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Roles of Auditor in Combating Money Laundering: A Concept Paper

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Abstract

Money laundering is the process of obtaining huge sums of money through unlawful means. It is a significant financial offence committed by white-collar criminals. This study's primary purpose is to evaluate the responsibilities of auditors in preventing money laundering. The research is conducted in Malaysia because financial crime has been documented there. It elaborates on the auditors' tasks in terms of their expertise and independence. This concept paper's technique is a literature review through framework and research. Internal auditors, forensic auditors, and the Anti-Money Laundering Act (AMLA) play a crucial part in putting a stop to this crime, as recommended in the concept paper. In conclusion, these findings contribute to the identification and prevention of money laundering.

Keywords: Money Laundering, Auditor Independence, Auditor Knowledge, Auditor's Roles, Anti-Money Laundering Act

Introduction

Money laundering is not a new phenomenon in the current period. As early as the 1920s and 1930s, cases have been identified not only in Malaysia but also across the globe. It has become the most serious transnational crime. Money laundering is the illicit practise of making huge sums of money earned through criminal activity appear to be from a legitimate source (Chen, 2022). It is thought that the first incidence of money laundering originated with the US Mafia, whose intention was to legalise their dirty money gained from prostitution, gambling, and extortion (Shanmugam & Thanasegaran, 2008). Criminals use various creative techniques in hiding their activities to launder the funds obtained such as online banking and

cryptocurrencies where it is hard to detect during transferring and withdrawing the money. This white-collar crime has widely become a main concern to laws and society as it has been practiced by irresponsible people for their self-interest which proved by the recent case such as the 1MDB scandal. The effect of money laundering is not only limited to the perpetrators themselves as they could be held liable for the crime, but it could deteriorate the reputation and public trust in the institutions due to bad publicity as well as the overall country's image. In Malaysia, the advent of information and communication technology has increasingly become challenging for authorities to detect the identity of the perpetrators as anyone with the tech knowledge is able to commit such crimes (Shanmugam & Thanasegaran, 2008).
Various initiatives have been enforced such as the establishment of Anti Money Laundering Act 2001 (AMLA), Financial Intelligence Unit (FIU) of the Central Bank of Malaysia and the Southeast Asia Regional Centre for Counter-Terrorism in order to curb this issue. In addition, the role of accountant and auditors also has become more significantly important in dealing with the prevention and detections of these fraudulent activities in the financial transactions of their business. Their responsibility went beyond investigation to additionally evaluate possible risks and ensure the effectiveness of internal control mechanisms (Cindori & Petrovic, 2018). As it would become a lengthy discussion to look at every aspect on this issue, this paper will focus on the role of auditors in combating money laundering.

Background of the Study

How can the auditor's function contribute to the fight against money laundering? According to Cindori and Petrovic (2018), auditing has become a platform for detecting suspicious activities due to the fact that auditors have access to all financial transactions and may study any transaction of a company extensively. Auditors can be of vital assistance to the relevant authorities monitoring corruption situations (Aslani et al., 2011). The competent authority could be an internal organisation, an anti-corruption commission, the police, the judiciary, or a special body for a large corruption case. Malaysian Anti-Corruption Commission (MACC), sometimes known as SPRM, is an example of a competent authority in Malaysia. The Malaysian Anti-Corruption Commission investigates and prosecutes governmental and private sector misconduct.
This research is undertaken in Malaysia, where it has been stated that certain businesses are implicated in money laundering. The 1 Malaysia Development Fund Bhd (1MDB) scandal, according to Jones (2019), is the most egregious instance of corruption in history. The corporation was able to steal and launder billions of dollars from its accounts, in addition to profiting from bribery and bond pricing, since its officials and others made false representations. This demonstrates the necessity for a comprehensive research on money laundering in Malaysia to prevent similar scandals to 1MDB from occurring in the future.
Thus, this study will provide crucial information on how the function of the auditor can successfully address the growing number of money laundering instances. The report also provides auditors, auditing companies, and government organisations with recommendations to remove and reduce money laundering. By gaining a thorough understanding of the auditor's function, numerous areas can be enhanced.

Problem Statement

Others believe that auditors are the first line of defence against money laundering since they should analyse their customers' papers and identify unusual transactions within their organisation (Aslani et al., 2011). Nevertheless, auditors only report a small percentage of money laundering situations. According to research by Ringh and Sultani (2014), auditors seldom report instances of money laundering, despite having extensive knowledge of corporate activities and being viewed as the first line of defence against the crime. Auditors may be held responsible for money laundering if they fail to prevent and detect instances of money laundering, theft, and other illegal actions as expected by the general public. Among the variables that may contribute to the rise in money laundering instances is the lack of independence and expertise among auditors.

Even though the majority of auditors were aware of the country's attempts to prevent money laundering, this crime may continue to be committed due to the lack of auditor independence. Due to a lack of auditor independence, a number of businesses, including prominent ones, have failed (Lokman & Bakri, 2020). Auditor independence is essential for evaluating the dependability of accounting data and identifying suspicious transactions, as it is a key indicator that audit and control responsibilities are carried out in line with the specified code of ethics (Cindori & Petrovic, 2018). A reluctance to submit suspicious instances to authorities for fear of being sued for false charges and a lack of faith in law enforcement's competence to handle money laundering cases are factors that weaken the independence of auditors.

Insufficient awareness about money laundering by auditors may also contribute to the incidence of money laundering operations. Although most examiners were aware that their country had rules to prevent money laundering, examiners have a great degree of confusion about what these regulations are and how they impact their work (Standing & Vuuren, 2003). This is supported by Ringh and Sultani (2014), who assert that auditors lack understanding concerning money laundering and do not understand how legal requirements pertain to their work. According to the same authors, it is still uncertain whether or not auditors can educate themselves on money laundering. Auditors are unable to discover and report on this type of crime due to insufficient information, training, and updates on changes in anti-money laundering legal processes, as well as uncertainty about anti-money laundering procedures.

This study aims to develop a conceptual framework for how auditors' independence and expertise might aid in the fight against money laundering. This would aid the interested parties in gaining a better perspective on the prevention of money laundering operations.

Gap of Research

This paper aims to build the case by examining the responsibilities of auditors in Malaysia's fight against money laundering. This is due to the fact that financial crime has become an epidemic in Malaysia, with numerous Malaysians, including politicians, under investigation and facing charges. Some studies in Malaysia only briefly address the auditor's function, not as one of the primary concerns in preventing money laundering. In the meantime, our study underscored the importance of the auditor's independence and expertise in this situation.

In addition, there are studies conducted in countries such as South Africa and Romania that examine the role of auditors in organised crime. Petrascu and Tieanu (2014) highlight the benefits of internal audit to the management of an organisation. Whereas the later states that auditors could raise awareness of this concern or advise clients on reporting, the former does not (Standing & Vuuren, 2003).

Thus, this study is restricted to two roles: autonomy and knowledge. Future research may investigate auditors' other functions, such as supporting law enforcement with investigations. Unfortunately, this study did not cover a wide range of auditor responsibilities, since we solely focused on their independence and expertise.

Literature Review

The roles of the auditor are not necessarily just to audit the transactions that happened in the business entities, but it goes beyond that. Auditors should have a better awareness of their duties and responsibilities related to combat the money laundering, as well as its impact on the financial statements and the sustainability of the business (Al-Husseini, 2018). The auditors could help in combating money laundering if they are able to play their roles efficiently especially on their independence and knowledge.

Independence of Auditor

The independence of the auditor is the foundation of the profession of auditing. Auditors are expected to provide an objective and knowledgeable evaluation of the work they evaluate. According to a study by Cidori and Petrovi (2018), the independence of the auditor is crucial when evaluating the dependability of accounting data and reporting on suspicious transactions, as it is a key indicator that auditing and control tasks are performed in accordance with the established code of ethics. An audit that is objective, dependable, and ethically sound lends credibility to a corporation and inspires public confidence in the accuracy of the results and the ethics of the accounting profession.

According to research conducted in South Africa by the Institute for Security Studies (2003), thirteen of the interviewees claimed to having suspected money laundering on at least one occasion. Four of the thirteen elected not to disclose the information, while the remaining nine disclosed it to various individuals and groups. Some of the auditors interviewed for the poll said that if an auditing firm suspected that one of its customers is involved in money laundering, the firm would quietly warn the client or cease to do business with the client. In this situation, the customer will be able to choose an alternative auditing firm and continue the crime.

Even though the majority of respondents elected to disclose, this may indicate a pervasive disregard for money laundering dangers in the business. Due to the risk of being sued by a client in the event of a failed prosecution or a false charge, many auditors would be unwilling to reveal money laundering. In addition, the unwillingness of auditors to disclose money laundering may be exacerbated by the fact that many auditors lack confidence in law enforcement's competence to handle money laundering cases.

Knowledge of Auditor

According to an article published by Cidori and Petrovi (2018), auditors conducting general audits do not explicitly look for proof of this type of crime because it is outside the scope of auditing. Yet, according to study conducted by Standing and Vurren (2003), it is not impossible for auditors to detect money laundering during a general audit, despite the fact that it is difficult to do so. Thus, what should auditors do to aid in the detection of money laundering when conducting their audit work?

In the general execution of money laundering, auditors are needed to check representative samples of transactions for indications of theft. Yet, because money laundering has no immediate effect on financial statements, they are required to execute more rigorous controls of transactions in order to detect it. According to another theory, many instances of unidentified money laundering involve transactions that do not sufficiently deviate from the normal course of business, making it difficult to identify money laundering (Ringh & Sultani, 2014).

Hence, the question of how much knowledge auditors need hold prior to conducting audits has arisen. The conclusion from the same research indicated that the majority of auditors had confusion in separating the job of forensic auditors and other types of auditing. Some auditors do not comprehend and are not exposed to sufficient knowledge regarding their scope of work, causing them to disregard abnormalities that appear throughout the audit. Moreover, the studies demonstrated that the expertise of auditors on economic crime and money laundering is generally inadequate (Ringh & Sultani, 2014).

Hence, auditors are expected to have knowledge, skill, and experience in money laundering, particularly in regards to the inventive strategies employed, how to detect them, and what actions should be taken to address this issue. They should also be aware that their scope of work is not just confined to reviewing the business transactions of the entities but also from a legal standpoint where they need to be particular on the possibilities that money laundering might happen.

In relation to the legal responsibility to disclose suspected instances of money laundering, the misunderstanding intensifies when the element of regulations is introduced. The allegation was based on the auditors' supposition that financial-related crimes did not fall under their purview, hence they were not responsible for investigating the possibility of money laundering. The auditors are aware of the anti-money laundering measures that have been adopted, but they are not supplied with appropriate guidance and understanding on the subject. Insufficient training and updates on changes to statutory anti-money laundering processes are among the issues that have contributed to a lack of interest in the issue of money laundering.

It is obvious why it was so difficult for the auditor to detect instances of money laundering, given that he or she was not conducting a general audit but rather searching specifically for evidence of money laundering. Due to the complexities of money-laundering strategies, the secretive nature of business, and the collusion between auditors and clients, criminals, and corrupt officials, it is difficult to detect money laundering (Standing & Van Vuuren, 2003). The only way for auditors to detect abnormalities is if there is a considerable amount of cash on hand or if there are hidden financial transactions. In order for them to discover money laundering during general audits, they must therefore be well-informed, well-trained, and up-to-date.

Conceptual Framework

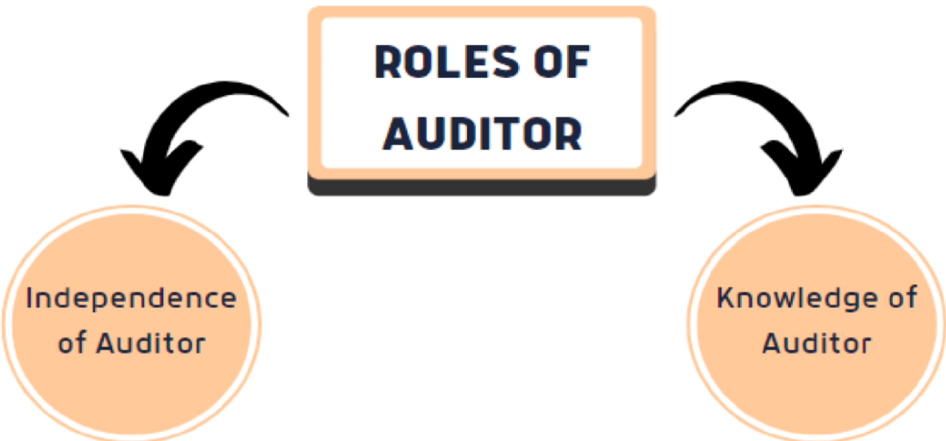

Figure 1: The Proposed Conceptual Framework on Roles of Auditor

The roles of auditor have become more crucial in this era of rapid changes in technology where a lot of opportunities allows criminals to commit various financial crimes. However, the role of auditor that this study mainly focuses on is the independence and knowledge of the auditor. Figure 1 above illustrates a conceptual framework on roles of auditor in combating money laundering. Especially in Malaysia, a few cases of money laundering can be seen such as 1MDB where auditors failed to play a big role in capturing the trust of society and breach their independence by falsifying the report for their self-interest. The inadequate knowledge of auditors may also be a factor of the rising cases of money laundering where they do not possess the required information which enable the criminal to have an easy access to commit the crime. There is a clear link between both roles where auditors should be independent and acquire enough knowledge at the same time in order to help in combating money laundering.

Conclusion

In conclusion, money laundering is the most destructive form of international crime, as evidenced not only in Malaysia, but globally. Money laundering is the criminal practise of making large sums of money obtained through illegal means appear to have originated from a legal source. Thus, this study will provide crucial information to better understand how auditors' tasks may effectively combat the growing number of money laundering cases. With a solid understanding of the auditors' activities and a clear understanding of their responsibilities, numerous elements can be enhanced.

Due to the absence of auditor independence, even if the majority of auditors were aware of the country's efforts to combat money laundering, this crime may still occur, which is the issue that may be determined through this study. Lack of desire to report suspected instances of money laundering due to fear of legal action for a false accusation and lack of faith in law enforcement's ability to handle such situations is a factor that will compromise the auditor's independence. In addition, auditors' ignorance about money laundering may contribute to the prevalence of such activities. Due to a lack of knowledge, training, and updates on improvements to statutory anti-money laundering mechanisms, as well as uncertainty over anti-money laundering procedures, auditors are unable to identify and report on this type of crime. Therefore, auditors can help organizations develop effective internal controls and risk management strategies, which can help prevent money laundering and other financial crimes from occurring in the first place. Besides, it is crucial that auditors maintain their independence and avoid any conflicts of interest that could compromise their objectivity and integrity. By doing so, they can play a vital role in the fight against money laundering and other financial crimes.

Thus, several recommendations should be implemented to solve money laundering issues in Malaysia. Internal auditors must acquire the skills and information necessary to identify suspected fraud or financial crimes and report them to their supervisors in order to decrease or prevent the occurrence of these crimes. To be able to identify the symptoms of money laundering, auditors must also get the requisite training and maintain current legislative anti-money laundering measures. In addition, auditing firms should consider advising their clients about money laundering as a means of preventing the crime. The Malaysian government has also enacted the Anti-Money Laundering, Anti-Terrorism Financing, and Proceeds of Illegal Activities Act 2001 as a preventative measure against this activity (AMLA).

In order to prevent and reduce cases of money laundering in Malaysia, it is essential that auditors carry out their duties with honesty, reliability, and exercise higher scepticism.

Recommendations

These are suggestions for eliminating and reducing money laundering, a white-collar crime that occurred in Malaysia and discredits the country's democracy. Preventive strategies could aid auditors and businesses in anticipating questionable transactions. To combat any issue, one must first understand what money laundering is, how it is committed, and the impact of the crime on the company and society. Eliminating and minimising money laundering with the correct methods can decrease its potential impact. The proposals address the duties of internal auditors, the sufficiency of auditor training, the relevance of client education, and the government's efforts to manage and avoid this problem.

Internal auditors play a crucial role in the fight against money laundering. "Organizations can achieve their goals and objectives with the assistance of internal audit activity through a methodical and disciplined approach to enhancing governance and risk management" (The Institute of Internal Auditors). Auditors may uncover material which may raise issues concerning possible unlawful conduct done by the audited organisation, such as improper transactions, substantial payments for unspecified services to consultants or receives of unusually large payments in cash (PCAOB, 2016). Internal auditors must acquire the skills and information necessary to identify potential fraud or financial crimes and tell their supervisors in order to prevent or eradicate the occurrence of these offences. Nonetheless, the illegal transactions done by the audited organisation could not be prevented totally by the internal auditors, but they may practise the necessary procedures and methodologies to flag out any possible illegal acts (Dimitra & Georgios, 2015).

To be able to detect signs of money laundering, auditors must get proper training and be updated on the current legislative anti-money laundering procedure. Auditors should recognise that even though they are not involved in the forensic audit, they are also responsible in detecting the evidence of money laundering throughout their routine audit work. Auditors should be responsible for adhering to all anti-money laundering protocols, as their work is essential for the competent agencies investigating money laundering situations to take further action.

Not only the auditors' knowledge is vital in limiting this circumstance, but also the clients. Moreover, auditing firms can educate their clients on money laundering. Being informed of the money laundering occurrence and the needed safeguard to be taken by the clients could limit the crime from happening. Advice offered to the clientele that concerns about money laundering could discourage businesses from involvement with this wrongful crime. According to research (Jamaliah et al., 2013), providing training on the identification of suspicious conduct to the company's personnel would aid the audit firm in educating its client.

The Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Illegal Activities Act 2001 (AMLA) was enacted by the Malaysian government as a preventative step against this action. The AMLA was intended to prosecute those who finance terrorist organisations. In addition, it protects informants who report questionable transactions to the legal authorities. According to Section 24 of the 2001 AMLA, no criminal or civil action may be brought against a person who disclosed or gave information about illegal financial transactions unless the disclosure was made in bad faith (AMLA, 2001).

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