

Conference Paper

Money Laundering in the Area of the State Defense Order

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Abstract

The choice of the topic is based on the urgency of the problem, since the second position in the structure of the budget expenditures of the Russian Federation in 2016 is occupied by the item "National Defense" 3 091.0 billion rubles (19.2%). Responsible monitoring of compliance with the law in the implementation of state defense orders is really a significant issue. This article describes the basic principles of the operation of all the processes connected with the movement and control of money in relation to SDO. Also schemes of illegal money laundering and withdrawal of funds within the limits of current legislation are presented. Changing of some restrictions in the framework of the federal law, dated 29.12.2012 N 275-FZ "On State Defense Order" is proposed basing on the analysis of these schemes.

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1. Introduction

In the modern world it is difficult to imagine the economy of a developing country without moderate intervention in its development. Historically, development of the Russian economy is inextricably linked with the military industry. This is one of the most developed industries in Russia, which annually brings more than \$ 15 billion (according to 2016) to the Russian budget. [4] Controlling of defense enterprises which can target the external and internal markets is a complex task which can be fulfilled only with the help of many structures, legal support and compulsory legal conscience of citizens.

Currently there already exist instruments to control defense enterprises in the field of spending in the Russian practice. Federal Law No. 275-FZ, dated December 29, 2012 "On the State Defense Order" was adopted as the main means to combat the withdrawal of budget defense funds and to combat corruption in December of 2012. Since 2012 it has been significantly changed, the final version was adopted on July 29, 2012.

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2. Features of implementation of defense order

How does this federal law work? Formation, approval and placement of an order takes place in accordance with the established form, a unique identifier of the state contract (ISC) is assigned. A contractor provides a customer with a set list of executors (suppliers and contractors of the lead contractor) before concluding a contract to prevent a change in the price policy for supplies with regard to the state defense order (SDO). Further, a "special account" is opened in an authorized bank after the lead provider approval. The bank support of such accounts is the main controlling tool for combating theft of budget funds and corruption. The process of spending money from these accounts is extremely difficult and has many limitations, the main ones are:

1. Transferring of funds to a normal pay - roll account is possible only in the amount of approved profit.

The marginal level of profit is determined by the formula "twenty plus one" (20% + 1%). 1% of profit is wound on the introduced costs (purchased components / semi-finished products and works / services of other providers), and 20% for other items of costs (own costs). At the same time, the size of profitability, taken into account in the price for products, can not be less than 5% of the costs.

The principles of profit calculation are established by clause 35 of the Regulation on the determination of the initial (maximum) price for the state defense order, approved by the RF Government Decree No. 407 in April 28, 2015. [2, art. V]

But in the public domain, public contacts with the approved profit of 20% of the total cost of the contract are encountered more often, while these contracts can include both purchased semi-finished products and materials, as well as works provided at their own expense. Further the term maximum possible profit (MPP) will be used in the article. MPP is the profit agreed with the customer in the state contract.

2. Implementation of payments for basic supplies to their providers can be transferred only to a special account which has the same restrictions and is opened with the same indication number of the SDO.

3. Implementation of payments not according to ISC by the lead provider for a sum not more than five million rubles a month and payments by the provider of expenses for the sum not more than three million rubles a month. These expenses include rent expenses, license fees, bank charges, security services, fuel and lubricants expenses and other overhead costs related to SDO. [1, art. 8.3]

It is necessary to maintain a separate accounting for public procurement and other commercial activities for making payments that satisfy item 3. Control function is

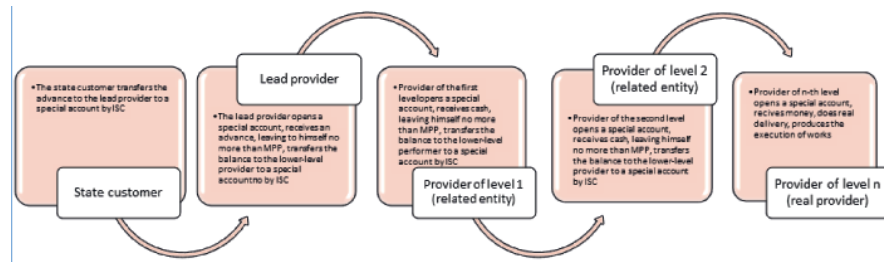
assigned not only to authorized banks, but also to the prosecutor's office. The lead provider and providers must confirm any payment from a special account and prove involvement in the SDO at any time.

What is the most dangerous limitation for the chief provider which occurs when working with funds in the implementation of SDO? These are monopolists-executors. One possible and extremely unprofitable situation lies in this dangerous combination. If the equipment of a particular brand is included into the state defense order, but this equipment is imported to the Russian Federation by only one company which refuses to open a special account, since it understands that the lead contractor has no other way of delivering, and the chief provider pays an advance payment at his own expense or from the borrowed funds, since he will not be able to use funds on special accounts. Also a provider of any level will have to provide supporting documents to reimburse the money spent and prove the impossibility of using a special account for an authorised bank.

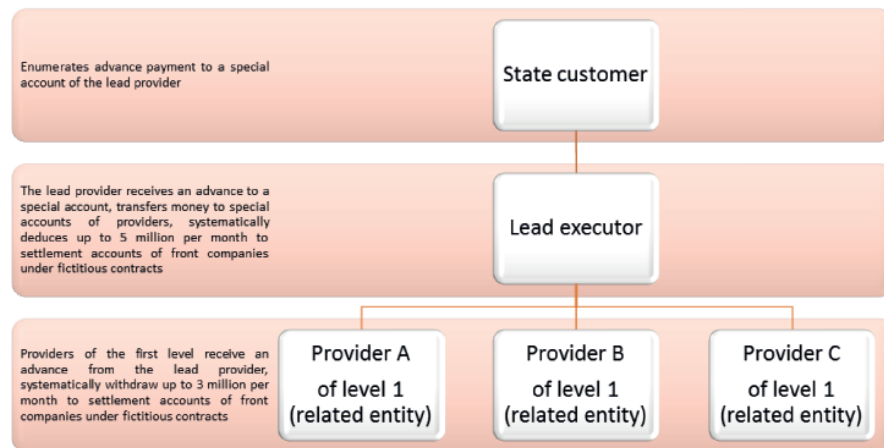
There are some illegal schemes not going beyond the framework of existing legislation that are already applied despite a rather complicated process of spending money.

One of the most common schemes is using of multiple levels of implementation. In the moment of reconciling the maximum cost of an order with the government, a large profit (which can reach 100%) is initially pawned into the state contract by means of overstating the estimates and increasing the required amount of work. Further the chief provider applies scheme 1 for this profit to "settle" on the settlement accounts of the contractor and subsequently pockets of authorized persons. Since each level of execution must open a special account, it also has a right to transfer the calculated profit (not more than MPP from the contract with a superior provider). Using Scheme 1 allows the lead provider to leave the maximum possible profit from the contract, which will not be limited to MPP from the amount of the state contract, on the accounts of interconnected companies. There can be any number of provider levels. The law does not limit the depth of communication between the lead provider and the actual provider. The method is laborious, requires due diligence, the companies of all levels of implementation must be transparent, acting but not imitating activities, as each organization must open a special account in an authorized bank.

Banks are entrusted with the main supervisory function, financial institutions are particularly responsible and prudent in discharging their duties. It takes a bank security service from 10 to 21 working days before opening a special account and allowing to use it. If there are discrepancies the bank refuses to open an account or blocks a special account in the case of suspicious transactions. Interconnected companies will have to



Scheme 1: "Using multiple execution levels".



Scheme 2: "Using restrictions on other expenses".

confirm the targeted use of funds, be ready for inspections by the prosecutor office and tax authorities. The duration of receiving money is another negative side of this scheme. None of the levels has a right to use estimated profit and transfer it to a settlement account until the moment of execution of the contract. We will discuss Scheme 2 "Using Restrictions on Other Expenses" below which is also actively used at present time.

Executing a prolonged state contract the authorized amount of five million rubles for the lead provider and three million rubles for providers of any level for various overhead expenses per month is quite profitable. Each provider of any level in the above mentioned scheme 2 can pay any overhead costs, which can in reality or only on paper concern the implementation of the contract. The number of first-level executors who will execute the contract at an inflated cost or perform it fictitiously is fixed before the conclusion of a state contract depending on the total value of the contract, the higher is the cost the greater number of fictitious / semi-fictitious executors is needed. The smaller is an initial state contract with a state customer the faster a head contractor will be able to reset a special account. The benefit of the scheme is a systematic withdrawal of funds from special accounts. The necessity of waiting for completing the contract is practically absent.

But, as in the previous method, special attention to keep separate records of all the levels providers is required from the executors of these machinations. Of course, most often providers use both schemes simultaneously in order to increase the speed and volume of illegal withdrawal of funds.

The Central Bank of the Russian Federation has conducted verification of 27 credit institutions during the audit, it revealed:

1. Cases of violation of the procedure for opening a separate account and the mode of its use;
2. Failure to meet the deadline for sending electronic messages to a single information system;
3. Establishment of facts of conducting individual transactions, not having an explicit economic sense, on these accounts, schematic operations aimed at "cashing out" funds
4. Cases of transfer of funds to counterparties in the liquidation phase or having signs of a lack of real activity. [3, 85 sec]

Some adjustments to the federal law in connection with the above stated schemes should be proposed in order to more closely monitor the expenditure of funds under the SDO, namely:

1. To allow expenditure of funds for overhead expenses only for the chief provider and a provider of the first level. Companies starting from the second level of execution have a right to transfer only to a special account of their providers and an estimated profit on a settlement account after the implementation of a contract.
2. To change the amount of allowable overhead per month. It is necessary to introduce dependence on the value of the contract and the due date. Otherwise, injustice and incommensurability of the conditions for the providers remain. The approximate form of the formula of admissible expenses per month can look like:

1. For the lead provider - $AE = (TC * 15\%) / TE$

2. For the provider of any level - $AE = ((TC * 15\%) / TE) - 20\%$

where AE - allowable expenses, allowed to be transferred to target needs without specifying ISC on settlement accounts of legal entities; TC - the total cost of the state contract (for the lead provider with the state customer, for the provider with the higher level provider); TE - the term of execution of the state contract in months.

3. To introduce a condition according to the depth of the execution levels. This restriction must be introduced relative to implementation of works for avoiding finally the emergence of sub-subcontracts and providers of more than the third level for the

same amount of work by SDO. In case of such condition the lead provider and providers of the first levels will have no other way but to become the final providers of the works.

With the supply of material assets it is a little more difficult to control the depth of the levels. It is necessary to distinguish categories, for example, easily accessible and produced in the Russian Federation and ones difficult to access. The depth of the supply levels of the commodities can depend on these factors.

3. Conclusion

Unfortunately, only these conditions and limitations for the uncompetitive functioning of the federal law and the transparency of the implementation of the GOZ are not enough. It requires a deeper look than only the scope of this law. Money frauds and embezzlement of budgetary funds will function as long as there are tools to withdraw funds by fictitious documents at excessively inflated prices. Illegal cashing out of money which ensures filling of personal pockets of authorized persons in a state defense enterprise still functions in an uncomplicated format. And Russia is still very far from the withdrawing of the money masses owned by a significant part of business in the informal economy.

It should also be noted that involvement of every legal and physical person into implementation of the state tasks, assessing the significance of maintaining effectiveness of spending of budgetary funds by each participant in this market should lead to a fair assessment of their work and ensuring an adequate level of both economic and national security as a whole. There is a direct dependence of the future of Russia on actions of each SDO market participant and ensuring proper understanding and legal awareness of the consequences of illegal frauds, creation of schemes, and criminal groups. Therefore, the state needs to increase the level of legal and economic education of the society together as well as to develop new control methods in order for the dialogue with the business sector and state executive bodies to take place and be fully realized.

References

- [1] Federal Law, dated December 29, 2012 N 275-FZ (Edited on July 29, 2017) "On the state defense order"
- [2] Resolution of the Government of the Russian Federation No. 407, dated April 28, 2015, "On the procedure for determining the initial (maximum) price of a state

contract, as well as the price of a state contract concluded with a single supplier (contractor, provider) when purchasing goods, works, services under the state defense order ”

[3] Report on the development of the banking sector and banking supervision in 2016

[4] Internet resources: ria.ru/defense_safety/20170207/148738