, and when a partner who is in charge of supervising his team upholds his everyday professional responsibilities (Hemraj, 2002)

Pointing to the academe, researchers show how business schools should play a larger role in creating the ethical independence required; in other words, ethical training should be a standard part of the structure of the programs.

Additionally, the issue of auditor independence or lack of independence is shown to be part of how the auditing and accounting firms perform normal business and the business lines that they participate in, the latter often creating conflict which in turn can result in ethical dilemmas for the auditors directly involved with the clients.

Independence from the client company is necessary in order that an auditor can maintain his investigative freedom. An auditor who receives payment for non-audit services from his client raises a potential for conflict. But then is not the accountant providing services for which s/he is trained?

Performing other professional services in addition to audits, or entering into business relationships with clients in any way that might jeopardise auditors' independence—cases, in other words, of other relationships beyond financial interests, such as providing other services such as design and installation of computerised information systems. (Johnson, 2002)

Previously in the paper, the issue of a failure to perform was discussed. It is interesting to note (see quotation below) that failure to perform in some situations is being described as a situation of “pressure” on the auditors.

The need for preserving auditors' independence or objectivity arises, according to a commentator, because the accounting profession has over the years built up a reputation which encourages others to rely upon the opinion's auditors express. If these opinions are unclear or even unreliable, serious consequences may, and indeed have, resulted. In more recent years wide publicity has resulted from the failure of the auditors in their duties, and these failures have arisen not so much due to inefficient working, but rather due to pressure put upon the auditors. However, fear of losing the client's business makes auditors unwilling, even where the situation merits it, to issue to a going concern any qualification on its accounts. This calls into question auditors' competence and independence. Auditors generally fear qualifying accounts for two main reasons: (a) if the company survives after the qualified report, it will most surely hire new auditors; and (b) a qualified report will lead to the collapse of a fragile company. (Rahmdel, 2002).

There is a strong argument that the independence of an auditor's ethical stance cannot be disentangled from the nature of the business of the clients that hire auditing firms. Throughout the

journal the response to the financial scandals has been one of an ethical tone and the lack of auditor independence. Even a decade after Enron's collapse, there are calls for stronger ethical training and courses at the university level. Prabowo (2013) in *Better, faster, smarter: Developing a blueprint for creating forensic accountants. Journal of Money Laundering Control*, 16(4), 353-378.

*doi:10.1108/jmlc-05-2013-0017*, discusses these ethical issues:

A decade had passed since Enron collapsed and yet fraud remains a major international problem. Efforts have been made to fully identify the types of fraud for prevention and investigation purpose without success as there appears to be new kind of fraud emerging every day. This has created a high demand for forensic accounting skills globally ([27] Kranacher et al., 2008). Such demand has been responded widely by higher education institutions all around the globe in the form of forensic accounting programs or courses ([60] West Virginia University, 2007; [27] Kranacher et al., 2008; Hendi, 2013). These responses suggest not only a change of the capital is required, but the habitus of the auditor would change (Prabowo, 2013)

### ***2.5.3 Legislation and Accountancy***

Legislators are continually looking for ways to improve or change the laws to prevent money laundering and other negative practices. In October 2001, The Patriot Act was enacted in the US. The Patriot Act defines 'financial institution' to include businesses ranging from banks, securities dealers, insurance companies, investment bankers, money transmitters and casinos to cheque cashers, issuers of travelers cheques and money orders, credit card companies, jewelers, real estate agents and brokers, automobile and airplane dealers, travel agencies and pawnbrokers (Title 31, USC Sec. 5312(a)(2)). The Patriot Act brought about many changes, including greater requirements from professionals such as lawyers and accountants. As a result of The Patriot Act, many countries implemented Anti-money-laundering laws or made changes to existing laws to

strengthen acts against money laundering. Countries such as Italy, Belgium, France and many others were seeking to implement changes to the anti-money-laundering rules. As noted by Mohamed (2002) in *Legal instruments to combat money laundering in the EU financial market. Journal of Money Laundering Control*, 6(1), 66-79. doi:10.1108/1368520031080943:

The objective of this law is to deprive crime barons of their wealth. It seeks to simplify money laundering offences and close loopholes in the existing law. The new law would make it an offence for someone to fail to report information on any form of money laundering. It would be sufficient for the prosecution to prove that someone had reasonable grounds for suspecting a person to be engaged in money laundering. The punishment for the breach of the law would attract up to five years in prison or an unlimited fine or both. The offence would apply only to people working in the regulated financial sector, in banks, accountancy and law firms. The law also establishes a criminal assets recovery agency, which will investigate and seize wealth accumulated through criminal activity. Financial investigators, such as police and customs officers, will have new powers to require banks and other financial institutions to provide details of accounts held by a person under investigation. Banks could also be required to provide transaction information on specified accounts. (Mohamed, 2002)

The law directly impacts accountants and their reporting of suspicious activity. By making it a penalty for observing the process of money laundering and failing to report, accountants could be charged in the process.

Much conversation has occurred around the use of shell companies and trusts to move assets and conceal the origin of the company as well as the identity of the owners. The research in the journal mentions accountants, lawyers and other professionals assisting in the setup of the accounts and strategies to facilitate the illicit cash flows. Silets & Drew (2001) wrote:

For someone seeking to place his assets out of the reach of creditors, Offshore Asset Protection Trusts (OAPTs) offer the potential settlor secrecy, control, choice of law and jurisdiction, and favorable taxation. While many legitimate entities make use of the benefits of OAPTs, criminal entities have also seized upon them as a means of furthering their crimes. Criminals can use Offshore Asset Protection Trusts (OAPTs) in two ways: (1) hiding legitimate assets for the purpose of avoiding paying taxes and (2) channeling illegitimate assets for the purpose of laundering them. Both tax evasion and money laundering schemes can possess multiple layers. The basic premise, however, is always the same: take the criminal assets and place them into one trust and then have the assets returned to the criminal through an entirely different trust. (Silets & Drew, 2001).

The changes to the money laundering laws in the EU and USA seek to penalize the professionals for being a part of the 'ring' that has facilitated the process, even if it was done blindly. The changes to the regulation suggest it is the responsibility of the professional to perform the due diligence prior to the event.

OAPTs also allow assets to be held in any part of the world, not just in the jurisdiction whose laws govern the OAPT. (Silets & Drew, 2001). This means accountants must be much more aware of what assets are passing through the trusts. The journal articles implicate accountants and auditors in the process but do not delve into any of the details of how the processes work. As noted by Johnson (2001):

An increasing number of countries are taking seriously the threat that the move to the non-financial sector poses, particularly at the layering stage. Laundering schemes could not achieve the layers of complexity observed without the aid of experienced accountants and lawyers. (Johnson, 2001)



Currently UK law firms, which give investment advice, must have a properly trained money laundering officer. Unfortunately, the level of training given to a designated officer is unlikely to be extended to all legal professionals throughout the firm, even though all lawyers are required to recognize and report suspicious money laundering activities. (Johnson, 2001)

#### ***2.5.4 A Few Good Accountants Required***

Although auditors and accountants go through a similar institutional setting to attain their social position, there are many differences based on the industry, experience, ethical stance, and their overall ability to perform specific functions. There is a theme in the journal of searching for accountants with the skill-sets to prevent and detect fraud and money laundering. Specialists are being sought with the skill-sets to target money laundering and launderers. As noted by Bell (2002):

Though initial discovery of this category of launderer may stem from another investigation, this type of launderer clearly requires a full investigation in itself. It can only be effectively undertaken by a specialist money laundering investigation unit with access to significant resources including forensic accountancy services. The further one moves up the laundering hierarchy, the more likely investigators are to need the full panoply of innovative methods which many organizations have found are necessary to gather evidence in respect of members of organized crime groups. It is only as jurisdictions develop expertise in money laundering investigations, that this type of investigation can realistically be attempted. However, if organized crime groups are to be seriously tackled, this type of launderer must be targeted. (Bell, 2002)

The structural setting in which different groups of accountants and auditors are trained can vary, but ultimately researchers judge all accountants and auditors under the same umbrella.

In the USA accountants hold an undergraduate degree before embarking on a professional qualification. In the UK, because of the competition for article ship, employers tend to select prospective students who have an undergraduate degree, not necessarily an accountancy degree (Johnson, 2002).

Above, the article highlights differences in the institutionalized capital. No judgment is made as to which is better; it is simply to know and to point out that specific skills are required to be a 'good accountant'. The statements below clearly show the need for specific skills to combat money laundering. These skill-sets are rare but are needed for the fight against money laundering. As noted in "*Part 7: Investigation and enforcement (Sub-group 3: Implications of investigations and enforcement: international cooperation aspects)*", *Journal of Money Laundering Control*, Vol. 6 Issue: 3, pp.269-288, <https://doi.org/10.1108/13685200310809608>:

Cultural change without structural change in organizations will be insufficient. In the UK a new Terrorist Finance Team has been established within the NCIS Economic Crime Unit(35). In addition, a new taskforce has been established, bringing together financial, commercial and academic expertise, including forensic accountancy expertise to look, in particular, at hawala banking (Investment and enforcement, 2003)

.....not only will forensic accountancy skills be necessary but also a Customs presence where finance is being derived from complex VAT carousel frauds or smuggling activities (Investment and enforcement, 2003)

And Johnson (2001), in looking at ways to prevent and detect money laundering also noted:

The current report also calls for a study group, comprising representatives of FinCEN, the SEC, federal bank regulators and the Treasury and Justice Departments, to examine how accountants and auditors can be used in the detection and deterrence of money laundering. (Johnson, 2001)

### ***2.5.5 Forging an Auditor***

Another important theme is the way the journal articles have portrayed the auditor. Reading through the scripts, it became clear that the general view is that the auditor should stand out above all. The skill-sets, knowledge, talent, and mindset of the auditor all has to be aligned to perform the audit. The auditor has to be developed through institution and training. The auditor needs a mindset that is unwavering and yet have a human personality. The auditor must be created and forged over time.

Burger considers independence to be a crucial concept that sets auditors apart from the accountancy profession, as their core mission is to certify the public reports that describe companies' financial status - an exclusive function performed by auditors for society.<sup>5</sup> By expressing an opinion, the independent auditor assumes a public duty. (Hemraj, 2002)

“...all accountancy firms need to develop controls specifically aimed at assuring their professional independence in both fact and appearance.”  
(Hemraj, 2002)

What the problem is and how the rules tackle the problem needs to be clearly stated as a prelude in order to "instil and nurture in each auditor a state of mind that makes independence in fact virtually automatic"...  
...representatives of FinCEN, the SEC, federal bank regulators and the Treasury and Justice Departments, to examine how accountants and auditors

can be used in the detection and deterrence of money laundering. The group's goal in is to increase auditor awareness of possible money laundering and develop additional guidance, training and educational materials that address money laundering vulnerabilities. (Johnson, 2001)

There ought to be more contact between auditors and shareholders. Auditors need the power to communicate their concerns to the shareholders. (Johnson, 2002)

The research in this journal points to the nature of the tasks accounting auditors perform as being different from those of other accountants. Such tasks are often considered to be more difficult and require personnel who can handle considerably more pressure (Hendi, 2013).

## **2.6 Discussion**

This paper looks at how accounting and auditing is situated in *the Journal of Money Laundering Control* over the 16-year period from 2001 to 2016 inclusive. Starting with the notion that first, accountants are on the forefront in the fight against money laundering and corruption (ICAEW, 2002; Everette et al., 2007), and second, that academic research in the field of money laundering and corruption can possibly provide insight into ways money laundering and corruption can be prevented or detected. Given the considerable research in the field of accounting, some of the recommendations may have a high likelihood of gaining acceptance by practicing accountants and regulators (Edwards, Dean, Clarke & Wolnizer, 2013). Access to the field of academic research and publication requires researchers to follow a particular pattern of practice that would

be accepted by journals, which are the markets that place a value on the production of academic writing and research.

This paper examined the use of accounting and auditing in the journal of money laundering control by looking carefully at the ways in which the words have emerged in different publications, the frequency of use and how the use of accounting and auditing has changed as seen through the eyes of academic researchers. The analysis identifies several clear patterns and the ways we have come to view auditors.

The academic field has its own distinct principles of production, evaluation, and exchange (Bourdieu et al., 1994), and as academic researchers acquire the skills and competencies required to succeed in the field of academic publishing, they also acquire a practical sense or feel for the game (Bourdieu & Wacquant, 1992) which is attuned to the conditions of the field making the researchers better at publishing in more recognized journals. Although Academic researchers in this field are faced different types of constraints such as competition for publications, conformity to the type of writing, or their ability to join a specific conversation within a journal, these constraints do not make the practical findings of any research less valuable to practice. In other words, as the ranking of journals increases, so to does the level and depth of the analysis and how the publication adds to theory, but this does not make the publications with less theoretical insight less valuable or applicable to practice. Prior research has shown, a change in conversation in a journal can occur through several ways including editorial changes or when a rupture occurs in the field (Cooper et al., 2005). Hopwood (2007) discussed how the journal conversations can be changed and showed how researchers such as Ball & Brown (1968) and Beaver (1968) changed the conversation by discussing the informational content of earnings and reports, linking these to stock returns.

The thematic analysis of the use of accounting and auditing in this body of research have identified some specific patterns of the way accountants and auditors are seen through the eyes of researchers. Using the Praxeology of Bourdieu, the paper shows how researchers view or depict accounting, accountants, and auditors in this field and although research publications can be constrained or enabled, based on the volume and forms of capital a researcher possesses, the value of a particular research publication to practice is different than the value to academia. Joining a conversation in a journal is a separate skill that requires careful attention to what has already been said and what direction the conversation is taking. In both the field of practice and producing academic publications tact is important since one must both observe the formalities of the field as well as possess the capacity to assess the market accurately (Bourdieu, 1994).

Although the journal shows the use of accounting and auditing, the body of research and the consumers of this research can benefit further from research that delves into another level of the mechanisms at play—how the accounting and auditing practices are used in the field of money laundering. Understanding the actual practice of accounting will illuminate the processes and may allow regulators and other practitioners to move a bit closer to prevention and detection of money laundering, with the possibility of reducing the negative practices that lead to it in the first place.

I believe this research paper makes two primary contributions to accounting research. First, performing the analysis and identifying the themes of how accounting and auditing is used within a practice journal gives us, not only an indication of the level of analysis of research that is required going forward, but also tells us how accountants and auditors are viewed in the fight against corruption and money laundering. The research highlights themes that show a view almost contrary to what the accounting bodies and transnational organizations portray. The high ethical standards, and accountants joining the fight, is an area of research and practice that needs highlighting. And

second, the paper highlights that the value of research to academia is different compared to the value of the research to practice. These difference in value may work against us in the fight against corruption and money laundering.

This discussion will not be complete without reference to its own biases. Performing the analysis on a practice journal is important to this study and the choice of journals is justifiable given the journal's mandate. The five themes identified through the analysis are: (1) Accounting professionals and a failure to perform, (2) Independence and ethical delimas, (3) Legislation and accountancy, (4) A few good accountants required, and (5) Forging an auditor. These represent a subset of a multitude of other themes which were not specific to the use of the words "auditing" and "accounting" but can form the basis for other analysis and discussions. For example, the initial analysis of the publications (Figure 5) shows the most frequently used words such as: corruption, crime, terrorist, banks, and public, coupled with other analysis (figure 6) that shows the word use increasing considerably from 2001 through 2016. A more detailed look at this combination, first without the use of the terms "auditing" and "accounting", then coupled with the terms, may lead to different insights. Another area of research that can be looked at is the geographic locations or country-specific dimension of the analysis (figures 2,3, and 4) and the type of accounting systems employed in these locations. This research can build on prior research by Everett, Neu & Rahaman (2007) who call for a better understanding of how exactly accounting is implicated in the racial, class, and/or gender biases that underlie the field. Although this paper asks for more, and greater depth of, research in the field of corruption and money laundering, there already exists a body of research to draw on. By looking at another journal, *Accounting Organizations, and Society (AOS)*, the findings are considerably different when it comes to context-based research in the area of corruption and fraud. The majority of publications sighted in this paper which are context-specific

were published in the *AOS journal*. Additionally, although the use of a practice theory to explain and add clarity to accounting research has not shown up in *the Journal of Money Laundering Control*, references to Bourdieu's use in accounting appears in the AOS journal which contains thirty-two papers utilizing Bourdieu's practice theory. The aim of this research is to work toward a deeper understanding of the practices leading to the propagation of corruption and money laundering, so we can try to eliminate or minimize its negative effects.



### **3 Money Laundering and Accounting**

#### **3.1 Abstract**

This study focuses on accounting and the accountant's role in the complex relationships between organized crime and the mechanisms for moving illicit financial flows into legal financial systems. Recognizing that being able to launder criminal proceeds helps to propagate criminal activities, the paper contributes to the body of research on corruption (Mitchell, Sikka & Willmott, 1998; Everett, Neu & Rahaman, 2007; Compin, 2008; Neu, Everett, Rahaman & Martinez, 2012; Cooper, Dacin, Palmer, 2013 ) by providing supporting evidence highlighting why such negative behaviors persist despite regulation and strong anti-corruption barriers (Neu et al, 2012).

First, we highlight some of the major areas of the production of money to be laundered: fraud, organized crime and drugs, the drug supply chain, corruption along the supply chain, and politically exposed persons and public corruption. Then the paper shows some methods of moving bulk cash into the financial system and highlights the financial system's vulnerability to money laundering. The case studies on two banks— Ocean Bank and Zions Bank—highlight how a bank's internal controls provide opportunities to money launderers; the case studies also contribute to the existing literature by discussing several factors that ultimately lead to money laundering.

The paper discusses how banks' responses to regulators' allegations regarding issues of internal control deficiencies have become standardized, with banks neither admitting nor denying the issue of internal control problems, which leads to propagating internal control practices ultimately leading to money laundering. The paper also adds to the practice literature by highlighting some of the standard transactions and accounting techniques used by money launderers, with the hope that these can be used to detect money laundering activities at an early

stage. There are many other areas where corruption and crime networks operate which are specific to different contexts and these must be studied to ultimately uncover more reasons for money laundering to persist. Technological advancement has created new opportunities for money laundering and the crime networks.

### **3.2 Introduction**

“Money Laundering” refers to the processes, activities, and financial transactions undertaken with the specific goal and intent to conceal or obscure the origin or true source of the funds (IMF, 2017; IRS, 2017; UNODC, 2011). The process of money laundering leads to the legitimizing of the proceeds from illegal and criminal activity. It is believed the first legal appearance of the term “Money Laundering” occurred during the Watergate scandal in 1973, but other documentation shows the term originated in the United States during the period of prohibition in the 1920’s (About Business Crime Solutions, 2015). During this period, organized criminal networks acquired large sums of cash from smuggling alcohol. To legitimize these funds, the criminal networks invested in cash intensive businesses such as laundromats, combining the proceeds from both illegal and legal sources for deposit to financial institutions. Once the process is complete, it becomes difficult to trace either the origins of the cash flows or the persons involved in the process. Money Laundering first became illegal in the United States with the passing of the Money Laundering Control Act of 1986. This Act, which consisted of two sections, was passed by a United States Congress, essentially making money laundering a federal crime (U.S. Cong., Caucus on International Narcotics Control, 2004). In Canada, money laundering became a criminal offence under Canada’s Criminal Code in 1989 and the Office of the Superintendent of Financial Institutions (OSFI) took an active role in 1990 in issuing guidelines on anti-money-laundering techniques and best practices (Gerstein & Hervieux-Payette, 2013).

Financial gain is probably the main reason for engaging in criminal activity, and although the risks may be high, the rewards must certainly outweigh these risks. In 1998, the International Monetary Fund (IMF) estimated that two to five percent of global GDP is laundered annually. At that time, the range was between USD 590 billion and USD 1.5 trillion (IMF, 1998; FATF, 2004).

In 2009, the United Nations Office on Drug and Crime estimated that criminal activity accounted for approximately 3.6% of global GDP with 2.7% or USD 1.6 trillion being laundered (UNODC, 2011; FATF, 2018). In 2016, global GDP was just over USD 75 trillion. This equates to just over USD 2 trillion being laundered. In perspective, the GDP of Spain in 2016 was USD 1.24 trillion, and there are only fourteen countries on the OECD's list with a GDP greater than USD 2 trillion (OECD, 2018). These numbers begin to show the size of the problem of money laundering, but to understand the true impact of the problem, we must at minimum understand the main sources of the funds being laundered.

Organized crime and organized criminal networks working in the areas of drug trafficking, human trafficking, illegal arms sales, prostitution rings, and smuggling are just some of the cash generating businesses that produce large amounts of funds to be laundered (FATF, 2018; UNODC, 2011), and activities such as bribery, embezzlement, insider trading, and computer fraud can lead to significant amounts of cash to be laundered as well. (FATF, 2018).

The UNODC reports that cocaine and opioid drug production and consumption is on the rise and unfortunately this leads to a greater number of premature deaths. These drugs are of serious concern and the proceeds of these drugs continue to be a major source of income for organized criminal networks. The U.S. Immigration and Customs Enforcement—in combating the opioid crisis—believes the majority of the illegal opioids originate in China (ICE, 2017).

“Globally, there are an estimated minimum of 190,000 — in most cases avoidable — premature deaths from drugs, the majority attributable to the use of opioids (UNODC, 2017).”

It has been documented that terrorist organizations such as the Taliban are also involved in the illegal drug trade. In Afghanistan for example, the Consolidated United Nations Security Council Sanctions List contains several Taliban leaders accused of direct involvement in illicit

opiate production, manufacturing and trafficking. The Security Council Committee established in 2011 that the Taliban receives approximately USD 200 million annually from the illicit narcotics economy (UNODC, 2017).

In 2015, the United States department of treasury estimated that about \$300 billion is generated from illicit proceeds within the U.S. The department believes that fraud and drug trafficking offenses generate most of the proceeds (U.S. Department of Treasury, 2015). It is estimated that approximately \$64 billion is generated from drug trafficking and over \$125 billion from fraud perpetrated against the US federal government programs which includes food and nutrition subsidies, Medicare and Medicaid reimbursements, and false claims on federal tax refunds (U.S. Department of Treasury, 2015). Healthcare fraud involves submitting false claims for reimbursement which may include a ring of professionals, patients, and even check cashing services. Claims are made with the aid of medical professionals and support staff, and the federal refunds are then cashed using check cashing services to help obscure the traceability.

These examples indicate that the sources of money to be laundered can originate equally from countries with low anti-corruption barriers as well as from countries with robust anti-corruption barriers. Being able to effectively launder the proceeds from any criminal activity continues to incentivize and propagate corruption and crime. Additionally, terrorist organizations previously believed to be independent of criminal networks may now have some overlapping means of acquiring funds. Although the end result and the use of the funds may be different between terrorist organizations and criminal networks, terrorist organizations may have similar incentives to obscure or conceal the origins of the funds to avoid traceability, and to protect those providing the goods or services.

There is an intrinsic link between money laundering and corruption (OECD, 2018; FATF, 2010), even described as a symbiotic relationship (Chaikin, 2014), but this body of research takes the view that the intrinsic link between money laundering and corruption is more of a co-dependent relationship—one that will wither without the other. Corruption has been defined as the abuse of entrusted power for private gain<sup>4</sup> (Transparency International, 2005) and corruption can permeate every aspect of society—from political and economic to environmental and social, and in the worst cases, it costs lives (Transparency International, 2014).

So far, some of the criminal activity leading to the necessity for money to be laundered have been mentioned and these activities should not be minimized or understated in terms of their impact on society and human life, however, the ability to launder the money in part creates an opportunity to propagate the corrupt and criminal activities that led to the money laundering process in the first place. The current study attempts to shed light on the accounting mechanisms, technologies, and techniques used in the process of money laundering with three main motivations. First, the paper discusses some of the major areas of production of money to be laundered along with the vulnerabilities of particular sectors of the economy where money is laundered with particular attention to the financial sector. Second, the paper contributes to the body of research on corruption (Mitchell, Sikka & Willmott, 1998; Everett, Neu & Rahaman, 2007; Compin, 2008; Neu, Everett, Rahaman & Martinez, 2012; Cooper, Dacin, Palmer, 2013 ) and provides supporting evidence which complements this body of research highlighting why such negative behaviors persist despite regulation and strong anti-corruption barriers (Neu et al, 2012), by showing the role of accountants and knowledgeable professionals in the money laundering process in specific

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<sup>4</sup> Transparency International (<https://www.transparency.org/>) uses this definition. Similar definitions have been used by Corell, 2003; INTOSAI, 2004; Everett et al, 2007; Neu et al, 2012.

contexts. The paper discusses several cases but focuses on two cases between the financial regulators and banks and highlights how banks respond to allegations as well as how regulators follow up on allegations made to banks. And third, the paper attempts to identify patterned practices that over time allows money laundering to persist with the notion that pattern identification may be used to assist with the prevention of money laundering and ultimately reduce the level of corruption.

The remainder of this study is structured as follows. The next section reviews the existing literature dealing with the specific and overlapping areas of corruption, money laundering and accounting while section three discusses the theoretical framing. Section four performs the analysis starting with the stages of money laundering and incorporating examples from U.S. court cases. Section four also identifies the accounting mechanisms and techniques, and the role of accountants and knowledgeable professionals in the money laundering process. And section five performs a discussion of the findings and looks at accounting and the accountants' role in crime networks and the capital needed for money laundering.

### **3.3 Current Literature**

In the fight against corruption, organizations such as the World Bank and Transparency International have often positioned accountants with the view of upholding a high level of accountability, transparency, and ethical standards with the shared responsibility of eradicating poverty and building an environment of trust (World Bank, 2014). This view can be understood in part, due to the rigorous system of formal institutionalized training and Code of Ethics set by the global professional accounting organizations (IFAC, 2016). In most cases auditors and accountants go through a certification examination process through which they are deemed to have acquired or

developed in parallel to the field experience, the technical knowledge and the ethical sense that sets he or she apart from the person who did not undergo this process. In other words, there is a notion that the institutionalized process of accounting and auditing training embeds the characteristics that may lead to the view of accountants and auditors as “virtuous actors” (Neu et al., 2012). While this view of accountants and auditors fits with institutional actors, another view should also be considered. Money laundering techniques can include complicated structures and strategies and generally requires skilled professionals to carry out these tasks to avoid detection. In many cases, accountants and auditors may be the most knowledgeable and best positioned to perform these tasks (Mitchell et al., 1998).

Although the association between fraud, corruption, and money laundering has been intuitively known for decades, little research had been done in the area of how accounting firms, accountants (Thinker & Okcabol, 1991) and other business professionals participate in setting up and structuring the transactions to allow events such as fraud and money laundering to be a success. Academics did not pursue this area of research until much more recently. One of the earlier papers on the subject of white-collar crime and the role of accountants in the process of money laundering is written by Mitchell, Sikka, & Willmott (1998). Their paper highlights how a group of accounting professionals worked together to defraud a company of over USD 10M by analyzing the details of the court case: *AGIP (Africa) Ltd. v Jackson & Others* (1990). Mitchell et al., (1998) showed how the fraud was committed<sup>5</sup> by looking at the case details and highlighting how money was transferred from AGIP to Kinz Joaillier SARL<sup>6</sup> using several other companies in

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<sup>5</sup> The AGIP court case provided the details of a case in which a small accounting firm was judged to have “knowingly” laundered money and assisted in the misapplication of the plaintiff’s (AGIP) funds (Mitchell et al., 1998)

<sup>6</sup> Kinz Joaillier SARL was incorporated in France and was a subsidiary of Euro-Arabian Jewelry. Euro-Arabian Jewelry’s main asset was debt from Kinz Koillier SARL.



the process. The courts judged the accounting firm, Jackson & Co., to have “dishonestly assisted in the misapplication of funds” (AGIP (Africa) Ltd. v Jackson & Others, 1990; Mitchell et al., 1998).

The High Court also stated that

“Jackson & Co. were introduced to the High Holborn branch of Lloyds Bank Plc. in March 1983 by a Mr. Humphrey, a partner in the well-known firm Thornton Baker [now part of Grant Thornton]. They probably took over an established arrangement...”

The researchers further explained the relationship between Mr. Humphrey and Grant Thornton which pointed to the involvement of an accounting firm in money laundering. It is interesting to note that these cases are generally problematic, with continually shifting responsibility; identifying which bodies are to be held accountable for providing a solution is often difficult. At that time the ministry’s response to questions pointed to either the governing body of accountants, saying it may be an issue of conduct, or a criminal offense which AGIP can take up elsewhere.

Looking at money laundering and anti-money-laundering mechanisms, Reuter & Truman (2004) discussed the advancement of the US and global anti-money-laundering (AML) regimes and the forty recommendations made in 2003 by the Financial Action Task Force. Reuter & Truman (2004) noted that the global AML system has improved considerably in a relatively short time; however we can also expect money laundering tactics to change. The risk-based system of money laundering has been adopted by financial institutions following the recommendations made by FATF. The risk-based system is applied to customers based on the institution’s knowledge and know-your-customer information held by the institution pertaining to the specific client. FinCEN, the Financial Crimes Enforcement Network generates a watch list based on country and specific names of persons deemed to be high risk for money laundering or terrorist financing. The risk-based system becomes part of the management control system of the financial institution. The

system is generally set up to encompass both the KYC information and FinCEN's information and is used to determine limits within which each customer transaction typically occurs, and would generate red-flags when the transactions are outside of the expected or norm for the client.

The risk-based approach adopted by financial institutions can be adjusted within the institution's management control system (MCS) but it argues that the system put in place can wrongfully deny legitimate customers of fair banking transactions. Customers may be subject to harassing questions and the self-policing on which the regime relies can fail (Reuter & Truman, 2004). Reuter and Truman (2004) also discusses the possibility that as barriers continue to be erected, customer transaction costs will increase and financial institutions with these systems will be tarnished with false links to money laundering practices leading to reputational risk and business loss.

There is also the argument that has taken a different view of the direction and prospects of the AML system both in the US and globally. Mariano-Florentino Cuellar (2003), views the list of crimes punishable for money laundering as too extensive and argues that law enforcement officials will focus on the fight to prosecute individuals for the crimes that lead to money laundering rather than a focus on the methods to prevent money laundering. This would work against the original intentions of implementing a system of AML and Counter Terrorist Financing.

Special purpose entities and shell companies have been a point of discussion for some time but the set-up and use of these types of companies is not always with negative intent. The term "shell company," refers to non-publicly traded corporations, limited liability companies (LLCs), and trusts that typically have no physical presence other than a mailing address, and generate little

to no independent economic value<sup>7</sup>. Businesses may have legitimate reasons for concealing or creating a lack of transparency of their operations and hence shell companies may have characteristics desirable to those businesses. But disguising the ownership and purpose in some cases has become problematic (FinCEN, 2006) and has created vulnerabilities to terrorist groups and allows money laundering to occur.

Prior studies have shown the use of shell companies and accounting practices (Mitchell et al., 1998; Baker & Hayes, 2004; Sikka & Lehman, 2015) in moving and cashing false checks, falsifying corporate profits, and defrauding investors of large sums of cash and investments. Shell companies have also been used by both individuals and corporations to evade taxes, costing governments millions in lost revenue (Sikka, 2003,2008; Sikka & Hampton, 2005; Bakre, 2007; Palan et al., 2010) and in the use of tax evasion using varying transfer pricing mechanisms (Otusanya, 2011; Sikka & Willmott, 2010). Baker & Hayes (2004) details the levels and complexity of use of special purpose entities (SPE)<sup>8</sup> by Enron to defraud investors and falsify profits. During the period 1993 to 2001, Enron reportedly created over 3000 SPEs towards overstating Enron's shareholders equity by USD 1.2 billion. Although the use of SPEs and shell companies for corrupt practices were known prior to 2003, the FATF 40 recommendation only

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<sup>7</sup> U.S. Money Laundering Threat Assessment Working Group, U.S. Money Laundering Threat Assessment (December 2005), p. 47.

<sup>8</sup> Special Purpose Entities (SPEs) are defined as entities formed for some specific purpose or activity. SPEs were initially used by banks and financial institutions to provide off-balance sheet financing for mortgage loans and other types of receivables (Perry, 1993; Baker & Hayes, 2004).

covered shell companies specifically dealing with banking. Recommendation #18<sup>9</sup> covered shell companies. In 2006, FinCEN issued a cautionary statement to financial institutions:

This advisory is being issued to alert financial institutions to some of the potential money laundering risks associated with providing financial services to shell companies... This advisory is not intended to encourage financial institutions to discontinue business or refuse accounts or relationships with shell companies. Rather, the purpose of this advisory is to remind financial institutions of the importance of managing the potential risks associated with providing financial services to shell companies.... As noted in the 2005 U.S. Money Laundering Threat Assessment, shell companies have become common tools for money laundering and other financial crimes, primarily because they are easy and inexpensive to form and operate (FinCEN, 2006).

FinCEN's advisory leaves two things to be considered. First, although FinCEN explains the use of shell companies and the risks of money laundering, it appears it is taken for granted that all financial institutions that are subject to the Bank Secrecy Act (BSA) examines the risks from shell companies, and reviews their anti-money-laundering programs regularly to ensure that any money laundering risks are being assessed and managed appropriately. The second consideration is the belief by the enforcement authority that the primary reason shell companies are used for laundering money is due their ease of use, and that they are inexpensive to set up. It was not until 2017 that FinCEN issues an advisory on the possibility of money laundering using shell companies and real-

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<sup>9</sup> Countries should not approve the establishment or accept the continued operation of shell banks. Financial institutions should refuse to enter into, or continue, a correspondent banking relationship with shell banks. Financial institutions should also guard against establishing relations with respondent foreign financial institutions that permit their accounts to be used by shell banks (FATF, 2004)

estate (FinCEN, 2017). Thus far, the research has shown that although the use of shell companies can be shown to be used with negative consequences and to facilitate criminal activity and money laundering, the methods and transactions are different for different types of businesses.

Corruption in the public sectors of both developing countries and in developed countries is seen as having serious negative consequences to society (Transparency International, 2005). Although research has not yet been able to measure the specific loss to individuals as resources are diverted to personal gain, the exact amount of resources diverted is difficult to ascertain (Serra & Wantchekon, 2012). Transparency International has put a measure in place, The Corruption Perception Index<sup>10</sup>, which ranks countries based on the perception of the level of corruption in the country. Although we understand some of the mechanisms of money laundering, and Transparency International publishes the Corruption perception index, there is still a large area of research needed to help us understand how money laundering and corruption persist, the skill-sets employed, and how networks of professionals are brought together to successfully launder money.

A more radical role of accounting has been emphasized by Everett et al. (2007), by pointing to several class, race and gender-based issues. Taking a governmentality perspective, the paper highlights the possibility that accounting should not necessarily “do more”, but possibly “do differently”, particularly in the areas of record keeping in developing countries. Record keeping should be more contextually appropriate. Additionally, Everett et al. (2007) suggests, when dealing

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<sup>10</sup> Each year Transparency International score countries on how corrupt their public sectors are seen to be. Transparency International believes the Corruption Perceptions Index sends a powerful message and governments have been forced to take notice and act. The Index captures the informed views of analysts, businesspeople and experts in countries around the world.

with corruption and developing countries, the standard accounting rules must be viewed as problematic since they seem to be enhancing corrupt practices.

In their paper on accounting and networks of corruption, Neu, Everett, Rahaman & Martinez (2012) shed light on the topic of corruption in the developed world by disentangling and analyzing the events of the Canadian federal government's Sponsorship Program<sup>11</sup>. Further, Neu, Everett & Rahaman (2013) investigated the practices of auditors and auditing in a Government setting where corruption is involved. These papers help set the stage, sharing an understanding of how individuals in "influence positions" and those knowledgeable in professional practices work around the rules, and how networks of actors come together to propagate corruption in a particular context. (Neu et al., 2012; 2013). These papers utilize an institutional analysis approach by setting out the field, the players, their relative positions, and the struggles within the field (Bourdieu & Wacquant, 1992). This is helpful not only in understanding how money laundering, fraud and corruption may persist in an influence market setting, but also highlights how these events are highly context driven (Neu et al., 2012; 2013; Cooper, Dacin, Palmer, 2013).

Accounting and accounting practice are seen as performative in the sense that these practices create repetitive inscriptions and documents which in turn sets in motion actions to accomplish certain tasks (Ezzamel, 2009; 2014). In this way accounting inscriptions become the script for how performance and accounting practices are accorded power and status, in a particular context that allows accounting mechanisms to become a part of producing and sustaining order in society (Ezzamel, 2014). Yet, research has shown accounting practices also play a major role in creating disorder Compin (2008), and maintaining corrupts practices (Everett et al., 2007). As

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<sup>11</sup> The Gomery Commission of Inquiry into the Sponsorship Program and Advertising Activities. The summary report, fact finding report and the forensic audit were all issued in 2005.

financial crime moves from unorganized crime to organized crime networks, the level of sophistication and accounting knowledge used to launder money increases. Accounting creates the smokescreen for the illegal activities to occur (Compin, 2008) and enables corruption (Neu et al.,2012). While globalization, and free and open markets have increased both the movement and ease of movement of financial resources, uncertainties and risks have also increased (Harvey, 1989; Lash & Urry, 1994; Arnold & Sikka, 2001) and money laundering has become a greater problem in part due to open markets and deregulated economies (Compin, 2008).

We now have some understanding of the positioning of accounting practices in a field where it either facilitates or hinders corrupt practices within specific contexts, but we still do not have much information of how accounting is used to facilitate terrorist group actions. Compin (2008) asserts that considering the cost associated with the terrorist activity of September 11, 2001—approximately USD 200K—money dirtying operations and money laundering operations are not closely linked. A similar argument is made by Reuter & Truman (2004), sighting the amount of money used in terrorist activity is low compared to money laundering operations. Although this may be true, we should not broadly discount the notion that money laundering and terrorism are completely separate or not intertwined; nor should we assume that the financial cost to perform such terrorist activities are always low. Although the ideologies among the groups performing money laundering and those performing money dirtying may be different on a high level of analysis, there may be considerable overlap between the groups, since terrorists require funds for purchasing weapons, training, housing, bribery, and for information, among other needs. It has also been shown that there are links between terrorist groups and opium production in the middle east (UNODC, 2017). Hence, those involved in money dirtying practices or in the

operations common to money dirtying and money laundering will act in a manner to conceal the origins of the funds as well as to conceal the identities of those involved.

The current study analyses money laundering and corruption using the processes involved in numerous activities leading to money laundering. As mentioned earlier, the intent of the current study is three-fold. First, by using multiple case studies and reports from transnational organizations such as the United Nations and the Financial Action Task Force, the paper plans to shed light on the mechanisms, technologies and techniques used in money laundering. Second, the paper attempts to show how, within crime networks, accountants are able to accumulate the necessary capital that helps to allow money laundering to persist. The paper also draws attention to financial institutions and how the internal controls are bypassed to allow money laundering to persist. And third, the paper attempts to identify patterned practices used by individuals and networks over time and in different settings which may help to prevent these practices from continuing.

### **3.4 Theoretical Framing**

The primary theoretical lens through which this paper views the area of corruption and money laundering is the institutional sociology of Bourdieu—where theory and practice constantly inform each other (Bourdieu, 1977; 1990a; 1990b; 2005; Prasad, 2005). Within the context of corruption and money laundering, there are many ‘fields of play’ where social actors must understand the game — almost in an expert manner—to be successful at laundering money. Bourdieu encourages us to look at the contexts since different contextual settings produce differing sets of capital, and the capital acquired in one field may not possess the same value in another field. These different sets or forms of capital can then be utilized to position and re-position the



actors in the field of play. Bourdieu strongly emphasizes the notion of a *relational analysis* (Prasad, 2002), or always looking at the relationships with multitudes of actors or groups. For example, the money earned by the accountants or accounting professionals setting up the schemes for money laundering may mean very little until they are compared to an income earned in the broader accounting professional field. Discussing the field in terms of relations allows us to not only look at the interaction between and among social actors, but it also allows us to look at how actors react to changes in the institutional settings. For example, how do players react to changes such as the anticipation of new regulation, and how do different regulations and rules in different fields produce differences in capital, or how do modes of operation in a field change when law enforcement officials plan to detect organized crime networks in order to prevent money laundering change, to name a few.

Enlisting professionals or knowledgeable individuals such as accountants or lawyers in networks of organized crime can complicate the strategies used by these organizations and assist in making the detection and prevention of money laundering even more difficult. According to Bourdieu (1991), fields are linked and can be treated as large complex fields or smaller fields, depending on the level of analysis, but fields, regardless of the size, are characterized by the struggles and tensions within them which in turn defines the nature of valued capital in the specific field. The fight by law makers, local and international law enforcement officials and multi-lateral organizations, against corrupt practices, fraud, and money laundering is ongoing, and accounting-based practices help to organize the field (Neu et al., 2012) in a manner that either hinders or facilitates corruption and money laundering. This field could include regulators, banks and other financial institutions, business professionals such as accountants and lawyers, law enforcement

officials, government officials or persons in close proximity to government officials or politically exposed persons (PEPs), drug cartels and other criminal networks and even terrorist groups.

The groups that fight criminal networks and work to prevent and detect corruption and money laundering, and the groups conspiring to perform the laundering processes, both have access to, or enlist business professionals with, similar skill-sets. Business professionals—professional accountants, lawyers etc.—generally acquire their foundational education through an institutionalized process that gives them the legitimacy to practice in their field (Bourdieu, 1991; Cooper & Robson, 2006), but though these skills and competencies that have been acquired through the institutionalized process are not sufficient at this level of the game. Professionals need to acquire a ‘feel for the game’ where reactions to some processes are almost instinctive and natural. We can say, in some ways, that professionals become attuned to the environment and the specific field. This field work allows professionals to develop or hone one’s skills in a manner that gives them a feel for the game. Through a continuous process of adapting skills and knowledge, responses are developed and become part of the natural strategic responses of the individuals (Bourdieu, 1977). On one hand, the regulators, law makers, accountants, and financial institutions set up rules and erect institutional barriers; personnel get special training in areas such as anti-money-laundering techniques and management accounting control systems; the training is then implemented to detect illicit financial flows. On the other hand, there are professionals who do not necessarily carry the seal of approval or may not be legitimized by any professional body—but who understand the rules and know how the barriers are set up in great detail. These individuals with extensive process knowledge may possess many of the skills above and beyond those acquired through the standardized institutional processes, and these skills enable them to succeed in the field. Many of these individuals may

secure employment in areas that are constantly working to undermine the corruption and money laundering processes such as banking and regulation. Others who possess these specialized skills may work as accountants with specialized knowledge in moving the proceeds from criminal activity through the money laundering process.

Financial institutions implement management control systems to prevent and detect illicit financial flows, and this has become a key part of the AML process. Employees involved in the AML departments of financial organizations go through certification processes—capital building processes—which not only makes the individual more valuable to their existing employer but also makes him/her more marketable since they are deemed to have better judgment when it comes to AML. With this knowledge, management control systems are set up as an interactive process to help manage risk as part of the ERM system (Power, 2009). The management control systems are set up to generate a red flag when a transaction falls outside of the norm; a person with their own decision-making style will then decide (Hopwood, 1974) how to deal with it, which in turn requires both the organization and the individual to not simply understand their risk appetite (O'Malley, 2004), but these risk appetites must also be aligned to give the best result. Although red flags are generated by a management control system, how it is processed becomes the judgment of an individual with the knowledge and authority to make such a decision.

Bourdieu allows us to apply his conceptual tools to environments where networks are developed, both to launder money and to prevent and detect money laundering, as well as to individuals who may act on their own. In the next section Bourdieu's conceptual tools are applied to help to identify patterned practices within the context of money laundering and corruption.

### 3.5 Analysis

#### 3.5.1 Sources of Illicit cash flows

##### *Fraud*

To fully understand practices within the field of money laundering, the study's analysis starts by outlining the sources of money to be laundered along with the vulnerable industry sectors where these funds can be laundered, thus mapping the field which according to Bourdieu is "the network of the objective relations among establishments that, like heavenly bodies belonging to the same gravitational field, produce effects upon one another from afar" (Bourdieu 1996a [1989]: 131, 132). This first attempt at mapping the field would give us a good indication of the flow of resources, the logic and rules (Bourdieu & Wacquant, 1992: 104; Neu et al., 2012), the players, and the structural and interactional relations occurring within the field.

In the United States alone, the US, Department of Treasury, in conjunction with data from the United Nations Office on Drugs and Crime (UNODC), estimated that since 2010, over \$236 billion is laundered from financial crime and a large proportion of this number is attributable to fraud (US, Department of Treasury, 2015). Although fraud is generally associated with corruption, it can be disassociated and defined separately. One definition from the Oxford dictionary states fraud is wrongful or criminal deception intended to result in financial or personal gain. A fair number of crimes involve fraudulent activities which generally do not start off as a cash transaction. The transactions are usually set up as "normal or everyday" transactions utilizing regulated financial channels to make them appear legitimate (US, Department of Treasury, 2015; FinCEN, 2009). These so-called "normal or regular" transactions are placed in such a way as to go undetected by the management control system put in place to detect such unusual banking activity.

Hence, without careful attention to the details, fraudulent activity occurs, and money is laundered and goes undetected.

Increasing globalization coupled with technological advances have become one of the drivers leading to increased international trade. Technology promotes the increasing use of financial instruments and hence the increasing use of accounting technologies for the debits and credits through automated payment systems. As globalization has accelerated, the mobility of capital and credit has also changed, and the faceless trading has added to and created numerous uncertainties (Harvey, 1989; Lash & Urry, 1994; Arnold & Sikka, 2001). The capital possessed by criminal organizations is changing, and many criminal organizations are now expanding their businesses to support on-line transactions. This shows there is room for organized improvisation (Bourdieu & Wacquant, 1992) by the crime group. Fraud and money laundering activities can now exploit new payment technologies as well as the original low technology options (Department of Treasury, 2015). Recent reports suggest that drug trafficking gangs are acquiring these new skill-sets based on the management control system used by port authorities (Freeman, 2013). The willingness of these participants to enter in and play this new game (Bourdieu, 1989a) shows not only that they are willing to expand their field of play, but that they are also acquiring new capital which defines the chances of profit in the given field (Bourdieu, 1994). These new skills can either be purchased by hiring an already trained hacker, or the gangs can acquire the training themselves. Europol has issued reports suggesting that the use of specialists and expert hackers will continue to grow (UNODC, 2015; Bateman, 2013) so be it skills for hire or skills developed as part of the crime group, acquiring these skills may be seen as a natural progression of survival; it is not seen as logical but rather as a practical sense of the game (Bourdieu, 1987a).

The United States Department of Justice and the Federal Bureau of Investigations have reported that healthcare fraud accounts for the largest dollar losses annually by the US federal government. Approximately \$80 billion is lost annually (FBI, 2016). And as a related but separate event, the FBI estimates there is an additional \$30 billion lost annually from fraud victimizing private insurance companies (FBI, 2016). Fraud in this sector is difficult to detect since check-cashing services often work in collaboration with those receiving the , to set up networks to produce the checks, receive the payments and ultimately cash the checks. The network of persons in healthcare fraud must be immersed in the processes to be successful, and this requires specialized and knowledgeable participants who are employed in the field of healthcare to approve each step of the process until a check is generated. It also requires insurance professionals who are familiar with the rules and how to work around them to tailor the entries to the documents to keep suspicion to a minimum while simultaneously ensuring that a post-audit will not detect fraudulent activity. This is a situation where success requires collaboration among the participants (Neu et al., 2013) and each participant must occupy a particular position in the field. This occupied position is defined by the volume of capital the participant possesses and the composition of capital (Bourdieu, 1994). Participants are expected to perform a variety of tasks, with each requiring different skill-sets and capital.

Healthcare and insurance companies generally utilize segregation of duties as a barrier to fraud; hence it's almost a necessity that a network is needed to work together to accomplish this activity. It is possible that under such tight controls and segregation of duties, once a system of working around the rules is set up, the network of professionals forms a durable network which can persist over time. This system makes it difficult—simply due to the very nature of the segregation of duties—for a single person to oversee the entire process; hence some type of self orchestrating

system takes shape that allows the practice to continue. These semi-durable networks hold together for reasons greater than simply the ability to perform specific tasks; the composition of their capital as defined by the relative weights of the different kinds of capital (Bourdieu, 1994) helps to create the cohesion. The participants develop a level of trust each now possesses a type of symbolic capital specific to the context of fraud in healthcare and insurance. Changing individuals within such a network may generate mistrust, with the possibility of the network collapsing.

Although the basic technical skills acquired in the process of becoming expert hackers in different industries may be similar, the industry and context-specific skills vary among industries. Identity theft, crimes whereby someone wrongfully obtains and uses another person's personal data in a way that involves deception, is another area of fraud where technological skills are industry specific. Identity theft includes, but are not limited to stolen payment cards, hacked bank accounts, and credit card fraud (Department of Treasury, 2015). Typical sales of stolen information and identity involved accounting technologies set up to transfer funds through money transmitters. The transfers have been structured to keep the dollar value below \$3,000 which represents the federal record-keeping threshold (FTC, 2013). This organized network operates in two ways when transferring funds out of hacked accounts. One way is by employing intermediates known as "money mules" or persons who will perform a specified transaction process for a fee—usually a percentage of the dollar amount being transacted. The more popular of the two are "money mules" who receive the fraudulent funds and, after extracting the fee, forwards the rest of the funds using licensed money transmitters to the destination person, who may be located on another continent. In this process, the intermediaries do not have to be a permanent part of the criminal network and in fact may not even be aware that the transaction is a money laundering process (FBI, 2010). Another way the criminal network has established the money laundering process is by eliminating

the intermediaries and setting up accounts using prepaid debit cards (Department of Treasury, 2015). This process not only reduces the transaction cost but also reduces the risk of flight by the intermediary, making the business process both more efficient and less risky. The completing transaction is performed by an individual with an ATM card at any bank machine. To be able to acquire “money mules” requires a level of dominance over the individuals and the act of naming helps to establish this social structure (Bourdieu, 1994). The use of insults, like naming, belongs to a class of socially based acts of institution and destitution, indicating to someone that they possess that property and that they must conduct themselves in accordance with their assigned role. These acts become ritualized strategies in the symbolic struggle for position (Bourdieu, 1994).

The criminal network performing different forms of identity theft have expanded their activities in recent years to the area of tax fraud. Electronic income tax filing facilitates filing a fraudulent income tax return early in the filing period using the stolen identity information from a legitimate tax payer (Department of Treasury, 2015) and income tax refunds can utilize electronic transfers through prepaid debit cards or direct deposit, allowing the fraudsters to cash out their proceeds at ATMs. The IRS and Treasury Inspector General for Tax Administration reported that over \$11.5 billion has been lost annually since 2010 and the amount appears to be increasing (TIGTA, 2012). The increase in personal tax fraud has prompted oversight bodies such as FinCEN to issue an Advisory establishing red flag indicators for banks to assist with identifying fraudulent tax refund through direct deposit (FinCEN, 2013).

Mortgage fraud, facilitated in part by the reliance of both financial and non-financial institutions on third-party brokerage (DOJ, 2006); knowledgeable industry professionals from the financial sector and the real estate sector; and technological advances in the underwriting and property valuation models (Lampe, 2008). Mortgage fraud schemes usually contain some material



misstatement, omission, or misrepresentation that is relied on by the lender to fund the loan (FBI, 2013; Department of Treasury, 2015). Criminal groups exploit avenues that reduce face to face communication; in many cases the financial and accounting transactions occur electronically. Falsified documents such as job letters, tax forms and pay slips are some of the common documents falsified. Two of the primary ways organized criminal networks utilize mortgage fraud is for the use of drug labs/grow operations and for laundering funds from other illegal operations. This type of operation requires an insider network to assist with setting up the documents and transactions to go undetected, since criminals earning income from illegal sources such as drug operations possess the financial resources to acquire the property, but will pass the background checks necessary to obtain financing which will allow them to launder the funds. Criminal groups are involved in different types of mortgage fraud at varying levels of sophistication (Lampe, 2008) and the level of sophistication of the accounting technologies follows suite (Compin, 2008). In this area of fraud, criminal networks seek out professionals or individuals with specialized skills in real-estate, financial and accounting (Department of Treasury, 2015), as well as law and title insurance (Lampe, 2008). The organized crime network will either possess the skills or hire individuals possessing the skills to successfully perform the operations. Although FinCEN issued an Advisory in 2012 to assist mortgage lenders in detecting and preventing mortgage fraud (FinCEN, 2012), highlighting potential red flags , mortgage fraud continues to persist and increase over time. This requires accounting practices that allow the actors to circumvent the institutional anti-corruption barriers in place. Neu et al. (2013) suggests that these accounting practices intersect with habitus, capital, and social position in different ways and at different moments in time, and one requires the ability to create the network. This strategy is realized, partly due to a conscious

calculative decision at the time and partly due to the habitus and capital possessed (Bourdieu & Wacquant, 1992).

With the advancement in technology and the available internet options for increasing sales, alternative payment systems have increased (Department of Treasury, 2015). These payment processing systems are coupled with the accounting systems dealing with the payments, the actual transactions, and the accounting and management control systems themselves, ensuring the receipt of legitimate goods or service on one side, and the receipt of payment on the other.

To fill the void created between the two ends of the process, both the need for third party payment-processing and the role of third-party payment-processing services, have increased significantly over the past several years. Third party payment-processing services act as intermediaries between banks and merchants and other business entities providing services for non-cash payments to complete business transactions. Third party payment-processing services are prevalent in many business areas from traditional stores with physical locations to stores with only an on-line presence. The merchant transactions typically covered by third party payment-processing services primarily includes credit card payments, automated clearing house (ACH) transactions<sup>12</sup>, remotely created checks (RCC)<sup>13</sup>, and debit and prepaid cards transactions.

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<sup>12</sup> NACHA – The Electronic Payments Association (NACHA) is the administrator of the Automated Clearing House (ACH) Network. The ACH Network is governed by the NACHA Operating Rules, which provides the legal foundation for the exchange of ACH and IAT payments. The NACHA Web site includes additional information about the ACH payment system.

<sup>13</sup> A remotely created check (sometimes called a "demand draft") is a check that is not created by the paying bank (often created by a payee or its service provider), drawn on a customer's bank account. The check often is authorized by the customer remotely, by telephone or online, and, therefore, does not bear the customer's handwritten signature.

Third party payment-processing services are generally not subject to BSA/AML requirements and as a result can pose additional risk for money laundering transactions, identity theft, and network fraud among other activities prohibited by the Office of Foreign Asset Control. According to the Bank Secrecy Act (BSA), third-party payment processors often use their commercial bank accounts to conduct payment processing for their merchant clients. For example, the processor may deposit into its account RCCs generated on behalf of a merchant client, or process ACH transactions on behalf of a merchant client. In either case, the bank does not have a direct relationship with the merchant. The increased use of RCCs by processor customers also raises the risk of fraudulent payments being processed through the processor's bank account (FFIEC, 2014). The Office of the Controller of Currency (OCC), FinCEN, and the Federal Deposit Insurance Corporation have issued guidance in dealing with the risks associated with third party payment-processing services in accordance with BSA/AML14.

Third party payment-processors cannot predict and may not have the ability to understand the type of customer groups a merchant may have. So while the third party payment-processors generally act on legitimate transactions for reputable merchants, the risk associated with different merchants can vary significantly, based on the make-up of the customer base and the risks of money laundering and other financial crime. These are heightened when the third party payment-processors do not perform adequate due diligence on the merchants for which they are acting and processing payments (FFIEC, 2014). Areas where there are unusually high reversed transactions

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<sup>14</sup> *FDIC Clarifying Supervisory Approach to Institutions Establishing Account Relationships with Third-Party Payment Processors*, FDIC FIL-41-2014, July 28, 2014; *Payment Processor Relationships Revised Guidance*, FDIC FIL-3-2012, January 31, 2012; *Risk Management Guidance: Payment Processors*, OCC Bulletin 2008-12, April 24, 2008; *Risk Management Guidance: Third Party Relationships*, OCC Bulletin 2013-29, October 30, 2013; and *Risk Associated with Third-Party Payment Processors*, FinCEN Advisory FIN-2012-A010, October 22, 2012.

stemming from customer returns or customer complaints may be one indication of a potential problem. Corrupt networks can also work within or around the third-party processing system by employing individuals to perform transactions on their behalf, where the transaction is reversed with the intermediary individual collecting a transaction fee for the service. But corrupt networks can also work with merchants directly. Payments are processed for goods; upon a reversal the merchant takes a standard re-stocking fee for processing the laundered funds. The industry average return rate for automated clearing house transactions is less 1.5 percent and less than 0.5 percent for checks, but some processors and merchants have returns of over 80 percent (Bresnickat, 2013). The merchant does not even have to be operating a legitimate business to perform transactions and produce false records of transactions. This method can be used successfully by criminal networks utilizing false businesses to launder funds generated from other illegal activities.

Private information can also be sold through "gateway" arrangements: the third-party payment-processor re-sells its services to another third party who may be referred to as an "agent or provider of Independent Sales Organization (ISO)". These gateway arrangements are similar to an Internet service provider with excess computer storage capacity selling its capacity to a third party that would then distribute computer services to various other individuals unknown to the provider. Although the provider would be providing the ultimate storage capacity, the third party would be making decisions about who would be receiving the service. Thus, the provider bearing all of the risks would be receiving a smaller profit (Department of Treasury, 2015; FFIEC, 2014).

Money laundering is typically seen as having three stages. The first stage involves getting the money into the legal financial system. The majority of fraud techniques described thus far focus on this first stage, commonly known as the placement stage. Accountants and other

professionals are enlisted, accounting transactions are fraudulently created, and methods of working around the accounting control systems are developed and learned.

The second stage of money laundering—layering—involves the process of concealing the source of the illegal funds. Funds from sources such as drug and human trafficking and other illegal sources often make their way into brokerage accounts in banks and other financial institutions at the layering stage more than at the placement stage (USA v. Oladimeji Seun A Yelotan, 2014). Utilizing brokerage accounts, high yield accounts, pre-initial public offering, insider trading and market manipulation techniques are all considered securities fraud and are the most common crime for criminal money laundering cases involving securities brokers (Department of Treasury, 2015).

In the third stage of money laundering—the integration stage—money previously laundered is returned to the beneficiaries of the illegal processes in a manner that appears to make the source of the funds legitimate, and can now be used for any transaction or transferred to almost any financial institution.

Hence, the process of money laundering involves three stages: placement, layering, and integration. The placement and layering stages are the main areas where business professionals are enrolled or enlisted to set up the transactions so that they go undetected, but quite often the schemes are very complicated and require the same group of professionals to undo the web of transactions that allow the funds to be returned to the beneficiaries. The schemes, type of transactions, and the network of professionals are formed based on the context where these corrupt networks perform their activities.

### ***Organized Crime & Drugs***

For centuries, organized crime groups have operated successfully and have been an important part of the drug trade in many parts of the world (Fijinaut, 2014; Kaplan & Dubro, 2012) and organized criminal networks have been involved in the international drug trade for over 100 years (Fijinaut, 2014, Koutouzis & Perez, 1997). But their operations have been nothing close to static; in fact, as there are shifts in politics, legislation, and technology, organized criminal networks and drug trafficking gangs grow and change over time (UNODC, 2017). Organized crime networks have proven to be resilient, resourceful, fluid and responsive, and quick to adapt to change. These are characteristics that many legal for-profit organizations struggle to attain even when they employ the most prestigious business professionals.

The United Nations Office on Drug and Crime (2017) reported that the importance of drug trafficking for organized crime seemed to have peaked in the late 1980's to early 1990's, but regardless of this apparent peak, overall, drug trafficking continues to be a major revenue generating source for organized crime groups. Although criminal networks have diversified their lines of business as their field of play has changed due to varying economic, technological, and social changes in different business areas, drug trafficking has continued to serve as an incubator in for new projects, and in some cases drug trafficking has become the fall-back revenue source for crime networks that started off in other corrupt practices (Department of Treasury, 2015; UNODC, 2017).

The UNODC (2017) reported that drug sales accounted for more than 25% of the overall revenue of transnational crime groups globally in 2014, second only to counterfeiting of a broad range of goods (May, 2017). It was also estimated that drug money formed the second largest

revenue source for organized crime in the United Kingdom, Northern Ireland, and in the United States. The data compiled by the UNODC (2011) show the results.

The table below shows the results of the compilation of revenue from illicit drug sales and other crimes in selected industrialized countries expressed as a proportion of GDP. (UNODC, 2011; 2017).

Table 3. 1 Drug sales and other crimes in selected industrialized countries

		As a percentage of gross domestic product		
	Year of estimate	Drugs	Total crime, excluding tax evasion	Total crime, including tax evasion
United States	2000	0.7%	2.3 %	8.0%
United Kingdom	1996/2003/04	0.5%	1.2% <sup>a</sup>	n.a.
Australia	2003	0.3%	1.5 %	n.a.
Netherlands	2003	0.4%	1.7% <sup>b</sup>	3.5%
Germany	2007	0.4%	1.3 %	2.3%
Italy	2009	0.7%	7.7 %	n.a.
<b>Unweighted average</b>		<b>0.5%</b> (0.4%-0.6%)	<b>2.6 %</b> (0.6%-4.6%)	<b>4.6%</b> (2.2%-7.0%)
<b>Weighted average <sup>c</sup></b>		<b>0.6%</b> (0.5%-0.7%)	<b>2.5 %</b> (0.5%-4.5%)	<b>5.3%</b> (2.9%-7.7%)

The estimates by the UNODC suggests that well over half of the revenues from the sale of drugs makes its way into the money laundering process. These results show that billions of dollars from the revenues of drug sales by organized crime networks are laundered annually, and depending on the method chosen, the crime network determines the skills and transactions needed to accomplish the task. Laundered funds in large quantities have different effects depending on the country in possession of the laundered funds. Small developing countries can benefit in the short term from large quantities of laundered funds used to stimulate the economy in a manner that may not be sustainable. Property prices can be distorted; unfair competition can be created among

businesses, leading to legitimate businesses closing; and increasing corruption may even reduce the country's ability to attract legitimate investments (UNODC, 2017). Even in countries with well-developed barriers to corruption and institutionalized mechanisms to prevent money laundering, the events and the revenue from crime networks have negative consequences to society in a manner that erodes the rule of law and distorts the social fabric of society.

The creation of money to be laundered does not simply occur at the ends of the process or drug supply chain. Legitimate for-profit businesses are always looking for ways to make the business more efficient with a specific focus on the bottom line. Speed to market is a primary concern for most manufacturers and distribution networks and the same focus holds in the drug supply chain. Organized crime groups have focused on improving the supply chain by changing the modes of transportation and the volume of goods transported in each shipment, and in some cases have become more innovative. Crime networks now use aircrafts, ships, containers, and have even developed and manufactured their own semi-submersible vessels, resulting in even larger amounts of drugs transported across the globe (Lampe, 2002). As mentioned earlier, mobile communication has also offered opportunities for changing the supply chain. Rather than engaging in traditional markets for sellers and buyers and personal contact, low level runners are now used for cash collection. Communication between buyers and sellers are through text messages (UNODC, 2017). The use of technology has changed the supply chain and reduced the business risk of the transaction (Cadet-Tairou, Grandihon, Martinez, Nefau, & Milhet, 2016). Technology has made this part of the process even more sophisticated by using encryption software to set up barriers, an area where specific skill-sets are required to establish secure networks of communication. This process makes the SIM card or storage device with customer lists a highly valuable asset which becomes a tradeable item for the crime network. Typically, customer lists in



accounting have a specific value and are allocated goodwill when a transaction is performed.

Customer lists and client information in a drug supply chain also possess this characteristic and become more valuable depending on how the list is perceived by the other groups.

Supply chain management requires careful planning and tactical knowledge of how to stay on top and avoid routine or special operations which target drug shipments. Unlike standard shipping of dry goods, crime networks, when transporting drugs, face the additional risk of being intercepted by law enforcement officials. There have been recent reports that crime networks are now hacking into the drone management systems used by law enforcement officials in the United States to police the Mexican borders (Waqas, 2016) as well as systems used by port authorities to manage and track container shipments (Freeman, 2013). This highlights two important things pertaining to crime networks and technology. First, crime networks are now showing that they either possess the technological skills to hack into management control systems or can expand their networks to enlist the necessary skills. These skills may be transportable to allow crime networks to hack into other management control systems in different industries. And second, with the emergence of this relatively new area of operation for crime networks, we can reasonably anticipate this field of operation to expand even further. These activities have highlighted the importance of technological experts and specialist hackers in crime networks and through investigations; Europol has suggested that these activities may continue to grow in importance (Bateman, 2013). Specialist or expert hackers' skill-sets, if not already a niche market with high demand, will soon become one. Just as financial institutions and banks employ individuals with the skill-sets for setting up management control system along with the barriers to entry, crime networks now employ similar skill-sets to work around the barriers. Hackers' outsourced work

provides an estimated monthly income of \$80,000 (Weissman, 2015) which produces a source of income to be laundered.

### ***Drugs Supply Chain & Corruption***

Corruption often occurs along the drug supply chain to secure safe passage of the drugs from the point of origin to the intended destination. These processes create the possibilities of financial exchange for protective services which in turn may result in the money to be laundered. The relationship between drugs and corruption have mutually helped to create an environment where organized crime networks enlist professionals, law enforcement agents, criminal justice institutions, and politically affiliated persons (Thoumi, 2015) to ease the passage or flow of the drugs along the supply chain. These mechanisms both reinforce corruption (UNODC, 2017) and consequently set in motion the process for continued money laundering. Prior research has shown many instances where criminal networks have benefited from political connections. In Italy, the Sicilian Cosa Nostra and Calabrian 'Ndrangheta, Italy's two largest and most powerful mafia associations have had high level political connections (Paoli, 2004), and similarly the Mexican drug cartels allegedly benefited from the protection of the local police agencies and politicians (Snyder & Duran-Martinez, 2009).

It is often unclear how accounting participates in the activities of corruption, and in many cases accounting techniques are not even considered to play a major role in maintaining and propagating these processes and practices. Known as high level corruption, these processes and practices often involve a small number of government officials, members of the justice system, police, and other officials, who enter into a business transaction by acquiring bribes in exchange for support which facilitates the illegal activities (UNODC, 2017). The proceeds obtained by the

public officials then must be laundered. Members of the public often perform a character assessment of public officials by looking at their lifestyles compared to what is known about the income of public officials. Depending on the size of the underlying bribe, a simple way the money is laundered is by paying cash for luxury items. How accounting techniques are used depends on the size of the funds to be laundered and officials in different institutions have a different level of vulnerability. There is a general belief that if the remuneration package for certain law enforcement and other public officials are low, they may be inclined to participate in corrupt activities; however, research shows that the individual's perception of how she or he is treated may have a greater effect on the decision to participate in corrupt practices (ACFE, 2016; Gong & Wu, 2012; Khan, 2011). Other factors of a management control system are also important, such as the presence of accountability measures, barriers to information sharing, and a strong organizational culture or ethical culture (UNODC, 2017).

Corruption enables the growth of the illicit economy, which includes the illicit drug trade ((Riccardi & Sarno, 2013) which in turn creates the cycle of money laundering. The beginning of the supply chain—the production process—requires labor, and whether this process occurs in a developed nation or a developing nation, the participants may view their involvement in the production process as a viable way to earn income and improve their lives. In essence this process forms another context in which social actors organize their lives (Neu, 2012) and accounting strategies are employed to manage the process. The drug production process can be viewed as any for-profit manufacturing facility that requires raw materials and labor at cost-effective pricing for the business to be successful. Cost efficiency is also valued in the process, since multiple groups may be competing for the same business. The supply chain then requires a wholesale distribution network followed by a retail distribution network in the market when the drugs are sold to the end

consumers. At each stage in the process, the value of the drugs increases as the networks at each stage get paid or collect a commission, generating sources of revenue to be laundered. This is primarily a bulk cash generating business.

### ***Politically Exposed Persons & Public Corruption***

Corruption can occur in any government setting and in any country with the right mix of participants, causing taxpayer dollars and state resources to be channeled away from its intended use for personal gain. During 2013 in the United States, 315 federal officials were convicted of public corruption offenses, some including money laundering charges (DOJ, 2013). Crime networks has often associated themselves with individuals having political influence in order to acquire contracts and other public resources. In addition to the Italian crime networks mentioned earlier, Russian and Eurasian crime groups have also been found to have close political ties and have utilized these connections to gain access to the international financial system (Burns, 2011). Criminal groups have persisted to launder money partly due to their ability to work around the rules using accounting techniques. The Eurasian crime groups have shown the ability to implement sophisticated strategies to move and conceal their crime proceeds using various accounting techniques, including the use of U.S incorporated shell companies and the U.S banking system (FinCEN, 2017).

Networks of crime also work within government groups to move resources to family members and friends. The federal government inquiry into the Canadian federal government's Sponsorship Program (Gomery, 2005) revealed how millions of dollars (\$13M - \$50M) was diverted to people with political affiliations (family, friends, administrators, and business colleagues), highlighting that even in settings where management control systems are implemented

and there are strong barriers to corruption (Neu et al., 2012), crime networks can flourish—and accounting techniques and strategies are continually employed to find innovative ways to conceal redirected assets for personal gain.

### ***3.5.2 Vulnerabilities & Money Laundering Methods***

#### ***Cash***

Billions of dollars from drug proceeds and other criminal activity pass through the hands of organized crime networks annually, and the value of the proceeds from an accounting perspective provides an idea of the sales dollars and the turnover of the drugs and crime industry. Estimates based on research by both the United Nations and FATF conclude that well over 50% of drug profits, as measured by the sales less cost of drugs, are laundered, with the remaining staying in cash for quick use when needed. (UN, 2016). Although drug proceeds start as cash and sometimes remain as cash, proceeds from other fraud and corruption usually do not start as cash but may be converted into cash during the layering stages, in an attempt to break the audit trail (Department of Treasury, 2015). Regulation requires that transactions greater than \$10,000 daily, whether cumulative or a single transaction, be reported to IRS and FinCEN<sup>15</sup>. The law was put in place as a barrier to breaking up a large sum into smaller transactions in order for the merchant to avoid reporting the transaction, and thus allowing the transaction to go undetected. Travelers' checks purchased with cash in an amount above \$3000 also must be reported by the institution performing the sale. But cash from these illegal transactions still find their way into the financial system in a multitude of ways such as real estate investments and construction activities, offshore investments,

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<sup>15</sup> 31 C.F.R 1010 – filing requirements

cash intensive businesses such as restaurants, gas stations, and casinos, luxury purchases such as villas, jewelry, and yachts, and using informal fund transfer systems commonly known as “Hawala” banking systems.

Networks can be set up using legitimate businesses as a cover for laundering cash from illegal sources. This requires the business owner to be complicit and possibly collect a transaction fee for the laundering services provided, or the entire business may be owned and operated by the crime network. Auto dealerships have been used to launder large sums of illegally acquired funds, as in the judgment in 2012 from the case of *USA v. Richard Alan Arledge* (2010). A Texas auto dealer was convicted for intentionally selling luxury vehicles for cash derived from illegal activities. The dealer used accounting to conceal the transactions by setting up legal leases for the vehicles which allowed the dealership to retain the ownership rights to the vehicles if they were seized by law enforcement. This transaction allowed the dealer to retain the asset ownership on the company’s books while collecting a lump sum cash payment for the lease transaction. Although it could be argued that ownership has passed from the dealership to the lessee as a result of the value of the financial transaction, the lessor retained title to the vehicles. In another case, *USA v. Peter Dominic Tocco, et al.* (2006), the debt collectors for an illegal gambling network utilized an auto dealership as the front-end business to receive, process and launder millions of dollars in gambling debt payments. Transactions at this dealership were set up in different ways. One method used was to collect cash and checks at the car dealership and disguise them as payments received for leased or purchased vehicles. The cash and checks were then directly deposited into the business account creating a transaction record without any physical goods changing hands. Another transaction occurring at this dealership was the receipt of physical goods as debt payment. The network accepted vehicles and took ownership of the vehicles as payment for gambling debt. These

vehicles were then entered as legal transactions of purchase and added to the inventory and asset list for the dealership. The vehicles were then physically located to the lot for resale to customers. Auto dealerships have also been used to purchase boats and other luxury vehicles in exchange for cash payments from illegal operations. In *USA v. Shirland L. Fitzgerald et al.* (2008), cash was received in ways to avoid or work around the reporting rules by using both personal and business accounts to deposit the received cash. The business account was used to purchase the luxury vehicles through a normal business transaction and cash was collected on the resale of the goods.

Real estate is another area where cash transactions are used to launder large amounts of illegally acquired funds. Real estate purchases by corruption networks or individuals deriving the funds from illegal operations can distort the value of the properties, particularly in areas where multiple bids on houses are received and competition is high. Real estate prices become artificially inflated and result in some home buyers being locked out of markets where they would have normally been able to afford a home. United Nations (2012) reported that real estate prices can be artificially inflated in both developed and developing countries because of illicit financial flows. One method used to facilitate the real estate purchase using cash is by setting up a network to include a broker and a straw buyer for the property. A straw buyer is someone who performs the purchase transaction on behalf of someone else with fraudulent intentions. In 2006, a Tennessee real estate broker was indicted for facilitating a home sale to a cocaine dealer (1:06-cr-00029, April 11, 2006). There are several transactions that have to occur to enable the process to be effective. The real estate broker must make the loan application using the straw buyer, hence falsifying loan documents and any transaction records. The broker receives cash from the cocaine dealer which has to appear as if it comes from the straw buyer.

Bulk cash smuggling is the process of moving cash in amounts over \$10,000 across country borders while avoiding filing the necessary regulatory paperwork. Although this process may appear unsophisticated, it provides a means of moving the profits of corruption and drugs to other jurisdictions where it may be easier to launder the funds or to where the funds can be utilized for other bribery, corruption schemes, or to settle the liabilities created by taking drugs on consignment for sale in high demand jurisdictions. Cash seizures consists primarily of \$20 bills, which suggests that drug trade organizations utilize these funds to pay operational expenses and employees. Keeping the notes small avoids suspicion. Larger notes are used to pay drug suppliers or stored for future use (U.S. Department of Homeland Security, 2011). Even in the bulk cash smuggling process, or through daily money carriers taking smaller amounts of cash on a regular basis, the supply chain can be set up in varying ways, which requires management. The process can be in-house to the crime network or the process may be outsourced to maintain efficiency and employ the specific skill-sets at particular nodes to ensure the operation's success. The crime network requires at minimum someone responsible for the collection and counting of cash, a manager of transportation services or coordinator, and an operations officer ensuring the overall operation is as planned (U.S. Department of Homeland Security, 2011). These roles can be compared to traditional organizational roles—an accountant, an operations manager and a logistics manager.

### ***Financial Institutions***

Globally, banks acquire business in part due to the ease of doing business with the particular institution, which in many cases includes the ease of access to funds and the ability to move money where and when it's needed. The United States banking system consists of a



multitude of bank holding companies with a network of deposit institutions across different states. The FDIC data shows there are over 1300 deposit institutions in the United States; however only six of the holding companies account for over 40% of the total deposits (FDIC, 2017)<sup>16</sup>. While banks provide a wide range of services and conveniences to customers, the banks are not the only point of access to the financial system. Individuals who choose not to utilize the services provided by banks can access the financial system using money service businesses. Banks and money services businesses are continually at risk of being exploited by crime networks who engage in the money laundering process and the higher the activity of deposit and customer relations, the greater the potential risks of misuse (Department of Treasury, 2015). Banks and other financial institutions depend on their management and internal control systems to monitor operations and to assist with detecting illicit activity and although there are robust anti-corruption barriers and regulation pertaining to internal controls, compliance failures and money laundering activities persist.

Financial institutions have reporting obligations which are well known by accountants and other knowledgeable professionals working in the financial industry. One method of structuring transactions to avoid the visibility by management control systems is to make multiple deposits or withdrawals of a smaller dollar amount well below the reporting threshold. Corruption and money laundering often have a symbiotic relationship as crime networks bribe law enforcement officials along the network supply chain. In 2009, in the case *USA v. Yaniris Balbuena* (2009), a New York police officer allegedly structured multiple deposits between \$1000 and \$7900 in seven bank accounts. The police officer was charged in connection with drug trafficking and money laundering. It was shown that the money was derived from a heroin trafficking network within

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<sup>16</sup> The top holding companies are Bank of America, J.P. Morgan Chase, Wells Fargo, Citi Bank, U.S. Bank Corp, and PNC Bank.

which the officer had a working relationship. In 2013, the FBI charged a former Albuquerque fire fighter with drug trafficking and money laundering. The firefighter admitted to structuring 37 cash transactions to launder drug proceeds (Department of Treasury, 2015; FBI, 2013). In 2013, the IRS charged a Las Vegas attorney in a scheme to evade taxes: structuring deposits in a manner to avoid the bank reporting requirements (Abhishek, 2014; IRS, 2013). As discussed earlier, another major area of corruption is fraud through the U.S government assistance programs. In 2012, a grocery store owner and employees were charged with laundering the proceeds committed against the U.S Supplemental Nutrition Assistance Program. First, the defendants allegedly claimed reimbursements of more than \$3.8M in benefits. Second, many of the beneficiaries were supplied with weapons, ammunition, cash, and other non-food items which are not allowed in the program. And third, upon receiving the reimbursements in the grocery store's bank account, the owner and employees made structured withdrawals to avoid the bank regulatory filing process (USA v. Al-Idu Al-Gaheem, et al., 2012; Department of Treasury, 2015).

Structuring also occurs with another variation where crime networks move funds across states for rapid use—known as funnel accounts—similar to regular businesses with multiple locations where business is transacted. An account is set up with a bank or financial institution with branches nationwide, which fits well with the notion that structured deposits can be made in different geographic locations and withdrawals typically occur in the state where the account was set up (ICE, 2015). This process avoids physical transportation of cash and provides crime networks the opportunity for rapid cash movement. The Federal Financial Institution Examination Council believes that funnel accounts are distinguishable from legitimately used business accounts in several ways. First, the account is generally held by a single nominee in one state and receives deposits from several other states and the time lapse from deposit to withdrawal only ranges to a

maximum of a few days. The nominee is usually paid a fee for the account and is required to relinquish all access to the crime network. Second, the individual deposits and withdrawals are always kept below the \$10K limit to avoid bank reporting. And third, the accounts have limited activity beyond these structured deposits and withdrawals (ICE, 2014). The United States Customs and Immigration believes this method of money laundering is increasing in part due to the enforcement efforts to detect bulk cash movements. The funnel account system is now widely used among crime and drug networks.

Bank customers can transfer funds locally or internationally between unrelated financial institutions by utilizing the correspondent banking process. The correspondent banking system is an essential component of the international financial system as it promotes trade, facilitates the movement of funds, and provides the clearing services for funds movement. Bank customers can also transfer funds in different currencies which makes it easier to perform business globally. The process of correspondent banking creates opportunities for the banking system to be exploited for several reasons. First, there may be multiple intermediary financial institutions involved in a single transfer, which makes it difficult to quickly and reliably trace the source of the funds being transferred. Second, when a North American or U.S bank receives instructions through this system, it may be unlikely that the bank has a relationship with the customer or originator of the transaction. Instead, that relationship is held with another institution, quite possibly in another country. This makes it difficult to conduct the appropriate due diligence prior to conducting the transaction. And third, due to the high volume of transactions that flows through correspondent banking accounts and the varying and uncertain information pertaining to know-your-customer rules in different countries, the risks of these transactions becomes very high (Wolfsberg, 2002; The Clearing House, 2016). Correspondent services are provided by approximately 300 banks in

the United States, the majority of which provide foreign currency correspondent banking (FinCEN, 2009). The large number of banks coupled with the high volume of transactions and the uncertainty of information increases the risk of the correspondent banking process.

Money orders, checks, traveler's checks, and cashier's checks have also grown in popularity among the crime networks, for transferring large amounts of money to destinations outside the U.S., by writing or acquiring the US denominated checks and depositing at a foreign institution (Department of Treasury, 2015). The process of clearing paper checks has improved significantly with technology changes. Checks are now scanned, and a digital image sent to the destination. This process of remote deposit capture (RDC) has improved the depositing time, the processing time, and has made depositing checks more convenient to customers. With the implementation of management control systems to properly overlook the process of RDC (FFIEC, 2009) processing costs can be reduced, and efficiency in processing time can be gained, which can result in cost savings for the institution and better customer service. The more efficient processing speeds of checks are not necessarily better for anti-money-laundering controls. The faster processing times make it more difficult to maintain the records of total checks by customer, and now requires scrutiny of deposits and withdrawals to occur at a much faster rate. The Office of the Controller of Currency (OCC) and the FFIEC had concerns pertaining to this process and issued a bulletin to this regard cautioning financial institutions of potential risks associated with the RDC system (FFIEC, 2009).

In 2011, Zions First National Bank was found to have deficiencies in its internal control systems by FinCEN as follows:

Zions failed to implement an effective AML program for its foreign correspondent business reasonably designed to identify and timely report transactions that exhibited indicia of money laundering or other suspicious activity, considering the types of products and

services offered by the Bank, the volume and scope of its business, and the nature of its customers. Zions failed to implement a program tailored to the risks inherent within its foreign correspondent business lines and geographical reach. As a result, Zions failed to timely file SARs representing billions of dollars in suspicious transactions, thus greatly diminishing the potential utility of such reports to both law enforcement and regulatory agencies. (FinCEN 2011-01, 2011).

FinCEN's assessment of Zions highlights three issues. First, Zions failed to implement the necessary internal control systems to meet the requirements of the BSA, which would effectively manage the risks associated with money laundering activities. Zions' documented internal control procedures and its ability to file suspicious activity reports (SAR) pertaining to its foreign correspondent accounts were inadequate. Second, Zions implemented the RDC process which allowed customers to make deposits globally and processed these transactions seamlessly to enable customers to have access to their funds. This process required new equipment to perform the scanning and interface process with the bank's control system, which manifested into different control issues, raising such questions as: In which jurisdictions was the equipment being used; and who was using it? Another issue came with the image processing itself. And third, Zions needed the development of internal control systems to ensure check images were not altered. Zions also needed the personnel in place to perform the checks necessary to detect fraudulent activity with traveler's checks (FFIEC, 2009). Zions agreed to implement the necessary changes to the internal control system and a settlement of \$8M.

This single case of Zions is important because it highlights the significance of internal control systems in the banking industry. During that period, Zions had 130 domestic branches located in Utah and Idaho, along with its foreign office in Grand Cayman, Cayman Islands (FinCEN 2011-01, 2011). Zions has over \$16.9B in assets according to their balance sheet<sup>17</sup> (Zions

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<sup>17</sup> Zions First National Bank, Call Report Quarter End Date 6/30/2010, Schedule RC Balance Sheet, Line 12 Total Assets

First National Bank Balance Sheet—Quarter End Date 6/30/2010, 2010) and in the ranking of the top fifty banks by deposits, Zions was ranked approximately thirty sixth (FDIC, 2011). The investigation into the deficient internal controls showed the Bank provided wire transfers, ACH transactions, deposits, RDC services and imaging for processing cash letter instruments to its foreign correspondent customers. After the bank launched its RDC product in January 2005, it realized a significant increase in activity involving its correspondent accounts in 2006 and 2007. In 2005, the volume of transactions using RDC exceeded hundreds of millions of dollars and continued to increase into the billions of dollars in 2007 (FinCEN 2011-01, 2011). Without understanding all the transactions involved and the reason for the significant increase in volume and dollar amounts of transactions, we cannot ascertain how much or if any of the increased volume was from illicit activity; however the internal control system was not highlighting the activity it was meant to highlight, and the increased volume only came after the new RDC system was implemented. This new technology system created a new sub-field in the banking industry where the rules were not fully implemented. The accounting system helped individuals and crime networks to work around the rules and move funds unchecked into the financial system.

As discussed earlier, networks of banks are necessary to facilitate the efficient movement of funds which in turn drives business transactions, creates employment, and supports the economy. But a closer look at financial institutions shows how some may work on the boundaries of the regulations in an attempt to facilitate business transactions, to gain customers and profit, while others appear to ignore or disregard the regulations altogether. In the case of *USA v. Ocean Bank* (2011), Ocean Bank, the largest privately-owned state-chartered commercial bank headquartered in Florida, entered into a deferred prosecution agreement in response to a charge following a criminal investigation involving at least \$11M of unusual deposits of money orders and cashier's checks,

structured currency deposits, and remittances from Mexican foreign money transmitters known as casas de cambio (CDCs) (Department of Treasury, 2015). The court documents highlight several important points on how Ocean Bank's processes and actions facilitated negative practices and money laundering. First, according to the court documents, Ocean Bank did not provide the necessary BSA/AML controls to mitigate its high-risk rating with regards to its BSA and anti-money-laundering ("AML") program due, in part, to Ocean Bank's high percentage of international account holders and international transactions. The court documents also show Ocean Bank was aware of the high risk that drug money was likely being laundered through CDCs as early as 1996 (USA v. Ocean Bank, 2011; DOJ, 2011). Ocean Bank was already aware its AML program was deficient but continued its operations without planning or implementing any changes to address the issues. In 2001, the FDIC and OFR noted deficiencies in Ocean Bank's BSA and AML programs and made recommendations to Ocean Bank on how to fix the problems (DOJ, 2011)

Second, the court documents show investigators specifically reviewed five subject accounts at Ocean Bank. The first account held by a Miami-area business was used to launder narcotics proceeds. The business accepted large sums of cash from convicted drug traffickers and money launderers which was then deposited into the business account at Ocean Bank. These large cash deposits and other unusual wire transfer activity were inconsistent with the normal operations of the business, yet Ocean Bank failed to perform the necessary due diligence, suspicious activity reports (SARs) were not filed, and authorities were not notified. Another account used by another Miami-area business to launder narcotics proceeds received wire transfers from several Mexican CDCs during the period 1990 to 2009. These transactions did not produce SARs and went undetected (DOJ, 2011).

And third, the remaining three accounts consisted primarily of large deposits through currency and wire transfers originating from Mexican CDCs controlled by the Bernal-Palacios drug trafficking organization. The Bernal-Palacios organization used the CDCs to transfer their narcotics proceeds to different bank accounts around the world, including the three subject accounts at Ocean Bank (USA v. Ocean Bank, 2011; DOJ, 2011). The Bernal-Palacios organization had been under investigation from 2002 for drug trafficking and money laundering (DEA, 2008) and prior to 2006, the Bureau of international narcotics and law enforcement affairs (INL) had information showing Mauricio Bernal Palacios had ownership interest in Casa de Cambio Ribadeo in Mexico City, which he used to receive and launder “bulk currency” narcotics proceeds generated in the United States and Europe (INL, 2008). The investigation of the Bernal organization documented amounts in excess of \$300 million laundered through the U.S.-based correspondent accounts of Casa de Cambio Ribadeo and another Mexican-based casa de cambio (INL, 2008; DOJ, 2011). This highlights much more about how crime networks are set up and operate and how accounting rules are utilized in the process. For years money has been moving among U.S, European, and Mexican banks through accounts structured in the name of the Mexican casa de cambio, with the true beneficiary having significant influence through ownership over the casa de cambio. Accounts held in the name of banks add another layer of complexity and anonymity to the account beneficiary, and having influence with a money transfer organization, as the Bernal organization has with Casa de Cambio Ribadeo, allows the crime networks the opportunity to work undetected within a network of banks.



### 3.6 Discussion

The analysis has detailed to some extent how accounting practices and techniques are adapted by individuals and crime networks to assist with money laundering strategies. In many cases these practices are propagated and sustained for extended periods of time by going undetected by the control mechanisms put in place to prevent and detect such practices, but there are other cases where the practices go unchallenged by the institutional processes in place to prevent such negative practices. The paper now discusses some of the ways these negative practices are propagated or go seemingly undetected or unchallenged, in the particular context of the banking industry and how networks are set up to work around the rules. The concept of the relational analysis of organizations as fields (Bourdieu, 2005) is of great value in this discussion and this study complements prior studies by examining how accounting techniques and practice are used within corrupt settings (Neu et al., 2006, 2012; Compin, 2008; Baker & Hayes, 2004) by outlining the detailed transactions used by individuals and crime networks in different contexts. The paper also complements prior work on how changes in institutions and technologies (Neu et al., 2006, Everett et al., 2007, Oakes et al., 1998) change the way in which “business is performed”. The banking industry can be viewed as a field containing banks and their staff, regulators, customers, shareholders, other businesses providing support, and other stakeholders, each having their own struggles for capital and position. The organizational field i.e. the banking field in this case, does not just include similar types of organizations or banks, but instead includes all the organizations that have influence or play a role in the activities in question (Bourdieu, 1993a; Emirbayer & Johnson, 2008) Simultaneously, we cannot treat all banks as being the same within the banking field; although the organizational structures may be the same for the most part, practices are often influenced by a wide variety of other factors. Among the factors to consider are

the social context within which each bank is immersed—and each bank has its own sub-field within the bank itself, i.e. each bank is a field on its own. The rest of the discussion focuses on internal and external banking practices—using the cases of Zion Bank and Ocean Bank—and on crime networks and how accounting practices and technologies are enlisted to propagate money laundering. This analysis also adds to our understanding of how specific institutions, in this case the banks and the regulators, can change a business setting, perhaps with unintended consequences (Burchell et al., 1980) allowing negative practices to persist.

### ***3.6.1 Internal—Turning a blind eye***

In 2011, Zions First National Bank was assessed by FinCEN with a civil money penalty requiring the bank to improve its internal controls along, with a fine of \$8M. The first few lines of the press release are shown below:

The Financial Crimes Enforcement Network (FinCEN,) today announced the assessment of a civil money penalty against Zions First National Bank, Salt Lake City, Utah, for violations of the Bank Secrecy Act (BSA). Zions, without admitting or denying the facts or allegations, consents to an \$8 million civil money penalty, which is concurrently assessed with the Office of the Comptroller of the Currency and satisfied by a single payment of \$8 million... (FinCEN, 2011a)

Similarly, Ocean Bank was assessed with a civil money penalty (\$11M) and the first few lines of the press release below:

Under the authority of the Bank Secrecy Act (“BSA”) and regulations issued pursuant to that Act,<sup>1</sup> the Financial Crimes Enforcement Network (“FinCEN”) of the Department of the Treasury has determined that grounds exist to assess a civil money penalty against Ocean Bank, Miami, Florida (“Ocean” or “the Bank”). Ocean enters into the CONSENT TO THE ASSESSMENT OF CIVIL MONEY PENALTY (“CONSENT”) without admitting or denying the determinations by FinCEN, as described in Sections III and IV below, except as to jurisdiction in Section II below, which is admitted. (FinCEN, 2011b).

The response by the banks, to neither admit nor deny any wrong doing, shows a pattern of practice demonstrating how knowledgeable actors within the banking industry work around the rules of the BSA, leading to potential money laundering by clients. Both the Ocean Bank and Zions Bank responses are similar, which leads us to believe the practices have become the norm or standard by banks management. Accounting and accounting practice are performative in the sense that these practices create repetitive inscriptions and documents which in turn set in motion the actions to accomplish certain tasks (Ezzamel, 2009; 2014, Neu et al., 2006). In the same vein, combinations of practices by accounting groups, regulators, and lawyers produce documents that become standardized templates used in the industry. This practice over time has become a part of the automatic response or a “standardized template” of the banking professional. Although a part of the response may be a conscious calculative strategy at the time, these responses are structuring in the sense that they help to shape the standard responses by most financial institutions to this type of assessment by a regulating body.

There is a certain struggle for position and power in the banking field which has partly manifested itself in the way the responses from banks to allegations of deficient practices by a regulating body occur. Even when it appears as if the evidence is clear that the bank has broken the rules and should be penalized, the strategies reproduced by the bank allows the bank to maintain a position of “normal business operation”. But in the struggle over position, different capital accumulation has different value in this field and the bank is willing to give up economic capital over cultural capital by agreeing to a financial settlement to maintain its social position in the field. The capital possessed in a field, among other things, helps to place and move the actor into different social positions within the field. Each time there is an event in the field, organizations or actors across the field are affected, the degree of which is determined by the social position held by

the actor and by the capital possessed by the actors. Hence, events in a field not only produce a reaction from the organization or actor acted upon, but also produce a reaction, to a greater or lesser extent, in associated actors. Maintaining cultural capital helps to maintain the social position by first demonstrating a level of competence in the business process, which projects a message to other banks and participants in the field that the bank understands there is an issue, but the bank is not the cause of the issue. Second, the bank's reaction under pressure from the regulating body sends a message of confidence to the bank's customers, signalling that they are not involved in any misconduct. And third, the bank leverages the economic capital it foregoes by showing it is willing to forgo any ill-gotten gains by being a good citizen. This example highlights how a dominant set of practices have emerged (Bourdieu, 1994). The combined effect of the institutions of accounting, law, and regulation, from either being in tension or working together over time, have generated a standard set of practices that now make it difficult to challenge the bank's position in this context. Although the analysis did not engage directly with participants in the field, the notion that habitus is impacted over time as a result of the standardized practices by the regulators and banking industry cannot be ignored. Prior research has shown how implementing technologies in a field changes habitus (Neu et al., 2006).

The internal control deficiencies of Ocean Bank identified in 2001 by the regulating body (FDIC) and brought to the attention of the Ocean Bank's management years prior to the actual allegations, were not acted upon. Since we do not have access to the minutes of banks meetings, we cannot determine if the deficient IC issues are brought up and this poses a challenge in understanding the actions of the banks internal control auditors. If internal control auditors continued to identify the issues, then this points to only management turning a blind eye to the

issues. However, if internal auditors did not identify the issues, then the routine responsibilities of internal auditors would be of concern.

The internal controls for both Zions Bank and Ocean Bank came into question since both banks systems failed to detect suspicious activity and failed to file suspicious activity reports in a timely manner. Although both banks are in different geographical areas and their customer base and hence the type of business activities are different, the requirements for identifying suspicious activity reports are the same and both banks exhibited a similar pattern in failing to detect and file suspicious activity reports. Excerpts as noted below point to a practice across both banks. The requisite knowledge, skills, and

“The failure to adequately conduct due diligence relative to foreign correspondent accounts, and the absence of effective internal policies, procedures and controls, and designated compliance personnel, resulted in numerous violations...” (FinCEN-2011-01, 2011)

“Ocean failed to adequately staff the BSA compliance function at the Bank with personnel to ensure day-to-day compliance.... and personnel lacked the requisite knowledge and expertise to adequately perform their duties.” (FinCEN 2011-07, 2011)

training in identifying money laundering practices are essential to the AML process, yet there appear to be a shortfall in the personnel or a lack of institutional knowledge and skills in how to perform these tasks. This requires further investigation, however, lack of technical skills required, the accounting, AML, and pattern recognition skills may be difficult to acquire but it may point to another issue of the value banks place on acquiring the personnel, knowledge, and skills necessary to prevent money laundering. This discussion leads us to take a close look at banks, the value

placed on different capital, and their relative positions within a field with attention to whether having a fully functional BAS/AML system gives the bank greater power or does it lead to a better social position within the banking field? Thus far, this research has identified a pattern of practice across banks that may be similar, further studies have to be done to answer the above question.

### ***3.6.2 External—Regulators shaping the field***

Similar to the banks' managements producing a standardized response to charges, regulators have become accepting of the standard responses, and appear to allow the banking practice of neither admitting nor denying the allegations to continue. The practice of the regulators falls into the very same category as their response—now institutionalized—to breaking BSA rules. The practices of the regulators show they are accepting of the responses by the banks. Additionally, in both cases, the deficient internal controls were highlighted years prior to the allegations; however the auditors for the regulating body did not pursue the deficiency and in this sense the regulators have also developed an automatic response, or inaction, which has become part of the standard relationship between the bank and the regulator.

Suspicious activity reporting is among the major ways banks can identify and prevent money laundering, and regulators have specific requirements for banks filing timely reports. The deficiency reports from the regulators identifies that both Ocean Bank and Zions Bank did not file the suspicious activity reports, and the quantity of suspicious activity reports were also in question. In addition to providing feedback and following up on deficient practices, the practice of regulators helps to structure the actions and reactions in the banking field by not only determining how the banks should react to an allegation but also by determining the time-line for the reaction. The

documents for both banks show the regulators identify issues but take a long period of time to perform the follow-up, which in turn sets the stage for the response from the banks and in some ways signals to the banks the value placed on the deficiency identified. Second, since the regulators can identify banks that are late in filing suspicious activity reports, along with the volume of reports filed, the regulators must have an internal control system along with procedures and operational methods, like the internal control systems the banks are required to have. But again, the timeline of the response by the regulator to these late suspicious activity report filings from the banks did not appear to have high priority or urgency attached to them. The regulation forms part of the social structure, creating the spaces for the type of practice that both limits and creates the opportunities for banking operations, but the regulators' actions set the stage for what is valued in the field. These cases show that a timely follow-up or action has not been set up with high value.

### ***3.6.3 Crime Networks and the Value of Accounting Capital***

The analysis points to some of the ways the crime networks' involvement with Government officials, healthcare fraud, government assistance programs, tax fraud, and retail and consumer fraud, utilize accounting techniques to move the ill-gotten gains into the financial system. Healthcare fraud and fraud related to government assistance programs requires the accounting knowledge to work around the controls, but not necessarily detailed accounting knowledge. For these to persist, the crime network has to be durable and the individuals must have a high level of trust with each other, since more often than not the crime network contains people who are currently employed in the field. The existing internal control systems usually contain segregation

of duties, specific signing authority for checks, and double signatures in cases where the dollar amount is high. But these control systems often are highly dependent on the personal values of the individuals and how they act to monitor each other in the process. These are more cultural controls in the sense that the space of possibilities is presumably limited by the values and attention of the actors in the field. The groups engaging in the fraud would possess the technical capital for both their normal operational activity as well as the social and cultural capital needed to engage in the fraudulent activity. The obvious benefit of this activity is economic; however this can lead to a different social standing in society, which further encourages the fraud to continue.

The UNODC report on drug and crime estimates that over half of the gross profits generated by the drug trade are laundered (UNODC, 2017) and even without knowing the exact number, it is still in the billions of dollars. The analysis showed several ways drug profits are laundered, including utilizing Mexican CDC's, Hawala banking, and off-shore accounts to transfer funds across borders, utilizing personal accounts in several ways, purchasing real estate through a crime network which may also falsify mortgage and other banking documents, and utilizing automobile dealerships, either through leasing activities or utilizing the auto dealer as a front to launder the cash directly. The paper discussed three main areas where accounting strategies are utilized by crime networks and money laundering from drug activity.

First, there is the area of "unnamed accounts". This area covers money laundering through activities such as the use of CDC's, Hawala banking, and off-shore accounts, where accounts are structured in a way to avoid making public the name of the account holder. Accountants and lawyers are often employed to assist with the setting up of these accounts, off-shore businesses, and transfers. Accountants working in this area generally possess a professional designation and are familiar with the institutional structures in place for setting up legal entities, tax laws, and the



means of structuring the movement of cash in ways that may go undetected. The accountants not only possess the symbolic capital of the accounting designation, but this particular group is able to draw on cultural capital which is much more specific—in this case, field specific technical knowledge is highly valued. Social capital will be built as the accountant proves he is worthy of that position, a position that in a way acts as a medium for the flow of financial resources between the illegal drug trade and the legal financial system.

Second, the use of personal accounts coupled with new technology allows customers to structure deposits and withdrawals while staying below the threshold at which regulation requires financial institutions to apply record keeping and reporting. The analysis explained the mechanics of these transactions and how the funds ultimately make it to its destination. Although this process does not require an accountant to set up the transactions, the crime network requires a mechanism for tracking the outstanding cash, knowing who is in possession of outstanding cash, and keeping track of the debits and credits. This record-keeping process of utilizing multiple accounts is a modification to the crime network's existing accounting practice, bringing with it a change in the capital required by the crime network's accounting group. Within the crime network there would be a bias to understand each other's actions and have an idea of how individuals would react in certain situations. To some extent, the habitus of the individuals or agents play a key role in the selection process of the individuals and their actions and reactions. Not all actions or strategies are consciously determined. The habitus enables agents to cope with the constantly changing or the unforeseen, and the interaction among several agents within the crime network possessing that foundational habitus takes place with reference to the habitus (Bourdieu & Nice, 1990a). Hence, part of the value of this field is an understanding of the strategies one will employ which comes from the habitus. The value of a professional designation may not have as high a value as the value

ascribed when dealing with unnamed accounts; instead, the practical real relations of the accountant with the money carriers and others associated within the crime network may be much more valued.

And third, networks are set up to work on real estate deals, utilize businesses as fronts to launder large amounts of cash, and other global trade-based activity where illicit finances are moved across borders and mingled with licit funds to further blur the traceability of the source of the funds. At the same time, these accountants are equally as talented in working around the banking rules to ensure the illicit funds are not caught by regulation or bank reporting. This is another area where an accounting designation may not have significant value. Having a practical sense of the accounting methods and transactions in these processes will be highly valued. Real estate deals usually have specific contracts and other goods of high economic value generally have some specific rules around the purchase (automobiles have licensing agreements, purchasing goods across borders have bank agreements and purchase documents or bills of sale) and understanding the regulation and how to work around the rules as the rules change. Each of these different skill-sets are acquired by accounting personnel, by working in different fields, and hence the feel for the game is slowly acquired over time. The earlier accountants and other business professionals enter into the field, the less they are aware of the structures or boundaries, the posts that are the regulations; and instead of seeing the posts, these individuals—because of a greater accumulation of the capital in each sub-field—can now see the spaces between the posts with greater ease. These professionals have an investment in the field and their accumulation of capital, along with their interest in perpetuating the field, gives them a sense of power and position that enables them to be sought by others in the network.

### ***3.6.4 Crime Networks' Adaptability***

Over the centuries of their existence, crime networks have always proven to be resourceful in the methods they use to adapt to the changing environment, and in some cases crime networks have even moved into areas of tighter regulation when there is a social network of persons willing to participate to allow the crime network to profit. Crime networks have profited from high regulation areas such as hazardous waste, regulation systems aimed at protecting wildlife, and intellectual property, to name a few (UNODC, 2017). And although there have been some major break-throughs in the crack-down on organized crime in various parts of the world, new crime groups have emerged with diversified portfolios, resulting in new areas of the production of money to be laundered.

The analysis highlighted some areas of the drug supply chain where crime networks have been innovative in protecting their network assets while simultaneously increasing the speed to market of their product. The UNODC (2017) reported crime networks have been reshaping their structures to become more network oriented; in other words the groups are becoming smaller, more responsive to changes, and consequently able to generate more income, which requires more technical accounting expertise, to assist with money laundering. The new pattern of practice by crime networks shows the value of accountants, not necessarily having a professional designation, but having the knowledge to perform the necessary tasks or a feel for the game, to be increasing. Large scale operations looking to launder hundreds of millions of dollars could face fees between 5 and 10 percent (UNODC, 2017) whereas bulk cash smuggling fees range anywhere from 10 to 17 percent (Soudijn & Reuter, 2016).

Accountants play a significant role and can be a part of the crime network in two ways, first by direct employment being a continuous part of the network, and second, through contract work.

As part of the response by crime groups to the changing landscape, crime groups are also outsourcing, or sub-contracting critical work as stated below:

“Some traffickers use laundering networks embedded into their overall organizational structure and directly employ accountants and lawyers; other groups outsource to independent networks that specialize in hiding the proceeds of crime...the trend is moving towards professional outsourcing.”

UNODC (2017)

This statement reveals several things pertaining to accountants and money laundering. First, accounts directly employed by a crime network may be skillful in the accounting practices of money laundering but these accountants, depending on their role, may also be limited in the capital possessed. Since different crime networks work in different fields, the accountant’s skill-sets may only be specialized in the area of employment and may also possess the broader accounting knowledge through an institutionalized process. Similar to other organizations and career paths, these accountants can acquire the necessary specific skills by learning from other skilled accountants on the job. We can look at the relationship of the accountant within the network as if the accountant grew up in the specific field, and there is a sense of belief in the field and a gravitational pull towards the field. This is the part of his or her habitus belonging to the specific field. It is recognized by the other players in the crime network and carries an embodied state of cultural capital (Bourdieu & Nice, 1990a), which pre-exists any accounting qualifications and allows the accountant to occupy a valued position within the crime network. As the field for organized crime networks changes, the habitus of some players will be at a mismatch with that of the new field, which can create tensions within the organization. When these tensions are created, the organization has an opportunity to evolve and move into other areas of business. Accountants’ skills may be suited for such adaptability and organizational change since their training may allow

them to see opportunities which are not seen by other members of the organization (Emirbayer & Johnson, 2008).

The quote from the UNODC (2017) also points to the emergence of specialized networks to assist with money laundering. The emergence of this type of organization, a combination of accountants, lawyers, and other business professionals as needed, who understand and can structure the activities and transactions to facilitate the money laundering process, is interesting, and more than likely emerged and is sustained as a result of the high need for moving illicit financial resources to the legal financial system safely. Although this study does not analyze the organization itself or its formation, it would be important to understand how such organization gained (i) the cultural capital and (ii) built the social capital needed to be accepted by the crime organizations. However, for the purposes of this research, such organizations that specialize in money laundering strategies and have built connections with crime networks, will be highly valued and would serve as one of the mechanisms that allow the crime networks to focus on their core businesses of criminal activity, by providing the mechanisms for safe money laundering.

### **3.7 Conclusion**

The current study focuses on accounting and the accountant's role in the complex relationships between organized crime and the mechanisms for moving illicit financial flows to the legal financial system. By recognizing that laundering criminal proceeds helps propagate other criminal activities, the paper contributes to the body of research on corruption (Mitchell, Sikka & Willmott, 1998; Everett, Neu & Rahaman, 2007; Compin, 2008; Neu, Everett, Rahaman & Martinez, 2012; Cooper, Dacin, Palmer, 2013 ), providing supporting evidence that highlights why

such negative behaviors persist despite regulation and strong anti-corruption barriers (Neu et al, 2012).

After highlighting some of the major areas for the production of money to be laundered—fraud, organized crime and drugs, the drug supply chain and corruption along the supply chain, and politically exposed persons and public corruption—the paper shows some methods of moving bulk cash into the financial system and highlights the vulnerability of the financial system to money laundering. The case studies of Oceans bank and Zions bank discuss several factors that ultimately lead to money laundering, and by highlight how internal controls provide opportunities to money launderers.

First, regarding issues of internal control deficiencies, the paper discusses how the banks' responses to allegations by regulators have become standardized, and how neither admitting nor denying the issue of internal control problems leads to propagating internal control practices that ultimately lead to money laundering. Second, the paper discusses how the responses by regulators have also become routine, lacking a sense of urgency. Regulators have become accepting of the shortfalls of banks, and there is no real penalty for banks with deficient internal controls. The paper then discusses crime networks and accounting, focusing on the capital needed in the field to (i) be able to structure the transactions and (ii) to become recognized as someone who can perform the tasks of money laundering. And lastly, the paper discusses crime network adaptability from the perspective of the value of the accountant and how accountants, either from within the crime network or as a contract firm, position themselves with the capital necessary to sustain the crime network and money laundering.

The paper also adds to the practice literature by highlighting some of the standard transactions and accounting techniques used by money launderers, with the hope that these can be used to detect

money laundering activities at an early stage. There are many other areas where corruption and crime networks, specific to different contexts, operate. These must be studied to ultimately uncover more reasons why money laundering persists. Technological advancement has created new opportunities for money laundering and the crime networks. This is an important area of future research, as technology will be increasingly accessed to propagate crime activity and money laundering. The paper also proposes that, by understanding how new crime networks come into existence and how they gain the capital necessary for survival (such as the networks specifically focused on money laundering strategies) we can be a step closer to preventing such networks from operating.

## **4 Facilitating Money Laundering: The Role of banks**

### **4.1 Abstract**

The current study examines the adaptive nature of Management Control System (MCS) practices within the banking industry; more specifically, how control practices respond to changed money laundering regulations, but in ways that attempt to maintain a client-friendly focus. Using the HSBC bank as a case study, the analysis illustrates how new control routines are ‘learned’ through a combination of directive memos from head office and hands-on tinkering with existing practices. The study highlights how such adaptive practices allow banks to continue to process financial transactions in ways that are not too disruptive to clients. These practices, however, potentially undermine the regulatory intent behind the anti-money-laundering regulations.

### **4.2 Introduction**

This study examines the adaptive nature of Management Control System practices and how financial service firms use management control systems to facilitate financial service transactions in the context of an ever-increasing regulatory climate. The Financial services industry is among the most highly regulated industries in the world. Regulation has been increasing continuously, an increase partly due to international efforts to control activities such as money laundering. The lack of suitable controls in both the institutional setting and in law enforcement has allowed activities such as money laundering to go undetected to the extent that the United Nations Office on Drug and Crime (UNODC) has issued reports suggesting that money laundering is continually increasing. This high and ever-changing regulatory landscape requires firms to be responsive to regulation and adaptive to their customers’ needs. Financial service firms, similar to other for-



profit firms, attract customers and make profits based on their ability to effectively and efficiently process customer transactions and other business requests. But moving money can be a complex process. As industry regulation increases and businesses operate across multiple jurisdictions, the business process has become much more complicated. The role of management control systems (MCS) has changed and in some ways has become more challenging. The business environment has also changed, the efficient movement of funds sometimes requiring several banking institutions to work together to facilitate specific business transactions. This study examines the case of HSBC during the period 2000-2010, focusing on the role of internal controls in both complying with regulation and satisfying its clients. This case study provides a good setting for the study of internal controls and business practices, since HSBC is one of the largest financial institutions in the world, with multiple external regulators and customers globally. HSBC recently agreed to pay a record USD 1.9bn settlement for money laundering practices. Facilitation of business transactions is of major importance, not only due to its economic significance, but also due to the attention it has received over the past decade as money laundering and other illicit financial flows have increased significantly. The UNODC conducted a study to determine the magnitude of illicit funds generated by organized crime and drug trafficking and to investigate to what extent these funds are laundered, and although precise statistics are not available due to the illegal nature of the transactions, the report estimated that in 2009, criminal proceeds amounted to 3.6% of global GDP, with 2.7% (or USD 1.6 trillion) being laundered.<sup>18</sup> Money laundering facilitates a broad range of serious underlying criminal offences and ultimately threatens the integrity of the financial system (U.S. Department of Treasury, 2013), while propagating negative behaviors that erode the social

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<sup>18</sup> <http://www.fatf-gafi.org/pages/faq/moneylaundering/>

structure of society. Over the past decade the U.S. Senate Permanent Subcommittee on Investigations has worked to strengthen U.S. anti-money-laundering (AML) efforts by focusing on how U.S. banks, through the correspondent services they provide to foreign financial institutions, have become conduits for financial flows associated with organized crime, drug trafficking, and financial fraud.<sup>19</sup>

The primary motivation of the study is to better understand how external regulations intersect with internal practices to organize the possibilities and practices of money laundering and other illicit financial flows. Similar to accounting based anti-corruption barriers in political settings (Neu et al, 2012), the information systems and internal controls coupled with external regulation serve as a barrier to illicit financial flows in the financial sector. Focusing on internal business practices and the structures and processes of internal controls allow us to gain some insight into practices that both hinder and facilitate actions such as money laundering. We also understand on the micro or business transaction level how MCS practices both respond to regulation and are learned via practice and memos. Our notion is that being able to successfully move financial resources in an efficient manner across jurisdictions of high regulation partially depends on (i) the treatment or classification of the monies based on the rules and regulations of the industry and (ii) partially on the in-depth knowledge and skills possessed by the actors involved pertaining to the information systems and internal control practices within the financial institution. This is an important area of research since preventing illicit financial flows is directly linked to larger economic and social problems such as drug trafficking and corruption.

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<sup>19</sup> U.S. Vulnerabilities to Money Laundering, Drugs , and Terrorist Financing: HSBC Case History

A second and related motivation of this study is to gain a better understanding of the rules surrounding the internal controls and the external regulatory system that create a system of visibility (Adler and Borys, 1996) or an illusion of objectivity that allows particular practices to be propagated or go undetected for relatively long periods of time. By focusing on the material arrangements within the system (Schatzki, 2005; Ahrens & Chapman, 2007, D'Adderio, 2010, Neu et al, 2012; Neu, 2012) we gain an understanding of how internal controls are set up to be sufficiently flexible to navigate the complex web of external regulation while simultaneously promoting an efficient and effective business environment. We additionally gain an understanding of the factors that lead to internal control changes to facilitate business transactions.

A firm's MCS is continually evolving and can be defined as a combination of practices built around artifacts. These practices include the interactions among social actors (Latour, 1987, 2005) as well as the interactions between actors and artifacts such as forms (Neu et al, 2006, 2012) used to transmit information. The practices also include the interpretation of information (Ahrens & Chapman, 2007; Schatzki, 2005; Neu et al, 2006 & 2012) presented from different sources with the recognition that attention is limited (Simon, 1995) hence attention or focus on particular issues reduces attention on other issues. It is these interactions and interpretations that are then used by the MCS to align and control actions (Ahrens & Chapman, 2004; Chenhall, 2003; Merchant & Van der Stede, 2007; Zimmerman, 2003) within an institution. And finally, alignment involves, particularly within the financial services industry, the means of encouraging and maintaining clients and facilitating business practices to those ends. While many researchers including Zimmerman, (2003) and Merchant & Van der Stede(2007) has highlighted the role of information systems and MCS in the decision making process, and its' role in controlling and aligning

employees' interest with the goals of the organization as well as the enabling and constraining role of the MCS (Adler and Borys, 1996; Simon, 1995; Chenhall, 2003; Zimmerman, 2003; Ahrens & Chapman, 2004; Tessier and Otley, 2012), little research has been performed to show how internal controls and MCS are used to facilitate a client friendly climate particularly in such a highly regulated industry.

The remainder of the paper is organized as follows. Section two provides some detail on the changing regulation that governs the financial industry. Section three provides an overview of relevant prior literatures and the theoretical framing that informs the analysis. Section four discusses the research design and methods. Section five provides the case analysis and, finally, section six discusses the implications of the study.

### **4.3 Theoretical Framing**

The banking and financial sector is an interesting site of study because success requires extensive knowledge of both the changing institutional and structural conditions of the field, as well as knowledge of the processes within the field. Starting with the concepts of Bourdieu's institutional logic, the banking and financial system provides a context where different groups (dominant and dominated) are in a continual struggle to maintain positions that are advantageous to themselves (Harken, Mahar, Wilkes, 1990; Prasad, 2005). According to Bourdieu, a field consists of a set of objective historical relations between positions anchored in certain forms of power (Bourdieu & Wacquant, 1992. P. 16). And the notion of the field is not to be thought of as homogenous, but rather, the field is marked by endless tensions and struggles over (a) the

mechanisms of the field's reproduction and (b) the material and symbolic resources within it (Everett, 2002).

Organizations change by changing the capital at stake, and Bourdieu views power as central to understanding how control works within organizations (Oakes, Townley, Cooper, 1998). Our analysis is concerned with the material and symbolic resources and artifacts such as banking procedures and forms; and the mechanisms through which MCS is learned.

Success requires, among other things, firms to "appear to be legitimate" to the actors in this field. The issue of legitimacy this paper is concerned with is not so much the legitimacy of being given the status of "bank", but more to do with the bank's appearance to customers, auditors, and other stakeholders in the field. This paper is concerned with the specific strategies and forces the bank employs to form the practical relationships with customers that is necessary to retain such customers, while at the same time producing strategies and practices that are legitimate and to a large extent reproducible to allowing both the bank and its customers continued success in the field. As changes such as regulatory changes occur in the environment, firms either adapt to the changes or give the illusion that they have adapted to them (Meyer & Rowan, 1991; Oakes, Townley, Cooper, 1998). As changes occur, action or a reaction to the change depends on the perception of the change and the mechanisms of differentiating what is at stake, i.e. is the change of any significant interest to the field's participants? Interest, in this case, pertains to what happens and how much that matters (Bourdieu & Wacquant, 1992. P. 116). The decision and action also depend on the nature of the capital the actors possess. This is an important consideration since strategies are sometimes viewed as a product of a conscious or purely rational calculation. Instead, according to Bourdieu, these strategies or actions are often shaped by habits, traditions, social legacies, customs and beliefs (Bourdieu, 1977; Prasad, 2005), and are in part planned and in part

emergent (Simon, 1995). Similar to prior research on contextual factors and its influence on strategies adopted in accounting (Neu, 2012; Waterhouse and Tiessen, 1978; Ahrens and Chapman, 2004; Watts and Zimmerman, 1990), we adopt a similar approach by looking at how change in practices becomes formalized or a part of everyday business operations due to contextual factors.

The internal controls of an organization consist of a multitude of artifacts and practices. The arrangements in turn influence (i) the internal business practices and MCS, (ii) internal visibility, and (iii) the external regulatory visibility. As research has, over the years, outlined the increasing roles of these systems in managing and shaping organizational direction, so our understanding and definition of management control systems (MCS) and internal controls have changed. This paper focuses on the mechanisms through which internal controls shape practice by drawing on the notion that the arrangements of the artifacts and practices are a system of intentionality constituted in cognitive processes. This system includes but is not limited to the contexts and people involved in these processes (Neu, 2012; Ahrens and Chapman, 2007).

Early research showing the relationship between an organization and its technology and markets has, with little change, associated MCS with mechanistic routine systems (Burns and Stalker, 1961). Other research has shown the increasing importance of MCS and internal controls; for example, Henri's study on manufacturing firms showing the link to strategy (Henri, 2006), planned organizational change (Chenhall and Euske, 2007), and the growing body of research on creative exploration, innovation, and uncertainty (Brown & Eisenhardt, 1997; Ahrens & Chapman, 2004; Bisbe & Otley, 2004; Davila, 2000; Davila, Foster, & Li, 2009; Ditillo, 2004). Little research, however, has focused on highly regulated industries, in particular the banking and financial sector. In the context of the highly regulated banking and financial system, the function of the MCS and

internal controls may be heightened as a result of regulation providing the barriers or boundaries and limits to the opportunities available within the field; this, coupled with the bank's core business of taking deposits, providing credit, and moving funds globally in response to customers' requests, continually leads to the evolution of MCS practices.

The individuals (actors) and groups within this field draw upon a variety of cultural, social and economic capital in order to maintain or strengthen their position. These resources constitute different forms of capital (Bourdieu, 1991): economic, cultural, social, and symbolic, distinguished as follows: Economic capital refers to the tangible material assets such as property and investments. Cultural capital comprises items such as rare books and art for defining legitimacy and is usually associated with cultivated dispositions that are internalized from an early stage in life resulting in cultural marks of distinction (Bourdieu, 1989). Cultural capital is especially transferred by family and education and may be institutionalized in the form of educational qualifications and is often the primary cause for status and relative positions within a social field (Bourdieu, 1977). Social capital refers to those personal connections that give a person or group easy access to privilege or power. Influential networks such as politicians or business leaders are examples (Prasad, 2005). Social capital represents a person's entirety of social relations and encompasses one's network of actual or potential resources that can be legitimized by the family, group, or class membership (Bourdieu, 1986). And the last form of capital, symbolic capital is related to honor and recognition. Symbolic capital is not an independent type of capital within itself, but rather consists in the acknowledgment of capital by the entirety of the peer competitors on a specific field (Bourdieu, 1997). The recognition of the capital is a form of legitimacy (Bourdieu, 1989; Bourdieu & Wacquant, 1992) giving additional value to the bearer of such capital in the specific field. Fields are places of power relations where practices of agents are not arbitrary.

All interactions are anchored in a specific social field (Bourdieu, 1997). The field of banking and finance employs these forms of capital in various ways and different actors possess varying amounts of capital which allow each actor to take up different positions in the field.

Banking and finance are a field requiring highly skilled players. Navigating within the regulatory web requires both an extensive knowledge of the regulation and of the legitimating practices that reproduce the system. These are not just finance and accounting skills. Actors require knowledge of law and specialized training in anti-money-laundering (AML) to name a few. The practices within this field are organized by the external structures and create a ‘system of visibility’ that, in theory, act to prevent unethical behavior and fraud. As regulation changes, the material arrangements within the field often change requiring practice to change. Changing practices in the banking field requires skillful practice to change these arrangements, and it requires the change agents to possess the symbolic capital which gives him or her the legitimacy to facilitate the changes with the shared understanding of the actors involved in these new practices and arrangements. In other words, for one to be able to make changes and disseminate the changes successfully in the banking field, one must be recognized as possessing the capital to first make the appropriate changes; must be in a position to transform the practices; and must possess the capital to implement the changes. External regulators and auditors also possess some of these skills and capital and contribute to firms maintaining their legitimacy by providing oversight and in the case of auditors, often providing an opinion regarding the accounting practices and the correctness of the financial statements. Individuals’ social positions within a field impact their perceptions of the field (Bourdieu, 1988) and these perceptions may shape their actions when it comes to working within or around the complex structures in the banking and financial sector.



Skillful practice in the banking industry can be emergent in situations where regulations have changed, but the methods of satisfying the new regulatory requirement is left up to the individual bank. It is now up to the individuals within the bank to determine the most feasible course of action, and through this method different skills are developed in the industry. Emergent skillful practice can also occur through a process by which the head offices of banks issue changes through the use of internal memos but still leave the method of dealing with the specific change to different regions or individual branches. Customers' requests can also result in emergent skillful practices, as banks attempt to satisfy their customers' needs efficiently. This may mean utilizing their skills and knowledge of the existing system and developing ways to improve service by working on the margins of the regulation.

Conscious practices result from clear and deliberate action. Along with requiring changes to the MCS, regulators may impose changes in policy and controls and must give clear direction on how the changes are to be implemented. Head offices may perform similar actions giving clear direction. This method will most likely lead to documented processes and training to enhance these new skill-sets required. This imposed method of learning the skills of the trade now become a foundation for employees of these banks on which to build future skills as they become inculcated—first as part of the individual's capital within the banking environment and second, as time passes and these skills become a part of standard banking practice, they become common knowledge in the field and the associated habitus of the banking field.

Similar to prior research on supranational institutions, many of the banks and financial institutions transcend national boundaries (Neu et al., 2006). We propose that individual actors with expert knowledge of the control systems are less constrained within the field than those without such knowledge. These knowledgeable actors can make decisions to change the field

(Bourdieu & Wacquant, 1992). As explained by Berger and Luckmann (1967: 60), it is important to keep in mind that the objectivity of the institutional world is a humanly produced, constructed objectivity. Before being 'objectivated' (i.e. experienced as an objective reality) by human beings, institutions are produced by them. We tend to believe that institutions have always been there because most often those who are constrained by institutions, and those who initially created these institutions, are not the same (Battilana, 2006). Actors with intimate knowledge of internal controls and business practices act to shape the field to their advantage.

Internal controls provide a sense of visibility of the processes and practices within an organization to external stakeholders. High quality internal controls help to provide assurance that the firm's financial statements accurately reflect the firm's performance (COSO 1992). And internal controls provide clarity and functional direction to those within an organization through approval processes and operating procedures. This internal visibility helps to create the norms of business practice. This is part of the legitimizing process that gives customers and other stakeholders the sense of trust and belief that the bank is acting in a legitimate manner.

Internal controls coupled with the rules and regulations of the finance and banking industry create the visibility that allows large groups to act or react in a similar fashion to the information being presented, such as the stock market reaction to individual companies on earnings announcements. But we must also consider that visibility to particular parts of a process or information renders other processes and information less visible (Simon, 1995). To better understand the visibility of specific pieces of information requires us to further understand the choices being made in the design of internal controls, as well as the processing of particular information that allows for the production and re-production of particular sets of information required by particular groups.

Prior research has highlighted some of the variability of control systems across firms and sectors (Whitley, 1999) while others have focused on systems such as results controls, action, personnel and cultural controls (Merchant and Van der Stede, 2007). This paper is not prescriptive in terms of the type of control system that should be used in the banking and financial sector. This paper looks at how, within a single firm, the institutional context and business needs shape and are shaped by the internal controls. We look at internal control design focusing on issues such as banking affiliates, mergers and different control systems, environmental survey of risk, and trends of historical records. Recognizing that structures and processes can be institutionalized and often resistant to change (Oliver, 1991), we look at how internal controls are used to work within and around structures. Using Bourdieu's perspective of institutional logic, we show how internal controls make possible and facilitate a client-friendly climate. The next section of the paper describes the case and the context of the study.

#### **4.4 Data & Method**

As mentioned earlier, the study focuses on the case of HSBC during the period 2000 through 2010. HSBC was originally founded in 1865 to assist with trade financing between Asia and the West. HSBC has since expanded globally and is now one of the world's largest banking and financial services organizations (HSBC website), with over \$2.5 trillion in assets, 89 million customers, 300,000 employees, and 2011 profits of nearly \$22 billion. HSBC now has operations in over 80 countries, with hundreds of affiliates spanning the globe. Its parent corporation, HSBC Holdings plc, called "HSBC Group," is headquartered in London, and its Chief Executive Officer is located in Hong Kong. It is often difficult to obtain information about the internal controls and information systems of financial institutions since much of this is held as private information. The

primary data used for this case study was made available by the U.S. Permanent Subcommittee on Investigations hearing, completed in July 2012<sup>20</sup>. This data set provides us with a unique opportunity to study the internal controls of a bank operating in an international setting.

The institutional sociology of Bourdieu guided us to first map the field to understand the structural rules and the major actors involved and how they interact with each other. We then performed a thematic analysis (Yin, 1989; Eisenhardt, 1989) of the report and transcript data, identifying consistent themes followed by a detailed analysis building sub-themes. Although several themes emerged, we “bracketed” internal controls and information systems as the major focus for the current study.

#### **4.5 The Institutional Context**

HSBC’s key U.S. affiliate is HSBC Bank USA N.A. (HBUS). HBUS operates more than 470 branches within the U.S with assets totaling approximately \$200 billion. HSBC grew its business both in the U.S and internationally primarily through banking acquisitions. HSBC operates in many jurisdictions with banking regulations that are different than the regulations in the U.S. Some of these affiliates operate in environments with high risk clients, high risk financial activities, and weak anti-money-laundering (AML) controls. These high-risk jurisdictions include areas such as Asia, Middle East, and Africa. During the period 2000 through 2010, HSBC also acquired affiliates in Mexico and throughout Latin America.

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<sup>20</sup> *U.S. vulnerabilities to money laundering, drugs, and terrorist financing: HSBC case history: Majority and minority staff report, Permanent Subcommittee on Investigations, United States Senate.* (2012). Washington, DC: U.S. G.P.O.

Although it is common practice for firms to expand their businesses through acquisitions, the banking industry faces some unique challenges—and HSBC had specific control issues arise as a result of these acquisitions. First, cross-border business acquisitions can bring a unique mix of issues such as different information systems that do not ‘speak to each other’, creating the additional interim tasks of creating routines or manually transferring data across systems for proper decision making. In some cases, the information required by the decision maker is simply not present in the acquired system. Additionally, cross-border acquisitions may encounter cultural differences between the groups, with these differences translating into various types of measurement systems and controls used by different organizations. Culture is closely linked to what Bourdieu terms the habitus of the individuals. Habitus is the “durably inculcated system of structured, structuring dispositions” found within a field (Bourdieu, 1990b, p. 52) and habitus gives individual social actors “a feel or sense of the social game” (Everett, 2000). The field structures habitus and in turn, habitus structures the perceptions of the field (Bourdieu, 1988b). An individual’s habitus acts to generate regulated behaviors and practices. Hence, habitus, capital, and field determine the specific measurement systems, the methods of motivation and the internal controls of the organization. And second, different jurisdictions have different regulatory structures with varying risk factors. In the context of cross-border mergers and acquisitions, different fields are being merged. HBMX, the HSBC affiliate in Mexico is an example that demonstrates how an acquisition leads to the issues described. HBMN was created in 2002 by the acquisition of a Mexican bank, Banco Internacional, S.A. known as Bital. Mexico was known to be a country of high risk as a result of the drug trade and Bital had completely different internal control systems from the other HSBC affiliates.

Banking affiliates set up correspondent accounts<sup>21</sup> to facilitate the movement of currency and to perform other services on behalf of its affiliates. A senior HSBC executive told the Subcommittee that HSBC acquired its U.S. affiliate, not just to compete with other U.S. banks for U.S. clients, but primarily to provide a U.S. platform to its non-U.S. clients and to use its U.S. platform as a selling point to attract still more non-U.S. clients (HSBC Subcommittee Report). The movement of financial resources from high risk countries can be problematic particularly if the country is on a watch list for money laundering or terrorist activity. HSBC also has a Middle East affiliate, HBME. We focus our attention on the practices used to facilitate transactions on behalf of these clients and the link among the various affiliates. The next section looks at the analysis in detail, focusing on two main areas. First, we look at how internal controls are designed, given the risk of clients, and the potential high risk of the environment. And second, we focus on the strategies used by the bank to facilitate the movement of financial assets, given regulatory structures such as Government watch-lists.

#### **4.6 The Changing Regulatory Landscape**

Money laundering has grown exponentially over the last three decades as the rapid development of information systems and banking networks have facilitated the rapid movement of physical and digital funds. The United Nations Office on Drug and Crime estimates the amount of

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<sup>21</sup> A correspondent account is commonly understood to mean a deposit account established by one bank for another bank to receive deposits and make payments. *See* Federal Reserve Regulation O (12 CFR 215.21(c); Dictionary of Finance and Investment Terms, John Downes and Jordan Elliot Goodman (5th ed. 1998).  
<http://www.occ.gov/news-issuances/federal-register/67fr60562.pdf>

money laundered globally each year as 2 - 5% of global GDP, or \$800 billion - \$2 trillion in current US dollars.<sup>22</sup>

The banking system forms a significant part of the financial sector that provides a network of institutions or branches that offer financial services to individuals and businesses by taking deposits and reasonably meeting the credit needs of the community in which they are located. Bank branches can be located both locally and internationally. One of the primary services provided by the banking system is to facilitate the movement of funds through various transactions and services e.g. taking deposits, cash transfer payments and inter- bank transfers, contracts, credit cards, lines of credit, and travelers-cheques. And the consumers of these services depend on the efficiency of the institutions since the movement of monies is of paramount importance to most businesses for acquiring other resources.

Transnational organizations such as FATF, United Nations, and the World Bank, working with governments, have increasingly attempted to regulate the activities of the financial services industry as a means of curtailing money laundering. Efforts are continually increasing to prevent, detect and prosecute international money laundering and the financing of terrorism. These efforts include anti-money-laundering (AML) tools that impact the banking, financial, and investment communities. The Patriot Act which amends the Bank Secrecy Act in the United States is just one example of how governments have increased regulatory efforts in an attempt to prevent and detect strategies that may have negative consequences to society. The increasing regulation and institutional rules also represent an attempt by government actors to influence activities within this sector. These institutional rules or structures rely on a combination of visibility mechanisms that

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<sup>22</sup><https://www.unodc.org/unodc/en/money-laundering/globalization.html>

use archival accounting traces and auditing practices, which both limit the possibilities of actions within the field while simultaneously creating opportunities within the field or space. Institutional changes place different demands on the MCS, which is now meant to satisfy both the external demands as well as facilitate the internal objectives of the business. As noted earlier, MCS practices are continually changing and these changes occur primarily from two sources. First, MCS practices respond to regulation; and second, MCS practices change when business practices with customers change, and in response to memos from internal banking procedures. Changes in practices can be viewed as a second-order response to regulation.

The banking and financial sector is a specialized and highly regulated industry. Regulation in the United States and Canada has been, and is continually, increasing in the financial and banking sector for three reasons. First, the process of globalization, adopted here not only in response to heightened international trade and the increasing movement of goods, but also in response to an intensified use of financial instruments, processes that involve detailed everyday activity within diverse local institutions (Barrett, Cooper, Jamal, 200). Globalization has accelerated the mobility of capital and credit, and faceless trading has also created numerous uncertainties (Harvey, 1989; Lash & Urry, 1994; Arnold & Sikka, 2001). Western Governments have responded to globalization by increasing the use of regulation and accounting technologies for monitoring commercial and non-commercial activities. The use of internal auditors and external audits continue to be one of the major techniques of monitoring and surveillance of multilateral firms (Hanlon, 1994; Power, 2009; Arnold & Sikka, 2005). This increased regulation assists in the oversight of financial reporting requirements and tax collection and helps to assure external stakeholders that the firms are following proper business practices.



The second reason for increased regulation: the continuously increasing improvements in preventing and detecting money laundering practices. Money laundering is a process by which the illicit source of assets obtained or generated by criminal activity is concealed in a manner to obscure the link between the funds and the original criminal activity (IMF Factsheet, 2013). The Deputy Managing Director of the IMF recently stated:

Money laundering and the financing of terrorism are financial crimes with economic effects. They can threaten the stability of a country's financial sector or its external stability more generally. ... Action to prevent and combat money laundering and the financing of terrorism thus responds not only to a moral imperative, but also to an economic need.

—Min Zhu, Deputy Managing Director of the IMF

Advances in information systems and digital technology have facilitated the movement of monies for business purposes and has simultaneously increased the ease of entry of illicit funds into the U.S. financial system. Technology intensification is most visible in banking and finance where, with the aid of information and management control systems, trading on global stock markets, and the use of financial instruments such as futures, options, derivatives, interest rate swaps, and other forms of electronic payment and monetary transfers have continually increased (Arnold & Sikka, 2005). While technology has facilitated business practices, illicit financial flows have also continued to increase as money launderers develop new ways of utilizing financial instruments and technology to obscure the sources of the funds. In 2009 the United Nations Office on Drug and Crime report estimated USD 1.6 trillion is being laundered annually.

Although money laundering has been recognized as a federal crime for many years (Money Laundering Control Act, 1986), the U.S., in an attempt to stem the flow of funds from illicit sources, has continued to introduce further regulation, such as the Patriot Act in 2001, referred to as the International Money Laundering Abatement, the Financial Anti-Terrorism Act of 2001, and Intelligence Reform & Terrorism Prevention Act (2004). The Patriot Act gives authority to the

Secretary of the Treasury to prescribe regulations requiring certain financial institutions to report cross-border electronic transmittals of funds, if deemed necessary to the fight against money laundering and terrorist financing (FinCEN News), ([http://www.fincen.gov/news\\_room/aml\\_history.html](http://www.fincen.gov/news_room/aml_history.html))

And third, regulation is continually changing to encourage strong governance practices. One of the results of the corporate failures of the last decade is an increasing view that reliance on markets and the self-regulation practice of accounting is no longer seen as sufficient or adequate to protect investors and the public (Cooper and Robson, 2006). The practical side of the debate has increased primarily due to an intensified focus on the cause of much of the corporate failures in recent years. Issues such as management power and control, incentive structures, agency, and social responsibility, are all highly important in the conversation, leading to shifting and enhanced regulations. Additionally, accounting rules are changing. The general shift from the more rule-based US GAAP accounting system and other country-specific individual systems, to the principled-based IFRS, is an attempt to unify accounting practices globally. The shift represents a movement away from country-specific standards in favor of an international standard (Kadous and Mercer, 2011). Although a unified set of standards may assist globally in the fight against money laundering and corruption, operational concerns still remain—such as professional competence and training for the accountants already in the field, particularly those in developing countries (Everett et. Al., 2007).

Financial service firms and particularly the banking industry are among the most highly regulated industries globally. Understanding the role of regulation and the structure of the supervising bodies is important to this research, since bank operations are highly monitored by regulation. Regulation helps to structure the field in which banks operate by not only providing

some of boundaries of operation, but also by providing a level of contestation of power between the regulators and the banks. There is a practical relationship that exists within the field as both regulators and banks attempt to impose a presence of domination. Regulators shape outcomes by imposing certain urgencies of when and how things are done (Bourdieu, 1990). The regulatory structure of the US financial system comprises a network of regulatory, supervisory bodies, and support systems that act together but also has independence over different levels of banks. Banks are regulated at two levels, the federal level and the state level. The US regulatory system is unique, compared with regulatory systems of other countries and this allows for unique struggles within the banking field. At the federal level, a single bank such as HSBC can have two different regulators. The US Department of the Treasury<sup>23</sup> has two components: The Office of the Controller of Currency (OCC)<sup>24</sup> and the Office of Thrift Supervision. The Department of the Treasury regulates national banks. The Federal Reserve Board<sup>25</sup> (Feds) regulates bank holding companies (BHC) and financial holding companies (FHC). In terms of reporting structure, both the Fed and the OCC have equal power regarding their auditing practices and policies over the banks they oversee. This “equal power” may possibly create tensions for the bank, as serving two masters is

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<sup>23</sup> The U.S. Department of the Treasury, originally created specifically to manage government revenues (whereas the Federal Reserve manages payments), has evolved to encompass several different duties. It recommends and influences fiscal policy; regulates U.S. imports and exports; collects all U.S. revenues, including taxes; and designs and mints all U.S. currency. In terms of financial regulation, the Treasury Department functions primarily through the operations of two agencies it oversees, the Office of the Comptroller of the Currency and the Office of Thrift Supervision, which regulate banks and savings and loans

<sup>24</sup> The Office of the Comptroller of the Currency, or OCC, is the primary means through which the Treasury regulates U.S. banks. The OCC is responsible for chartering all U.S. banks and, more broadly, for ensuring the stability of the banking system.

<sup>25</sup> The Federal Reserve, commonly referred to as the Fed, is the central bank of the United States. The Fed is responsible for regulating the U.S. monetary system (i.e. how much money is printed, and how it is distributed), as well as monitoring the operations of holding companies, including traditional banks and banking groups. Broadly speaking, its mandate is to promote stable prices and economic growth.

often difficult. These regulations provide the institutional features that shape practice within the field. HSBC's North America holding company—HNAH is primarily regulated by the Federal Reserve Board and US subsidiary—HBUS is primarily regulated by the Office of the Controller of Currency (OCC). The OCC is responsible for the regular performance and compliance audits of HBUS.

In response to the events of 9-11 in 2001, the Patriot Act was introduced to amend the Bank Secrecy Act (BSA). The introduction and implementation of these changes occurred across several years with these changes requiring additional coordinating information to be shared amongst regulatory agencies and banks. Three major changes which occurred during the period 2001 to 2010 are: (1) the Patriot act with FinCEN<sup>26</sup> as the oversight body; (2) The Specially Designated Nationals and Blocked Persons List maintained by the Office of Foreign Asset Control (OFAC); and (3) the introduction of the Sarbanes-Oxley Act in 2002. The attached table shows the major changes that affect operations in the banking sector.

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<sup>26</sup> FinCEN's mission is to safeguard the financial system from illicit use and combat money laundering and promote national security through the collection, analysis, and dissemination of financial intelligence and strategic use of financial authorities.

Table 4. 1 Amendments to Banking Regulation

Regulation	Year Amended & Change	Description of change
Bank Secrecy Act (BSA) & The Patriot Act (FinCEN)	2001 Establishing AML Programs	<p>The Patriot Act amended the BSA to require that financial institutions establish AML Programs.</p> <p>An AML Program must be in writing and must include:</p> <ul style="list-style-type: none"> <li>• the development of internal policies, procedures, and controls;</li> <li>• the designation of a compliance officer;</li> <li>• an ongoing employee training program; and</li> <li>• an independent audit function to test programs.</li> </ul>
	2002 Verifying the Identity of Customers	<p>Final rules regarding customer identification programs have also been issued for financial institutions.</p> <p>These rules require that financial institutions have procedures for checking customer's names against lists of known or suspected terrorists or terrorist organizations that are prepared by any federal agency and made available to the institution.</p>
	2003 Reporting Suspicious Activity	<p>The Patriot Act authorizes Treasury to issue rules requiring financial institutions to file Suspicious Activity Reports (SARs). Treasury also has issued a Form 101, Suspicious Activity Report by the Securities and Futures Industries (SAR-SF) (with instructions), which FCMs and IBs must use to report suspicious transactions. Treasury has also posted guidance on common errors found in filed SARs.</p>

<b>Regulation</b>	<b>Year Amended &amp; Change</b>	<b>Description of change</b>
	2006/2007  Due diligence for certain types of accounts involving foreign persons	Treasury requires covered financial institutions to establish due diligence programs that include appropriate, specific, risk-based, and where necessary, enhanced policies, procedures and controls that are reasonably designed to detect and report, on an ongoing basis, any known or suspected money laundering activity conducted through or involving any correspondent account established, maintained, administered, or managed by such covered financial institution in the United States for a foreign financial institution.
	Special Measures	Patriot Act authorizes Treasury to find that a foreign jurisdiction, institution, class of transactions, or type of account is of "primary money laundering concern" and to require domestic financial institutions to take certain "special measures" against the primary money laundering concern.
Bank Secrecy Act (BSA) & The Patriot Act (FinCEN)	2001  Transactions in excess of \$10,000	A financial institution and any "nonfinancial trade or business" must file a report concerning a transaction (or series of related transactions) in excess of \$10,000 in currency.
	Foreign Banks and Financial Accounts	The BSA requires each United States person who has a financial interest in, or signature authority over, any financial accounts in a foreign country to file a Form TD F 90-22.1, Report of Foreign and Financial Accounts (FBAR) if the aggregate value of the financial accounts exceeds \$10,000 at any time during the calendar year. The term "financial account" includes any commodity interest account. The term "United States person" includes any Commission registrant that is a citizen or resident of the United States, domestic partnership, domestic corporation, or a domestic estate or trust.

	International Transportation of Currency or Monetary Instruments	The BSA requires the filing of a Form 105, Report of International Transportation of Currency and Monetary Instruments (CMIR) by any person, such as an FCM, who physically transports, mails, ships, or causes to be physically transported, mailed, or shipped, currency or other monetary instrument in an aggregate amount exceeding \$10,000 on any one occasion, whether that transportation is into or out of the United States.
	Information Sharing Among Financial Institutions and Law Enforcement	Pursuant to the Patriot Act, Treasury has issued a final rule that requires financial institutions, including FCMs, IBs, CPOs, and CTAs, to comply with information requests received from law enforcement. The final rule requires a financial institution to make an expeditious search of its records for accounts and transactions involving named suspects, provide specified information about the named suspects, and prohibit the financial institution from disclosing the fact that a request has been made (other than as necessary to comply with the information request).
OFAC Sanctions (OFAC)	2008 Rules for different countries	Financial institutions are separately required to comply with the rules of the Office of Foreign Assets and Control (OFAC) and must consult OFAC's lists of sanctioned countries and specially designated nationals and blocked persons. Sources for complying with OFAC rules: <ul style="list-style-type: none"> <li>• OFAC's "Opening Securities and Futures Accounts from an OFAC Perspective" guidance;</li> <li>• The American Bankers Association's primer and briefing on OFAC compliance; and</li> <li>• OFAC forms for reporting blocked or rejected transactions.<sup>27</sup></li> </ul>

<sup>27</sup> [http://www.cftc.gov/IndustryOversight/AntiMoneyLaundering/index.htm#P22\\_4541](http://www.cftc.gov/IndustryOversight/AntiMoneyLaundering/index.htm#P22_4541)

Sarbanes-Oxley Act	2002 Section 404- Management Assessment of Internal Controls	Issuers are required to publish information in their annual reports concerning the scope and adequacy of the internal control structure and procedures for financial reporting. This statement shall also assess the effectiveness of such internal controls and procedures.  The registered accounting firm shall, in the same report, attest to and report on the assessment on the effectiveness of the internal control structure and procedures for financial reporting. <sup>28</sup>
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## 4.7 Analysis

### 4.7.1 Designing Internal Controls

#### *Affiliates*

Traditionally, we have based our notions of management control systems on the idea that the system consists of an assembly of interconnected elements that function as a collective whole (Wilson and Chua, 1991; Kloot, 1997). We have further segregated MCS into process and structure, i.e. what they do and what they are (Anthony and Herzlinger, 1980), with each piece of the system having specific control functions. And we believe that as environments change, the organization modifies its behaviors to meet both internal and external demands (Kloot, 1997). But effective control is not just about following predetermined rules and ensuring employees work productively towards the defined objectives; control also allows the freedom to innovate (Simons, 1995). We now consider how the HSBC affiliated groups set up control systems that facilitated its business practices.

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<sup>28</sup> <http://www.soxlaw.com/s404.htm>



HSBC has hundreds of affiliates located around the world, many of which gain access to U.S dollars and the U.S financial system by interacting with HBUS (HSBC's U.S. division) through correspondent accounts. The correspondent accounts are used for different purposes such as: cashing U.S dollar instruments—e.g. traveler's cheques or money orders; clearing U.S dollar wire transfers; while others use it to buy or sell U.S dollars and foreign exchange. Correspondent accounts are an important part of this study since these accounts provide a gateway to the U.S. financial system. These accounts are not only used by legitimate cash-generating businesses but can also be used by businesses that generate illicit cash flows attempting to launder financial flows.

U.S. statutory and regulatory requirements explicitly direct U.S banks to conduct due diligence prior to opening a correspondent account for any foreign financial institution, with no exception for foreign affiliates.<sup>29</sup> Prior research on internal controls suggests that this regulatory requirement would be reflected in the internal controls of HSBC, screening candidates opening correspondent accounts—regardless of the originating request for the account, i.e. whether or not the request is from an affiliate, thus providing the external visibility required by regulation (It becomes an assumption taken for granted).

However, HSBC's business practice is different. HSBC's Group policy allowed its affiliates to assume that any HSBC affiliate owned 50% or more by the Group met the anti-money-laundering (AML) standards, were low risk, and did not required any further due diligence prior to opening a correspondent account. This is an example of one of the methods by which information is transmitted and processed within an organization.

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<sup>29</sup> [http://www.fdic.gov/regulations/laws/rules/8000-1300.html#fdic8000mfa5318\(i\)](http://www.fdic.gov/regulations/laws/rules/8000-1300.html#fdic8000mfa5318(i))

Our theoretical framing suggests that this policy works in several ways to create a position of advantage for HSBC. First, the policy provides a means of working around the dynamic tensions (Simons, 1995) and power struggles that could arise if HSBC Group affiliates were to begin questioning each other about their clients. Second, this policy is a business practice that creates its own external visibility. Although it does not follow the requirements of the regulation, it gives the perception to outside stakeholders that all HSBC Group affiliate customers have been vetted by the AML regulations. And third, HSBC's employees will generally be more familiar with the policies within the organization than with the requirements of the external regulation. This gives the employees the sense that they are adhering to an acceptable practice. Over time, these types of practices become embedded and form a part of the employees' habitus that gives them a sense of the game (Everett, 2000), forming a part of the organization's culture. The policy facilitates business practices and ease of doing business by reducing tensions and potential power struggles, creating an internal sense that acceptable practices are being followed, and providing external stakeholders with the knowledge that HSBC is meeting external regulation.

### ***Risk Rating***

As mentioned earlier, HSBC has a large number of affiliates in over 80 countries. Over the years considered, over 80 of the affiliates have turned to the U.S. affiliate, HBUS, for access to U.S. dollars and/or the U.S. financial system:

A senior HSBC executive told the U.S. Subcommittee that HSBC acquired its U.S. affiliate, not just to compete with other U.S. banks for U.S. clients, but primarily to provide a U.S. platform to its non-U.S. clients and to use its U.S. platform as a selling point to attract still more non-U.S. clients. (HSBC Report, pg. 2)

Processing USD transactions represented increasing business for HSBC. In 2009, HSBC determined that the majority of its affiliates processed their USD transactions at HBUS and these affiliate transactions accounted for 63% of all USD payments processed by HBUS. HSBC also estimated that over the period 2001-2009, their USD clearing business increased over 200%. HBUS' daily USD transactions increased from \$185 billion in 2001 to \$377 billion in 2009 (pg. 16). We focus on one of the key affiliates in Mexico, HBMX, to show how the design of internal controls facilitated business practices while simultaneously increased risks for HSBC.

To understand the risks that both HBUS and HSBC as a whole faced with HBMX, it is important to understand the country risk of Mexico at the time. HBMX was created in 2002 as a result of a purchase of an existing bank in Mexico. Mexican banks are regulated by the Commission Nacional Bancaria y de Valores (CNBV) which oversees Mexican banks and securities firms. The Mexican Financial Intelligence Unit (FIU), the Mexican Central Bank, and the Mexican Treasury Department all perform oversight functions. Similar to the U.S., Mexico has a well-developed set of AML laws and regulation (pg. 42) that financial institutions are required to follow. The U.S. Department of State issues an annual report, the International Narcotics Control Strategy Report (INCSR) of their risk assessment based on drug trafficking and money laundering. The U.S. State Department has consistently classified Mexico as a high-risk country.<sup>30</sup> In 2002 the INCSR described Mexico as follows:

Mexico faces a myriad of drug-related problems that include the production and transshipment of illicit drugs, money laundering, consumption and illicit firearms

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<sup>30</sup> See, e.g., "2000 International Narcotics Control Strategy Report," U.S. Department of State (hereinafter "2000

INCSR"), at 621; 2002 INCSR at XII-60; 2006 INCSR Vol. II at 39; 2008 INCSR Vol. II at 62; 2012 INCSR Vol.

II, at 33.

trafficking. ....Mexico remains a major supplier of heroin, methamphetamine, and marijuana, and the transit point for more than one half of the cocaine sold in the U.S. ... The industrial-scale drug trade has transformed narcotic trafficking into one of Mexico's deadliest businesses....

These organizations have demonstrated blatant disregard for human life...In recent years international money launderers have turned increasingly to Mexico for initial placement of drug proceeds into the global financial system.<sup>31</sup>

The State Department also wrote:

The smuggling of bulk shipments of U.S. currency into Mexico and the movement of the cash back into the United States via couriers and armored vehicles, as well as through wire transfers, remain favored methods for laundering drug proceeds. Mexico's financial institutions engage in currency transactions involving international narcotics-trafficking proceeds that include significant amounts of U.S. currency or currency derived from illegal drug sales in the United States. Although drug trafficking continues to be the principal source of the laundered proceeds, other crimes including corruption, kidnapping, firearms trafficking, and immigrant trafficking are also major sources of illegal proceeds."<sup>32</sup>

According to U.S. law enforcement officials, Mexico remains one of the most challenging money laundering jurisdictions for the United States, especially with regard to the investigation of money laundering activities involving the cross-border smuggling of bulk currency from drug transactions. While Mexico has taken a number of steps to improve its anti-money-laundering system, significant amounts of narcotics-related proceeds are still smuggled across the border. In addition, such proceeds can still be introduced into the financial system through Mexican banks or casas de cambio, or repatriated across the border without record of the true owner of the funds.<sup>33</sup>

Additionally, other reports produced by multiple agencies and FinCEN were directed directly to financial institutions operating in the U.S, supporting the risk assessment made by INCSR.

As part of its internal control system, HSBC performs an AML country risk assessment using four categories of risk from low to high: STANDARD, MEDIUM, CAUTIONARY, and HIGH. A chart characterizing the country risk assessment and recommendations is created and sent to each affiliate, allowing each to make its own assessment decision (pg. 42). Performing an external assessment of risk is standard in many industries and is simply recognized as good

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<sup>31</sup> 2002 INCSR, at V-27-V-28.

<sup>32</sup> Id. at XII-161.

<sup>33</sup> 2006 INCSR, at 268-269

business practice. HSBC compiled the risk assessments every six months using a variety of information sources. The information was rated by an AML officer who assigned numerical scores to each piece of information. The scores were then aggregated to form the specific country risk assessment. HSBC performed this task for over 200 countries. These individual country scores are aggregated with the intent that the rating will be used by each affiliate in setting up their internal controls and risk assessment strategies.

Although the scores are used to assign risk ratings, countries with similar scores often received different risk ratings. The differences were attributable in part to HSBC's practice that allowed its affiliates to use a 'discretion factor' in arriving at the final risk assessment. The primary U.S. regulator for HBUS (HSBC's U.S. affiliate), the Office of the Controller of Currency (OCC), found that the 'HBUS discretion factor' was listed as an official part of the risk assessment process and was used by HBUS to alter the risk ratings of over 60 countries in 2009. The OCC notes that HBUS did not provide any documentation or discussion pertaining to what constituted permissible reasons to use the 'discretion factor' to change the risk ratings of individual countries (pg. 43). For years, Mexico received the lowest risk rating (i.e. STANDARD) despite the other external assessments showing its high risk of money laundering and other criminal activity.

The classification method used by HBUS facilitated two types of business practices. First, wire transfer of funds was increasing at HSBC, and increasingly, wire transfer was being used as a means of laundering money. At HSBC, two-thirds of the total volume of wire transfers each year occurred from countries with listed risk rating of STANDARD or MEDIUM, the two lowest risk categories. According to the OCC, this represented a \$60 trillion cash movement. From an internal controls perspective, this cash movement would not be monitored as part of routine AML practice resulting in efficient banking practices for the customers but can also be facilitating money

laundering practices. And second, with respect to Mexico, the internal control system would treat all customers as having a low risk rating unless HSBC designated the client as Special Category Client—indicating that the client poses a high money laundering risk. The consequence of using the overall country risk rating for all clients in Mexico is that high risk clients residing in low risk countries could escape enhanced due diligence and account monitoring.

In the context of internal controls and monitoring, standardized processes lead systems away from discretion, creating a more uniformed process of decision making, yet in the changing business world with new and different opportunities being presented, managers are allowed a certain amount of discretion. At HSBC, we observe how the discretion factor both facilitates a client friendly environment while simultaneously facilitating negative practices. Discretion allows the individual actors to draw upon the capital they possess and allows the actors to utilize their habitus in making decisions about opportunities within the field. The specific risk designation makes visible the ranking of the country and in turn determines the level of controls used in doing business with the affiliate. But discretion in this case masks the method of arrival at the final visible stage. Actors within the bank using the risk rating to make decisions pertaining to transactions and accounts would not question the risk rating or the process through which it was determined. Hence the discretion used becomes embedded in all future transactions as well as in the decisions that are based on the risk assessment.

### ***Historical Records***

As part of the decision to purchase Bital in 2002 from HBMX, HSBC Group performed an audit of Bital's compliance program and found a range of specific deficiencies. The use of internal auditors and external audits continue to be one of the major techniques of surveillance of

multilateral firms (Hanlon, 1994; Power, 2007; Arnold & Sikka, 2005) and the results of the audits generally become future action items to be followed up in subsequent audits. We group the findings of the internal audit into two major areas that deal specifically with the design of internal controls. First, the report highlights a lack of client information pertaining to transactions and accounts as listed below:

“FRBNY [Federal Reserve Bank of New York] review in 12/2000 identified that 82 of the 248 accounts reviewed lacked full documentation.

And

A review ... of documentation of accounts booked at the target’s Cayman Islands branch ... found that 41% of the accounts reviewed (92 of 224 reviewed) lacked full client information. 37 files had no client information. ...

Know Your Customer information (KYC) is a legal requirement for all financial institutions to collect relevant information pertaining to their client’s address, employment, business and nature of transactions. This information is stored in the client information file and built into the institution’s database to monitor transactions.

Although KYC initiatives have been present in most financial institutions for some time, the level of detail of information is different for different institutions.

Complete and accurate information is mandatory for maintaining a good AML system. KYC weaknesses (pg. 61) in new accounts can lead to a high volume of red flags or no flags based on the nature of the weakness.

KYC rules are used to determine whether or not specific transactions are viewed as suspicious activity; however, suspicious transactions are limited to those identified by the control system and are further narrowed to include only those transactions deemed suspicious by the reviewing employees of the financial institution. The characteristics that determine suspicious activity can be changed based on patterns of similar transactions which have become the norm.

These changes may not be a direct intent to change KYC information, nor to manipulate transactions to produce fewer red flags, but in situations where decision making is slow or there is a backlog of transactions to be cleared, it may be simpler to merely allow particular transaction to go un-reviewed.

The lack of KYC information coupled with HSBC's Group policy of allowing its affiliates to assume that any HSBC affiliate owned 50% or more by the Group met the anti-money-laundering (AML) low risk standards, did not require any further due diligence prior to opening a correspondent account. This meant that clients with accounts at HBMX without KYC information could have access to U.S. correspondent accounts without any prior screening.

Second, the report highlights the need for a control system that has the capability of analyzing clients' transaction history:

- The [monitoring] system does not have any capacity to aggregate transaction activity for any period other than a given day ... [and] does not identify high risk clients as such. ...
- Private banking operations per se, are not identified. ...

And

- Client transaction and activity monitoring is very limited. The reliance on account managers to identify and report unusual and suspicious transactions of their clients is a serious internal control shortcoming. ...

In response to this deficiency, HSBC implemented a new monitoring system known as the Customer Account Monitoring Program (CAMP) and hired a new Money Laundering Deterrence Director. These actions taken together give the sense and visibility that the internal control issues at the time of acquisition have been addressed. The new monitoring system, CAMP, supposedly provides the capability of monitoring and reviewing customer transactions, hence regulators would be more confident that the rules are being followed. Additionally, affiliates would not be in a



position where they do not trust the information from HBMX. The structure of HBMX was being made similar to the structure of the other HSBC affiliates, demonstrating consistency across banking groups. In May 2004, the internal auditors of HBMX filed a report with the findings that HBMX's AML function was operating 'below standard':

HBMX has insufficient controls to detect money laundering transactions in all areas of the Group in a timely manner. The implementation of the CAMP system is in process yet it only includes the Bank's transactions that have been registered in the Hogan system and fails to monitor those registered in other IT systems/HBMX subsidiaries. Direccion de Prevencion de Lavado de Dinero [Direction of Money Laundering Deterrence] has identified high-risk areas of money laundering transactions, which are not being monitored. The communication between LCOs [Local Compliance Officers] and Compliance does not enable the timely detection of the needs and weaknesses of the areas and subsidiaries. There are inadequate internal controls over the IT systems used to send information to the regulator on suspicious or relevant transactions to authorities. In our opinion, based upon the foregoing, the Direction of Money Laundering Deterrence is operating with a **BELOW STANDARD** level of Control Risk.<sup>34</sup>

Although this report highlights serious concern about the internal controls of HBMX and the potential negative effects of business transactions originating in Mexico, no additional actions were taken by the HSBC head office to alert other affiliates of the potential risk of dealing with transactions with HBMX. The internal audits are not seen by Group affiliates and it was business as usual between HBMX and HBUS—who process the majority of U.S. dollar transactions from Mexico. These are the same issues that arose at the time of acquisition; however there was no additional need to either change the visibility of the issues by raising attention to its affiliates, or change any business practices since on the surface all actions appeared to follow good business practice. It has also been argued that in times of uncertainty, organizations mimic other successful

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<sup>34</sup> May 2004 "Informe General de Auditoria HBMX GAQ 040026 Compliance-Money Laundering," prepared by

HSBC Group's internal audit (Auditoria Interna Del Grupo), HSBC OCC 8874376-381.

organizations in terms of practice and processes (DiMaggio & Powell, 1983). HSBC's implementation of the CAMP technology and assigning a Director of money laundering can be viewed as a mimicking process, where such practices have been copied from successful parts of the same organization.

#### ***4.7.2 Creating Process Visibility***

##### ***Volume Processing***

Information systems assist with the routine, daily decision-making processes that would otherwise occupy a fair amount of employees' time and other organizational resources. Discussion on management control systems have often highlighted the importance of monitoring decisions and activities by labelling the control mechanisms for these processes as output controls or results controls (Mintzberg, 1979; Ouchi, 1977; Merchant, 1985). These systems provide assurance that the decisions are in line with the organizational goals. These formal information systems referred to as diagnostic controls by Simon (1995) are described as having three characteristic features: (1) the ability to measure the output of the process, (2) the existence of predetermined standards against which actual results can be compared, and (3) the ability to correct deviations from the standard s(Simons, 1995). These standards are adjusted from time to time based on changes in the environment or other internal processes and variances.

One example of environmental and regulation change came about as the Unites States began paying more attention to terrorist financing. In an effort to prevent money laundering and terrorist financing, the United States prohibits doing business with certain persons and entities in particular

jurisdictions. The U.S Treasury Department's Office of Foreign Assets Control (OFAC) has developed a list of those prohibited persons and countries which banks and financial institutions use to create an 'OFAC filter' to identify and halt potentially prohibited transactions. Transactions halted at the bank in this manner would then go through a manual review process to determine if the transaction should be processed (Pg. 118).

These halted transactions require organizational attention. And organizational attention requires the allocation of resources and information processing capacity to support this process (Simon, 1995). In addition to the financial institution's resources (management time and expense), it is possible for transactions stopped by the OFAC filter for further review to undergo substantial processing delays. Although not all halted transactions are associated with illicit cash flows, in some cases payments may be blocked and held for years (pg. 113). This type of issue has three interconnected yet separate implications for banks. First, the control system must be designed in a manner to allow rapid changes, since the external OFAC list can change often and the system has to detect suspicious activity without generating unnecessary red flags. Second, when a red flag is generated, the bank must have a clear and rapid process for resolving the issue. This process requires 'human interaction' to resolve the issue. Resources must be re-directed from other internal tasks to give the issue the organizational attention it requires, and discretion enters the process. And third, in one sense the banks must act to prevent illicit cash flows, but banks also exist to facilitate cash flow transactions on behalf of its clients. From the clients' perspective, payment transactions are of high importance and urgent, since businesses do not generally 'give up' cash until it is necessary to do so. Halted transactions can then create tensions between the bank and its clients, with both parties trying to resolve the issue in an efficient manner. Banking clients have a choice, and such issues can lead to reputational risk since clients would be attracted to banking

institutions that are perceived to have the capability of performing these transactions in an uninterrupted manner. Because of these issues arising from potentially halted transactions, banks and financial institutions have an incentive to minimize the halted transactions, then, should a transaction be halted, reduce the processing time. HSBC has developed several tactics or techniques for dealing with, and facilitating, such business processes.

### ***U-turn transactions & Information Stripping***

Dating back to 1979, Iran has been on the list of prohibited countries established by OFAC; as a result financial institutions have designed OFAC filters to prevent transactions that made reference to Iran from being processed.<sup>35</sup> However, during the period 1995 to 2010, the regulation included an exemption to the prohibited transactions known as a ‘U-turn’ transaction which only allowed those transactions that began and ended in non-Iranian banks. According to the U.S.

Treasury Department:

This is commonly referred to as the ‘U-turn’ authorization. It is so termed because it is initiated offshore as a dollar-denominated transaction by order of a foreign bank’s customer; it then becomes a transfer from a correspondent account held by a domestic bank for the foreign bank to a correspondent account held by a domestic bank for another foreign bank; and it ends up offshore as a transfer to a dollar-denominated account of the second foreign bank’s customer.<sup>36</sup>

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<sup>35</sup> C.F.R. Part 535, Iranian Assets Control Regulations, and 31 C.F.R. Part 560, Iranian Transactions

Regulations, which together comprise the Iranian sanctions program. Initial Iranian sanctions regulations, now detailed in Part 535, were created on November 14, 1979, after U.S. diplomats were taken hostage in Tehran, and President Carter blocked assets located in the United States belonging to the Government of Iran. On October 29, 1987, following Iran’s expressions of support for international terrorism and aggressive actions against non-hostile shipping in the Persian Gulf, President Reagan issued Executive Order 12613, the predecessor to Part 560.

<sup>36</sup> See Treasury website, [http://www.treasury.gov/resource-center/sanctions/Documents/fr73\\_66541.pdf](http://www.treasury.gov/resource-center/sanctions/Documents/fr73_66541.pdf); OFAC

Hence, the regulation allowed banks and financial institutions to clear U.S dollar transactions for Iranian clients as long as the transaction met the requirement of using non-Iranian intermediaries. U-turn transactions do not guarantee that the payments would not be flagged by the OFAC filter; however, if the transactions meet the U-turn requirements they will be processed. In many cases banks are aware that the transactions can be processed and yet the transactions are flagged for review. This process requires additional attention and can result in increased cost to the customer and lead to tension between the bank and its customers.

Since U-turn transactions can be complicated, HSBC affiliates looked at other processing methods that could reduce the probability of the transaction being flagged by the OFAC filter at HBUS (the U.S division) and result in processing delays.

One method used by HBEU (Europe) to process U-turn transactions efficiently through HBUS was to manually alter the documentation, removing any reference to Iran that might trigger the OFAC filter (pg.14). This alteration took place at the HBEU prior to sending the request to HBUS. Although we do not know at which level of staff this alternation occurred at HBEU, the process shows us how practices are being adopted to bypass the OFAC filter and facilitate the business process. This takes a practical understanding of the specifics of what language is acceptable by the design of the OFAC filter. HBEU was not the only HSBC affiliate to structure transactions to avoid the OFAC filter at HBUS. Another HSBC affiliate, HBME (Middle East) was also taking action to restructure payment transactions that appeared to be sensitive to the OFAC

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website, <http://www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets->

Control.aspx, at 2.

filter. In October 2001, the HBME Regional Head of Compliance was unsure whether the process they were using was appropriate and sought advice from the HSBC Group Compliance Head on dealing with OFAC sensitive transactions. According to Mr. Bagley's email<sup>37</sup>:

As I understand the current position we do routinely, and across the Group, adopt differing approaches to payments potentially subject to OFAC sanctions.

Highlighting that different Group affiliates may have differing practices when handling OFAC sensitive transactions. Mr. Bagley further explained that at HBME, payments were structured in this manner without the clients' explicit consent or knowledge:

At HBME, payments were not structured "against a specific request from the customer, rather we undertake this structuring as a routine," and that he was not clear about whether those procedures were viewed "as being inappropriate, and thus should be disallowed."

Structuring the transactions to avoid the OFAC filter had become common, routine practice, at least at two HSBC affiliates—which indicates the development of patterned practices across the Group to avoid the OFAC filters and to promote efficient business practice. He also wrote:

"I am advised that there may even be software in the UK which filters such payments for restructuring in the event that the original message has been structured in such a way that it will be caught by the OFAC filters."

Additionally, Mr. Bagley highlights that concerns with OFAC filters are with more than just the two affiliates identified, and technology is being enhanced to that ensure straight-through processing is successful. It appears that patterned practices are emerging because bank affiliates strongly believe that the transactions are legal, and that these enhanced processes will relieve personnel of any additional work that may be created if the transactions are caught in the OFAC filter.

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<sup>37</sup> 10/10/2001 email exchange among HSBC Matthew King and HBME David Bagley and others, "OFAC Sanctions," HSBC OCC 8873890-893, at 892.

HBUS has concerns that the processing methods being adopted by its affiliates could become an issue during regulatory audits and that this ‘new process’ of altering client documentation was against the guidelines set out by FATF<sup>38</sup> and the OFAC. During the period 2000-2001, HBUS sent various emails to its head office as well as to its affiliates outlining the potential issues and its dissatisfaction with the process, but did not take any direct action to stop the transactions.<sup>39</sup> In January 2001, HBUS also took the additional steps of consulting two law firms and the OFAC on handling transactions with the Iranian banks i.e. Bank Melli or Iran’s Central Bank, Bank Markazi. The law firms concluded that the transactions with Bank Melli could be considered as U-turn transactions. The details were emailed to HSBC’s Head Office and forwarded to HBME.<sup>40</sup>

HBUS created process visibility by showing and documenting that it had acted with due diligence. HBUS first raised the issue that the process may not be acceptable to the regulatory bodies, then it sought legal advice to protect itself from any reputational risk that may occur as a result of these transactions. HBUS continued with the transactions, in most cases without delay, facilitating the business practices. Although it appears that HBUS felt strongly about the transactions, no action was taken to prevent the direction, putting visible documentation in place in the event of an audit.

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<sup>38</sup> FATF is the Financial Action Task Force, the leading international body that set standards for combating money laundering and terrorist financing.

<sup>39</sup> 7/11/2001 email from HBUS Douglas Stolberg to HBUS Denise Reilly, HBUS Joe Harpster, and HBUS Michael

Gallagher, “Bank Melli,” HSBC OCC 8876129.

<sup>40</sup> 4/27/2001 email from HBME Brian Richards to HSBC Matthew King and others, “OFAC – Iran,” HSBC OCC

HBUS proposed a method of segregating Bank Melli's transactions with full detail of the transacting parties; however, the HSBC Group was concerned that the process would be too lengthy and ultimately hurt business. Mr. Bagley wrote<sup>41</sup>:

...disallowing all payments which are potentially subject to the OFAC process," or the alternative of forwarding "messages in such a way that they would be caught," would have a "significant affect" upon HBME's business within the Middle East and the Group's business within correspondent banking.

Mr. Bagley was also concerned about the resources HBUS would have to allocate to this process if all transactions were subject to the review process. He also wrote:

"given the likely volumes it is impractical to submit each payment to a process of referral to HBUS,"

Although the Group affiliates all function under the same HSBC umbrella, each Group affiliate is concerned with creating a visible process based on its own environmental conditions while simultaneously trying to maintain an effective and efficient business environment. The different boundary systems (Simons, 1995) for each affiliate create different risks to be avoided and the environment for HBUS is different than the environment for HBME or HBEU, which creates different opportunity sets. These risks and opportunities dictate what is made visible. This analysis also shows us that, in this context tension is created not only as a result of the conflict between customer satisfaction and regulatory requirements, but also as a result of varying regulatory requirements in different jurisdictions.

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<sup>41</sup> 10/10/2001 email exchange among HSBC Matthew King and HBME David Bagley and others, "OFAC Sanctions," HSBC OCC 8873890-893, at 892.



### ***4.7.3 Skillful Practice***

#### ***Form-Based Transactions—The U-turn Alternative***

In an effort to ease the tension and facilitate a straight-through processing method (STP) that would not require any human intervention while ensuring that such payments would not be stopped by the OFAC filter, HSBC affiliates, namely HBEU (Europe) and HBME (Middle East), began using a tactic known as "cover payments". In this context, the cover payments are bank-to-bank wire transfers without any reference to the originator or beneficiary of the funds. The cover payments utilize an information processing system known as SWIFT<sup>42</sup>. Society for Worldwide Interbank Financial Telecommunication (SWIFT) enables its customers to automate and standardize financial transactions, thereby increasing efficiency and reducing costs. The SWIFT transfer system 'arranges a cover' for the payment transaction by breaking the transaction into two individual and visually independent transactions. First, the SWIFT- MT202/203 payment instruction format provides the U.S bank, in this case HBUS, with the names of the foreign bank acting as the originator or beneficiary of the immediate transfer, but is not required to also provide the underlying origination and beneficiary customer information. This part of the transaction allows a U.S dollar payment to occur as long as the transacting intermediary is not on the OFAC watch list. The second part of the transaction is completed using the SWIFT- MT100 message, which provides full payment details for the originator and ultimate beneficiary. This method provides a means of making a payment in U.S. dollars without any risk of delays from the OFAC filter or human intervention. This is a standard and visible banking practice that was utilized by

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<sup>42</sup> SWIFT acts as a United Nations sanctioned International Standards Body (ISO) for the creation and maintenance of financial messaging standards.

both HBEU and HBME as an alternative to U-turn transactions. This alternative was used although the banks believed the U-turns were fully legal transactions. The primary motive of this alternative was to facilitate straight-through processing by bypassing any possibility of the transaction being halted by the OFAC filter—causing delay due to human intervention—hence facilitating efficient business practices while reducing tensions between the bank and its customers.

This process design requires an intimate knowledge of the internal control systems and of the banking processes, and it highlights how skillful practice is used to facilitate customer transactions in an efficient manner.

### ***Customer Training***

In 2001, HSBC's European affiliate (HBEU) had an opportunity to increase its business with the Central Bank of Iran and Bank Melli, the largest corporate banks in Iran. Through discussions with the Central Bank of Iran, it had become known to HBEU that the Iranian bank was dissatisfied with NatWest and was seeking another business partner for U.S dollar clearing (HSBC OCC 887618, pg. 196, Exhibit #41, Exhibits). HSBC was looking at increasing its presence in the Middle East due to increasing business opportunity, and viewed the opportunity as highly important since many other banks were also bidding for this opportunity. An email between senior HSBC executives from HSBC Asia-Pacific to HSBC Midland bank (UK) explains:

One of our key initiatives for the year is to develop HSBC's Asset Management activities in Iran and with the Central Bank now managing the oil price stabilization fund amounting to some USD 10bn there is considerable scope for this. Obviously many foreign banks are chasing the same business and so we need to demonstrate some competitive or relational advantage.

His comments give us a clearer understanding of the magnitude of this business and how a specific group within HSBC is ‘hand picked’ for such a project:

“In summary if we can make this business independently profitable and sustainable the benefits that we can derive particularly from the Treasury Asset Management and Investment Banking spin offs will be substantial. I want therefore to agree a strategy of how we go forward and who we involve before we make any further contact so that I am aware of all the issues involved.”

This executive makes it very clear that the US dollar clearing business is a very important part of this project since without it they will not have access to larger asset management and investments, signalling his intent of a hand-picked group:

“They (the Iranian Central Bank) have become dissatisfied with NatWest and with the exception of Lloyds, who will have the same issues we have there is little competition. I also assume that our technology advances will make the business more attractive than it was in the past.”

There appears to be an implicit understanding that issues exist with the proposed line of business and with the execution of the required transactions. To facilitate this line of business, HBEU had two proposals as mentioned earlier. The first example is to use a U-turn transaction and the second is to avoid the U-turn by using the alternative form-based two-step process.

The process began with HBEU personnel in the Multicurrency Payment Department (MPD) performing alterations to the clients’ documents to facilitate straight-through processing at the US affiliate HBUS. This process appeared to be an undocumented process where some of the employees were instructed in how to change the documents. This is evident from inter-bank correspondence explaining why a particular transaction was halted by the OFAC filter.

“in this instance MPD failed to spot the poor input and did not follow their normal procedure of altering the payment, hence it was blocked”<sup>43</sup>

Following this type of delay, HBEU embarked on the process of training Bank Melli to minimize the chances of delays and increase straight-through processing. On April 30, 2001 HBEU’s Multicurrency Payment Department sent a letter to Bank Melli outlining the details of how the MT202 and MT100 SWIFT forms must be completed, detailing exactly what information must be included, the language that must be used and what to omit. Specific fields were identified, and explanations were given on filling out the form. The email to Bank Melli’s Cash and Payment Manager in London included the templates with clear instruction and requested that Bank Melli perform a test to ensure that the process works. (HSBC OCC 8876135, pg. 203)

“[F]ollowing tests in our payments environment we are confident that we have found a solution to processing your payments with minimal manual intervention. The key is to **always** populate **field 52**—if you do not have an ordering party name then quote “One of our Clients”, **never leave blank**. This means that the outgoing payment instruction from HSBC will not quote “Bank Melli” as sender—just HSBC London and whatever is in Field 52. This then negates the need to quote “DO NOT MENTION OUR NAME IN NEW YORK” in field 72.”

The email further explained the options for the testing method:

“In order to test our proposed solution, we would appreciate if used the following templates when submitting your next payments to the following customer or alternatively submit a USD 1 test payment.”

This process highlights four important aspects of facilitating business practice and visibility. First HSBC designed a process from an existing form-based structure to avoid the OFAC filter and promote straight-through processing with minimal human intervention. This process utilizes an existing, well recognized method of performing bank transactions which makes it easy for actors in

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<sup>43</sup> 6/28/2001 email from HBEU John Wilkinson to HBUS Denise Reilly and others, “Bank Melli,” HSBC OCC

8876132-133, at 133

the industry to identify what the forms are and what they mean. In essence, this process draws on the existing knowledge of the field, knowledge that in many cases becomes second nature to the field participants, leaving less room to question the integrity of the process. Second, after starting with a few handpicked personnel for the project, HSBC tested and implemented a formal business process that everyone could follow. Training the Bank Melli's employees removes the possibility that HSBC's employees can make errors in processing and places the onus of filling and checking the forms on the clients' employees. Like any good business process, HSBC is reducing its workload and internal processing time by shifting the work to the client, making the process standardized and routine. The training disciplines those filling out the forms to follow the specific process, to get the process right so that there are no delays in the transaction. Third, HSBC using this process has shown that even in the complex banking industry, understanding how the control systems work can create an advantage in reducing tensions with customers. Although HBEU, HBUS, and HSBC Group Compliance continued to discuss methods of dealing with the Iranian transactions, HBEU moved ahead with its efforts, and HBUS continued to process the transactions. And fourth, we see that discretion, which is commonly viewed in control systems as giving power to overrule or bypass specific situations, are being removed from the process in favor of a more rigorous process that increases transparency.

#### **4.8 Discussion**

The current study has examined how the HSBC Group has utilized the information from the external environment in developing parts of its internal control system, and how internal control systems are used to create a system of visibility for its processes while facilitating business practices. The paper has also shown how, in this particular situation, the illusion of objectivity was

created by providing a paper trail supporting particular issues that were raised. We started from the premise that success in this industry partially depends on (i) the treatment or classification of the monies based on the rules and regulations of the industry, and partially (ii) on the in-depth knowledge and skills possessed by the actors involved in the MCS within the financial institution. We have looked at both MCS design and practices as a second order response to regulation.

Although through our analysis we attempted to isolate three key areas, i.e. designing internal controls, process visibility, and skillful practices, these are not isolated from each other but are in fact closely intertwined. Skillful practices, both emergent and conscious, affect the design of MCS and created process visibility. The evidence from our analysis shows how MCS both respond to regulations and are learned through practice and memos.

By analyzing internal control design from an environment risk perspective, we have shown how HSBC selectively utilizes the environment risk information produced by third parties. For many years it has been known that Mexico is a high-risk jurisdiction pertaining to drug trafficking and money laundering, yet this information was accidentally omitted from the country risk rating. But we also see how omitting the information has put HSBC in a position of advantage in two ways: First, this "accidental" omission coupled with unexplained discretion has reduced the risk rating sufficiently to allow all existing clients of the Mexican affiliate to have access to US dollar correspondent accounts, thus increasing the potential for cash flow between the two affiliates and ultimately between the two countries. And second, this process created a visible system for the regulators showing that HSBC has performed its due diligence and that the operating practices are legitimate. We show how different control systems, which would normally be expected to work as a disadvantage, were turned into an advantage by a policy treatment by HSBC that allowed its employees to treat all affiliates as if they met the standard of the US affiliate.

This analysis shows how the perceptions of a field changes given different rules. Prior to the merger, Mexico was seen as a high-risk environment, but once assimilated into HSBC, the business practices continue as if, by the mere act of acquisition, the Mexican affiliate became the same as the other affiliates. Internal policies are a part of structures and this process shows how closely policy and practice are linked within this context. Knowing the policy was accepted, the practices simply followed. The policies are part of the material arrangements within the system (Schatzki, 2005; Ahrens & Chapman, 2007, Neu et al, 2012) and have restructured how the field is seen by the employees. The internal control was shaped by the risk assessment information and in turn, the internal controls are shaping practice.

On one hand our analysis of the Mexican affiliate highlights the role of discretion as offering the flexibility to makes decisions, given the information presented; while on the other hand our analysis of the Iranian transactions shows that they strived toward a point of no discretion. This shows that creating a system of visibility is dependent on the consumers of the information. HSBC has also shown that the use of information and discretion can be used to shape strategy. Simon (1995) argued that strategy is both planned and emergent and our analysis of the Mexican and Iranian transactions support this notion.

Our analysis highlights the use of form-based transactions and its role in instituting a practice. The form-based process creates process visibility—but only regarding the parts of the process that the form highlights and the information presented. In other words, parts of the process and information are also hidden or made invisible by the use of forms. HSBC created a system of visibility by using standardized forms from an established and institutionalized practice. The SWIFT information processing system is used by most financial institutions. Forms only allow specific fields to be filled out, and the training HSBC provided to its client not only guaranteed a

fixed process, it also determined the language to be used and specifically shows what information should not be provided. This is another example of using artifacts to structure and organize the field. The form helps to organize the field in several ways. First, the form determines what information is collected and placed on the form and also what information is omitted. Second, the form becomes part of an auditable digital archive. This provides a permanent system of visibility, further giving the appearance of a transparent system. Training on the use of the forms restructures the capital in the field by changing the knowledge required at specific roles. And finally, the use of the form is geared towards eliminating the human interaction which would involve discretion, with preference for straight-through processing.

Our analysis also shows that knowledge of control system design facilitates business processes by allowing those with the specific knowledge the ability to work within and around the rules of the system. Using Bourdieu's notion of the field and power, we observe that individual actors with this knowledge (capital) are able to work with internal control systems to change the field, resulting in a position of power or advantage. The increased position of power occurred on two levels. First, although there was the constant tension between the Group affiliates pertaining to the treatment of Iranian transactions, the European affiliate proceeded without being challenged. And second, the analysis also showed that being able to work within and around the OFAC regulations placed HSBC in a position of competitive advantage with the Iranian banks.

In this instance, the MCS was built around the artifacts and interpretations of particular forms, records, policies, and processes which were not only used to create a system of visibility, but also used in some cases to create a sense of illusion. While a system of visibility was being created among banking affiliates, using processes such as U-turn transactions and straight-through processing, a sense of illusion was being created for the OFAC and regulators by documenting



issues, and using external law firms for legal verification processes. In addition to highlighting the role of MCS in facilitating these negative practices, the line of research touches upon the broader practices of visibility and illusion. Inherently, as particular aspects of a process are illuminated, other aspects become less visible and, in some cases, a more visible process may not allow actors to focus attention on the important aspects. We have shown how the use of form-based transactions cause attention to be focused on particular fields for correctness while eliminating other aspects of the transaction that could cause a flag to be raised and the transaction halted.

#### **4.9 Conclusion**

In conclusion, our analysis encourages us to consider that working around rules may provide a competitive advantage in one aspect but can also facilitate negative practices such as money laundering. HSBC created a system of visibility using its internal controls to facilitate its business practices while eliminating potential tensions between the bank and its customers. But HSBC also created a process that essentially circumvented the OFAC regulations. Although the transactions may have qualified as U-turn legal transactions, the straight-through processing has made it impossible to detect which transactions are legal and which ones are not. This reasoning also holds for the sweeping policies used to categorize all Mexican clients as low risk.

These highlighted practices belong to a broader range of practices that operate to organize the banking field in a manner that allows business to work around the regulatory structures. Continued use of such practices becomes the norm where regulation is not seen as barriers but rather as objects to constantly work around or renegotiate to facilitate business operations. The use of Schatzki's (2005) theoretical frame allowed a good analysis of how the use of the artifacts and practices, i.e. the banking forms, policies and procedures, informs and shapes the MCS and the

processes each bank follows. However, our analysis leads us to look at how practices, both emergent and conscious, become embedded as part of the MCS forming institutional rules and guidelines, demonstrating how the MCS is a living, breathing system which is continually evolving.

The analysis also leads us to consider how these practices migrate as the people within the organization move. Emergent and conscious practices may gradually become embedded in a person's habitus, and as these skillful practices accumulate within individuals, the value of these individuals to other organizations increases. As individuals change position or organizations, these skills as part of habitus, transfers to other organizations continuing the process evolution of the MCS and the growth of skillful practices within the banking sector. Hence these skillful practices become a part of the cultural capital of the individuals which then shapes not only internal controls but also the knowledge within the industry. These forms of capital, depending on where individuals move, can act to diffuse the tension between efficient banking and regulation, or it can enhance the tension.

## 5 Future Research & Discussion

This section of the research discusses the overall findings of the thesis and itemizes the potential for future research.

*How does money laundering persist and continue to increase or go undetected for extended periods of time given the institutional settings of increasing regulation, increasing monitoring and control systems at financial institutions, and increasing attention by accounting professionals?*

As a starting point to the research question as stated above, several other questions were raised, and these additional questions became the focus of the specific papers. The research first tried to understand how accounts and the role the accounting profession, be it certified accountants, auditors, or persons in accountancy not possessing an institutionalized designation, are seen by academic researchers. Given that institutional actors such as the International Federation of Accountants and the Association of Chartered Certified Accountants, have made the claim that accountants are on the forefront of the fight against corruption (ICAEW, 2002; IFAC, 2015; Kirtley, 2016; Tomlinson, 2017), understanding the role of professional and practicing accountants and whether they are seen as enabling, constraining, or standing on the side lines in the fight against money laundering and corruption helps us to understand, at least in part, how money laundering may persist for extended periods of time.

Accountants and other professionals are often implicated in the strategies of money laundering and as with many professions, it only takes a few ill or wrong doings for the community to be broad brushed as having a negative role in money laundering. The notion that accountants are the enablers or gatekeepers of corrupt practices, fraud and money laundering has to be worked on

to highlight the good accountants and the accountancy profession is doing in the fight against corruption and one way this research proposes is to call on accounting researchers to look at these aspects of accountants in specific contexts. This can help shed light on both context and the role of accountancy.

The second paper takes a deeper dive into the accounting strategies and mechanisms used to launder money in different sectors of the economy while taking a closer look at the role of accountants as well. This focus on accounting and the accountant's role in the complex relationships between organized crime and the mechanisms used to enable illicit financial flows into legal financial systems is one of the key premises of the research. The research takes the view in part that being able to launder large sums of money helps to propagate the crimes and corrupt practices that lead to the creation of money to be laundered. In other words, recognizing that being able to launder criminal proceeds helps to propagate criminal activities. This paper contributes to the body of research on corruption (Mitchell, Sikka & Willmott, 1998; Everett, Neu & Rahaman, 2007; Compin, 2008; Neu, Everett, Rahaman & Martinez, 2012; Cooper, Dacin, Palmer, 2013 ) by providing supporting evidence highlighting why such negative behaviors persist despite regulation and strong anti-corruption barriers (Neu et al, 2012).

First, the paper highlight some of the major areas of the production of money to be laundered: fraud, organized crime and drugs, the drug supply chain, corruption along the supply chain, and politically exposed persons and public corruption. Then the paper shows some methods of moving bulk cash into the financial system and highlights the financial system's vulnerability to money laundering. The case studies on two banks— Ocean Bank and Zions Bank—highlight how a bank's internal controls provide opportunities to money launderers; the case studies also

contribute to the existing literature by discussing several factors that ultimately lead to money laundering.

The paper discusses how banks' responses to regulators' allegations regarding issues of internal control deficiencies have become standardized, with banks neither admitting nor denying the issue of internal control problems, which leads to propagating internal control practices ultimately leading to money laundering. The paper also discusses how the response by regulators have become routine, with a lack of urgency. Regulators have become accepting of the shortfalls of banks and there is no real penalty for banks with deficient internal controls. The paper then discusses crime networks and accounting, with a focus on the capital needed in the field to (i) be able to structure the transactions and (ii) to become recognized as someone who can perform the tasks of money laundering. And lastly, the paper discusses crime network adaptability from the perspective of the value of the accountant and how accountants, either from within the crime network or as a contract firm, position themselves with the capital necessary to sustain the crime network and money laundering.

The paper also adds to the practice literature by highlighting some of the standard transactions and accounting techniques used by money launderers, with the hope that these can be used to detect money laundering activities at an early stage. There are many other areas where corruption and crime networks operate which are specific to different contexts and these must be studied to ultimately uncover more reasons for money laundering to persist. Technological advancement has created new opportunities for money laundering and the crime networks. This is an important area for future research, as technology will more and more be accessed to propagate crime activity and money laundering. The paper also proposes that by understanding how new crime networks come into existence, and how networks specifically focused on money laundering

strategies gain the capital necessary for survival, we can be a step closer to preventing such networks from operating.

This paper also highlights the need to change the narrative of the accountancy profession to a more positive and proactive role. The expectation is that the role of accountants will increase as technology and skill sets change in practice. The use of artificial intelligence is increasing, and accountants and auditors' roles will change as firms change their businesses. The role of the accountant in the fight against corruption may very well become much wider and deeper. Topics such as beneficial ownership and shell companies have been discussed with the belief that there will be new rules to follow.

Paper three examines the adaptive nature of Management Control System (MCS) practices within the banking industry; more specifically how control practices respond to changed money laundering regulations, but in ways that attempt to maintain a client-friendly focus. This study examines how the HSBC Group utilized the information from the external environment in developing parts of its internal control system and how internal control systems are used to create a system of visibility of its processes while facilitating business practices. The paper has also shown how in this particular situation, the illusion of objectivity was created by providing a paper trail supporting particular issues that were raised. Starting from the premise that success in this industry partially depends on (i) the treatment or classification of the monies based on the rules and regulations of the industry, and partially on (ii) the in-depth knowledge and skills possessed by the actors involved, pertaining to the MCS within the financial institution. We have looked at both MCS design and practices as a second-order response to regulation.

Although the paper attempt to isolate three key areas—i.e. designing internal controls, process visibility, and skillful practices—these are not isolated from each other but are in fact

closely intertwined with one another. Skillful practices, both emergent and conscious, affect the design of MCS and create process visibility. The evidence from our analysis shows how MCS practices both respond to regulations and are learned through practice and memos.

By analyzing internal control design from an environment risk perspective, we have shown how HSBC selectively utilizes the environment risk information produced by third parties. For many years it has been known that Mexico is a high-risk jurisdiction pertaining to drug trafficking and money laundering, yet this information was accidentally omitted from the country's risk rating. But we also see how omitting the information has put HSBC in a position of advantage in two ways: First, this accidental omission coupled with unexplained discretion has reduced the risk rating sufficiently to allow all existing clients of the Mexican affiliate to have access to US dollar correspondent accounts, thus increasing the potential for cash flow between the two affiliates and ultimately between the two countries. And second, this process created a visible system for the regulators showing that HSBC has performed its due diligence and that the operating practices are legitimate. We show how different control systems, which would normally be expected to work as a disadvantage, was turned into an advantage by HSBC's policy treatment, allowing its employees to treat all affiliates as if they met the standard of the US affiliate. This analysis shows how the perceptions of a field changes given different rules. Prior to the merger, Mexico was seen as a high-risk environment, but once assimilated into HSBC, the business practices continue as if, by the mere act of acquisition, the Mexican affiliate became the same as the other affiliates. Internal policies are a part of structures and this process shows how closely policy and practice are linked within this context. Knowing the policy was accepted, the practices simply followed. The policies are part of the material arrangements within the system (Schatzki, 2005; Ahrens & Chapman, 2007, Neu et al, 2012) and have restructured how the field is seen by the employees. The internal

control was shaped by the risk assessment information and in turn, the internal controls are shaping practice.

On one hand, the analysis of the Mexican affiliate highlights the role of discretion in offering decision-making flexibility, s given the information presented; n the other hand, our analysis of the Iranian transactions shows that they strived toward a point of no discretion. These differences demonstrate that creating a system of visibility is dependent on the consumers of the information. The HSBC case has also shown that the use of information and discretion can be used to shape strategy. Simon (1995) argued that strategy is both planned and emergent, a notion supported by our analysis of the Mexican and Iranian transactions.

The analysis highlights the use of form-based transactions and its role in instituting a practice. The form-based process creates process visibility, but only on the part of the process highlighted by the information present on the form. In other words, parts of the process and information are also hidden or made invisible by the use of forms. HSBC created a system of visibility by using standardized forms from an established and institutionalized practice. The Society for Worldwide Interbank Financial Telecommunication code also known as the SWIFT information processing system is used by most financial institutions. Forms only allow specific fields to be filled out, and the training HSBC provided to its client not only guaranteed a fixed process, it also determined the language to be used and specifically shows what information should not be provided. This is another example of using artifacts to structure and organize the field. The form helps to organize the field in several ways. First, the form determines what information is collected and placed on the form and also what information is omitted. Second, the form becomes digital archival records that are auditable. This provides a permanent system of visibility, giving the appearance of a transparent system. Training on the use of the forms restructures the capital in



the field by changing the knowledge required for specific roles. And finally, the use of the form is geared towards eliminating human interaction—which would involve discretion—and replacing it with a preference for straight-through processing.

This analysis also shows that knowledge of control system design facilitates business processes by allowing those with the specific knowledge the ability to work within and around the rules of the system. Using Bourdieu's notion of the field and power, we observe that individual actors with this knowledge (capital) are able to work with internal control systems to change the field, resulting in a position of power or advantage. The increased position of power occurred on two levels: First, although there was the constant tension between the Group affiliates pertaining to the treatment of Iranian transactions, the European affiliate proceeded without being challenged. And second, the analysis also showed that being able to work within and around the Office of Foreign Assets Control (OFAC) regulations placed HSBC in a position of competitive advantage with the Iranian banks.

In this instance, the MCS was built around the artifacts and interpretations of particular forms, records, policies, and processes which were not only used to create a system of visibility, but also used in some cases, to create a sense of illusion. While a system of visibility was being created among banking affiliates, using processes such as U-turn transactions and straight-through processing, a sense of illusion was being created for the OFAC and regulators by documenting issues, and using external law firms for legal verification of processes. In addition to highlighting the role of MCS practices in facilitating these negative practices, the line of research touches upon the broader practices of visibility and illusion. Inherently, as particular aspects of a process are illuminated, other aspects become less visible and, in some cases, a more visible process may not allow actors to focus attention on the important aspects. We have shown how the use of form-

based transactions cause attention to be focused on fields for correctness while eliminating other aspects of the transaction that could cause a flag to be raised and the transaction halted.

Overall, the three papers help us to understand how money laundering persists and goes undetected for long periods of time, but we must recognize that even the word “undetected” does not imply that it was not seen, but instead it’s more about the visibility and where our attention is permitted to focus. The following areas are just a few that require attention and can help us understand this topic:

1. The Role of Regulation in Curbing Money Laundering. An assessment of the stock market reactions to regulatory action.
2. An area identified as a potential space where negative practices can fester is in the positioning of the regulators within the regulatory system and the levels of power accorded to different regulators.
3. Red flags and the banking industry.
4. The role of ethics in the banking industry

The research started from the premise that when tensions exist within the field, pockets or spaces are created which allow money laundering to fester and grow undetected for extended periods of time and has further considered how accounting practices become standardized and embedded as part of the money laundering process. Although each paper has its individual contributions, there are a few points worth discussing as part of the overall thesis. The research has also looked at management control systems and its use in identifying “red flags”, and has shown how these very systems, set up to identify routine suspicious activity, can be used to by-pass these identifications and allow negative or corrupt activities to persist. In one sense, this can be seen as

enabling practices (Neu et al., 2006; Miller & Rose, 1990) that banks perform to facilitate “normal business transactions”.

While paper one has helped us to better understand how accountants and auditors are viewed through the lens of researchers, it is somewhat surprising to find that tensions exist within this sub-field. What is being said in the practice journal is different than what is being said by the professional accounting bodies. This analysis encourages us to think more carefully about how we utilize the information we acquire through research and how we inform practicing accountants of the research findings. To help in the fight against corruption and money laundering, researchers must join the fight with practicing accountants and share the findings in a positive light. While the research has shown how skillful practice is being used to propagate negative practices, we can utilize the research to strengthen the institutional training programs in accountancy. We should also consider highlighting more of the positive work accountants are currently doing in the fight against corruption.

Although it may be clear that context matters—as shown in paper two and paper three using the HSBC case study—paper three brought to light a struggle for position within the regulatory bodies themselves. The regulatory structure is a field on its own and I believe this research has only touched the surface of how the battle for position, and complacency within the regulatory bodies, help to create the spaces that allow negative practices to persist. This research is not advocating that this is intentional by any means; however more research in this area may help to reduce the negative behaviors. One of the future studies proposed is the work on “red flags”—how they are generated and how the information is used. The HSBC case study also encourages us to reconsider the process of moving money itself, and how human intervention in the process at a high level can make negative practices routine, in a manner that allows the transactions to occur in

plain sight. For example, the research showed how customers and bank employees are trained to fill out forms to by-pass the checks put in place to create red flags. In other words, fabrication of information became the institutionalized practice for working around the regulatory rules and reporting systems.

Future research intends to analyze the impact of regulatory actions on banks and how the penalty and future earnings potential of the bank is seen by investors; and how investors' perceptions of banks have changed over time, with respect to money laundering and other negative practices that affect society.

In sum, the research has identified some areas that help propagate negative practices and money laundering. The diagram of the field and the possible tensions have helped to focus the research, but like all research endeavors, there are limitations to the findings. This research is based on archival data only. Interviewing regulatory personnel as well as bank personnel dealing with AML represents another future research opportunity. The research methods used in the individual studies were selected based on the information available and the type of analysis the data lends itself to. The first study uses a mix of quantitative word count analysis coupled with qualitative research; papers two and three are primarily qualitative based.

Among the benefits of this research thesis is the ability to take some of the findings to practice and have a direct impact on the way we teach and engage in the fight against corruption and money laundering. Some areas of future research have been identified and hence this thesis provides a good spring-board to future work.



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