

Investigative Techniques for the Cash Economy



Risk Indicators





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Challenge

"Fraud is a crime that is seldom observed."

"You can only see, what you can see.

You can't see, what you can't see.

And you can't see, that you can't see, what you can't see."

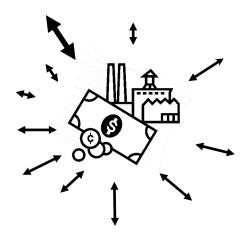


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Risk Indicators

 Risk Indicators is about identifying financial crime and proceeds of crime by comparing <u>expected</u> behavior and circumstances to <u>actual</u> behavior and circumstances



Risk Indicators can provide fast overview and direction at low cost





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Risk Indicators: transactions

Unusual transactions and parties

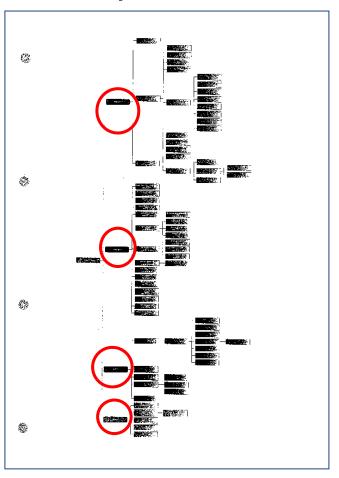
Entrepreneur demonstrates poor knowledge about their business
Transaction in goods or services not fitting company's profile
Transaction without an evident commercial basis
Transaction or agreements without relevant supporting documents
Transactions with offshore companies
Transaction with suspected criminals or their partners
Non-transparent / non-identifiable customers, creditors or lenders
Transactions with business associates or customers that share a common address
Transactions identified as asset sales but assets cannot be substantiated
Inusual money flows
Payments to or from third parties who are not involved in the transaction
Payments to or from unrelated offshore companies or accounts
Company bank account used as a cash flow-through account
Non-transparent or non-verifiable origin of the money
Denominations and currency not the norm in the industry
Bank deposits not declared as turnover (sales)
Money flows without apparent economic reason or supporting documentation



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First impression....



Key fig. mil. EUR	Y1	Y2	Y 3
Turnover	85	167	311
Result	16	19	32
Equity	21	32	55
Assets	154	239	401
Work in progress	12	36	130



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"We believe the Group is a success because we constantly focus on adding value to what we are dealing with. Another reason for our success is that we go into new businesses to run them in an industrial way."

Cash flow (mil. EURO)	Y 1	Y 2	Y 3
Business activity	-30	-10	-150
Investment activity	-150	-51	-55
Financial activity	72	77	198



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Risk Indicators: Tax examination

Unusual off-balance items

- Non-transparent ownership
- Ownership by relations/partners of criminals
- International structure with no apparent commercial, legal or tax benefits
- Purchase or sale of the companies' shares at a nonmarket price
- Companies/directors registered at a foreign company service provider's address

Unusual balance sheet items

- Ownership contributions of capital are not supported by previous tax returns
- Interest accumulating on loans receivable or loans payable
- Large cash holdings which are excessive for the business

Unusual profit and loss items

- High rise in turnover/sales
- High rise in profit margin
- Business ratio of costs and sales not in line with industry

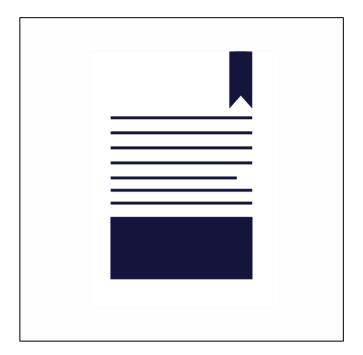


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Two tax audit cases: Fake invoices and fake agreement

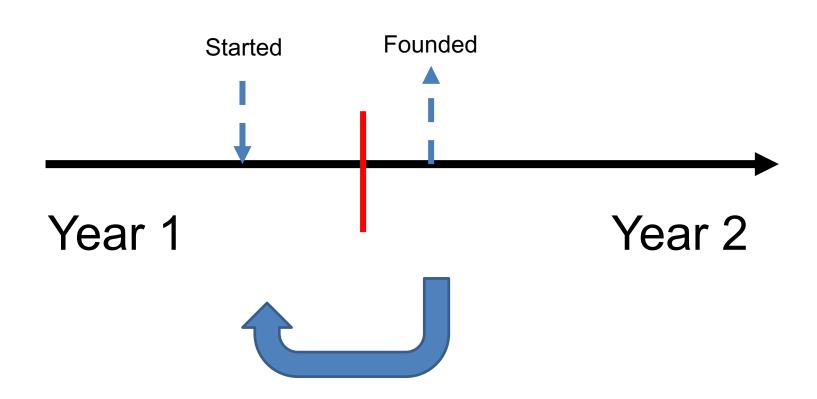






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Case: Private House – owned by the Company

- Purchase 3 mil. €
- Renovation 10 mil. €
- Booked value 22 mil. €
- Sold for 6 mil. €

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OECD International Academy for Tax Crime Investigation

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Other Risk Indicators

Loans

- origin of the flow of funds
- financing

Individuals

rise in net worth

Service providers

- service provided by a professional service provider
- reward for a professional service provider

Cash

- Incomplete, unlikely explanations origin, deposits and withdrawals
- Transport method costly, risky or concealed

International trade

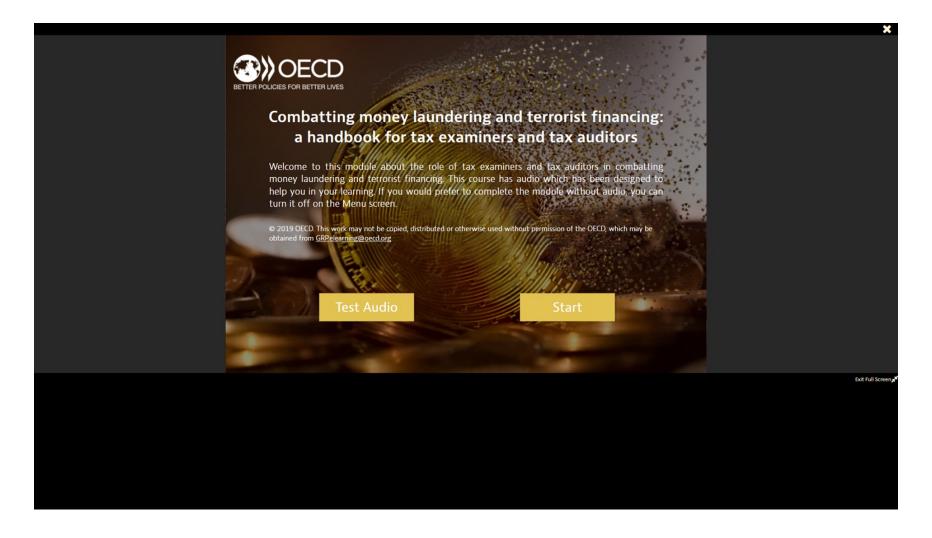
- Newly or offshore companies with large imports/exports
- Multiple billing and false descriptions
- Difference origin of goods and destination of payments



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Online...



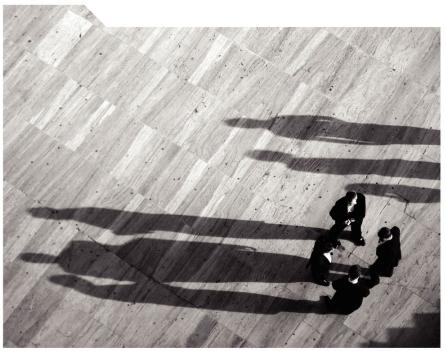


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Bribery and Corruption Awareness Handbook for Tax Examiners and Tax Auditors







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Bribery and corruption risk indicators

- Indicators concerning parties to transactions
- Indicators concerning the terms of transactions
 - No underlying documentation to contracts or loans
 - Key terms not clear
 - Actions outside the terms of a contract
 - Under-qualified people in senior positions
- Indicators concerning outcomes that impact the taxpayer's financial records
 - Balance contain assets acquired at higher or lower than market value
 - Taxpayer, employee or family member lifestyle not supported by income



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Cash Economy – Characteristics

Table 1.2. Industry sectors commonly reported by revenue bodies

Industry sector	Bodies reporting (%)	Nature of activities included in this sector	
Personal Services (B2C transactions)	22.1	House cleaning, hairdressing, beauty, dry cleaning, catering, pest control, computer maintenance, security, health, pet care, matchmaking, etc.	
Hospitality	16.4	Restaurants, cafés, pubs, takeaways, hotels	
Retail	15.6	Store based, flea/public markets, etc.	
Construction	15.6	Building, home renovations, home repairs	
Car sales & service	5.7		
Transport	3.3		
Taxi	3.3		
Agriculture, Fishing, Aquaculture	2.4		
Other	15.6	Tourism, real estate (incl. rental), recycling, internet based, freelancers, professionals, entertainers, etc.	



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Cash Economy Sectors – Indicators of Fraud

Pressure/Motive:

- Financial needs
- Social pressure
- Greed/Injustice
- Etc.



Opportunity:

- Lack of controls
- Business culture
- -> Capabilities
- Etc.

Rationalization: Justification Etc.

Questions:

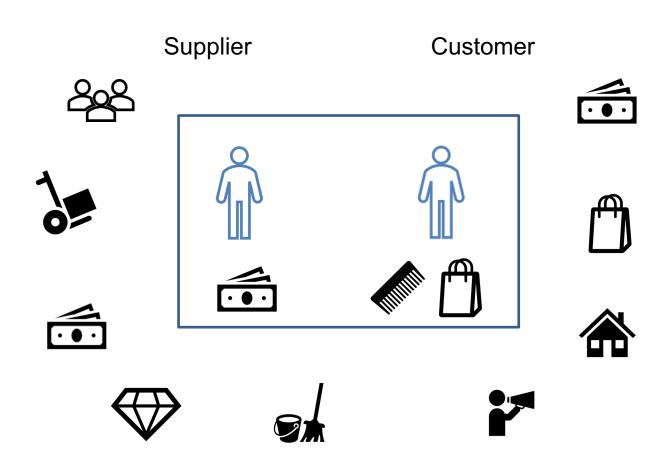
- 1. What Fraud-Triangle elements can be found in Sectors of concern (personal services B2C, hospitality, retail, construction, and agriculture)?
- 2. Where can you find risk indicators of fraud in the cash economy sectors?



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Indicators in a cash business



Activity	Examples
Non-registered businesses	Businesses that do not register with the tax administration for either income tax or value added tax (VAT). They may still register with other agencies or service providers.
Under-reporting of business income	Ranges from businesses or sole traders which skim off some cash sales to those which engage in large scale fraud.
Unreported sources of income	Businesses or individuals receiving sources of income not known to the tax administration from investments, property etc.
Inflation of costs	Those who inflate tax deductible expenses, for example through the use of false receipts or invoices or collusion with others.
Identity fraud	Use of fake identities to avoid tax liabilities or to claim refunds due to others. Also commonly used to continue to claim benefits while working.
Phoenix companies	Companies that are created with the intention of becoming insolvent before paying tax and other pills (with the business being transferred but not the debts). Similarly companies may strip assets and disappear prior to paying tax due.
Moonlighters	People registered with the tax administration for some employment but not for all, for example someone with a part-time job paid by cash on top of regular employment.
Ghosts	Those unknown to the tax administration, never having registered for tax Examples may be some informal market traders, day or seasonal labourers, those providing domestic services and those carrying out serious crimes.
Cross-border fraud	Those who carry out activities across border with the aim of exploiting gaps and being able to hide out of reach of another tax administration.
Employer fraud	Not registering workers with the tax administration or requiring such registration as a condition of employment; not complying with requirements to withhold tax or social security liabilities; employing illegal workers – for example those without a permit or underage; not carrying out identity checks; paying less than required minimum wages etc.
Money laundering	Bringing money from illegal activity into a legal business in order to make its origin appear legal.

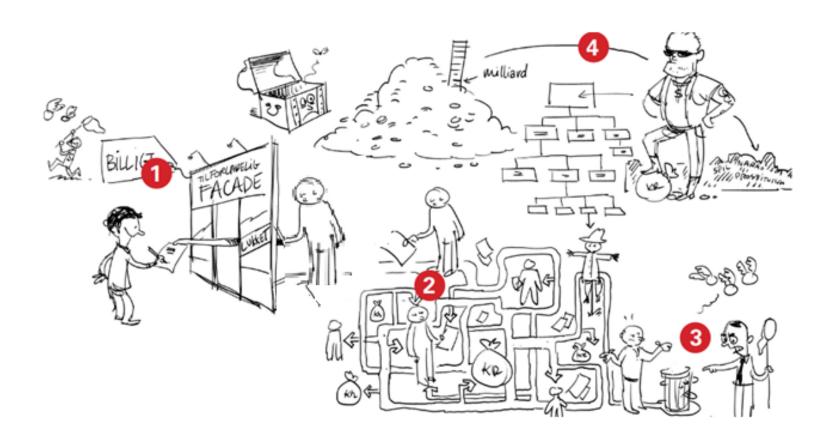
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Cash Economy - Supply Chain Fraud





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Cash Economy – Risk indicators company registration



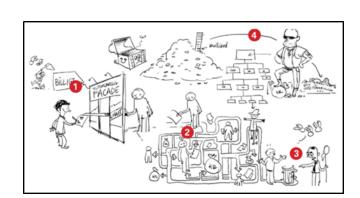


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Cash Economy – Risk Indicators of fictitious companies

- Periodically reporting requirements
- Payments on time
- Activity: employees (and their other activities), web page, reportings, customers etc.
- Directors and owners
- Physical contact and correspondence



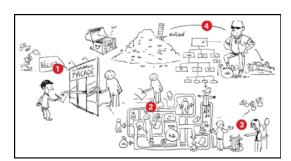


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Cash Economy – Risk Indicators during a tax audit

- Registrations at authorities tax and vat, employer, foreign workers etc.
- Indicators regarding seller and subcontractors
- Contracts, agreements, invoices, slips etc.
- ID of workers and directors
- Money flow
 – cash, unusual payment instructions and further flow
- Physical contact and correspondence
- Projections, projections





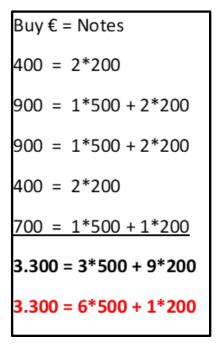
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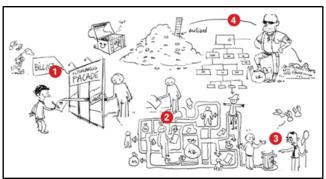


Cash Economy - Money flow risk indicators

- Documentation
- Know Your Customer File
- STRs and SARs
- Note types:









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Financial Risk Indicators - How to cook the books?

- Valuating assets and liabilities wrongly
- Controlling transactions not on market conditions
- Omitting booking of transactions
- Booking of transactions in wrong periods
- Not linking sales and cost of sales to same period
- Classifying income as loan or receivables as expenses
- Over- or understating of accruals
- Booking directly on the equity accounts
- Off-balance items not disclosed or wrongly disclosed
- Wrong elimination of intercompany profit
- Changes in accounting policies



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Risk indicators: Annual Report

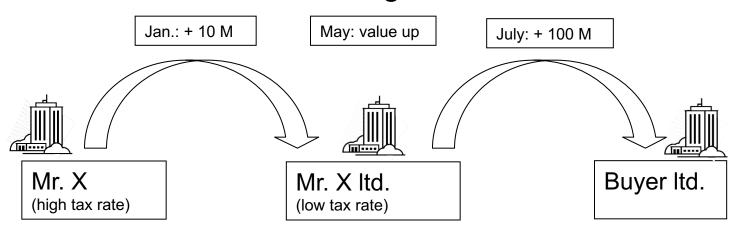
- Management report content
- Continuity management, business, ownership, company name, address etc.
- Different amount levels and complexity in Income Statement and Balance
- Unnatural high level of controlled items
- Significant balance items not related to business
- Audit opinion



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Case: Consecutive booking numbers



Mr. X ltd Property account 123456			
Booking Booking			
no.	date	Text	Amount
		Opening balance	0
6541	01.01.2010	Purchase property	50,000,000
6557	15.07.2010	Sold property	-150,000,000
6558	15.07.2010	Gain on sale	100,000,000
		Balance	0

Wii. A Ita Salary account 765012			
Booking no.	Booking date	Text	Amount
		Opening balance	0
749	31.01.2010	Salaries Jan.	17,512
6948	29.07.2010	Salaries Jul.	25,318
		Balance	138,477

Mr. X ltd. - Salary account 789012

Fax received:

17/07/2010 4'48 p.m.

Fax number:

+45 123456789 652

Outstanding invoice 95-2010

Dear Sirs,



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Case: biggest accounting fraud in Denmark - ever



Nordisk Fjer A/S



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Testing Risk Indicators - How to look beyond the numbers?

- Cash is king!
- Compare bookings with independent valid infomation
- Compare with companies in similar business and in similar size
- Scrutinise major postings in general ledger and bank accounts, all the way!
- Scrutinise accounts with management, group companies
- Scrutinise adjustment bookings
- Check sub ledgers for manual, old and significant bookings
- Look for major development in account balances from one year to another
- Identify what drives the company's major development key bookings
- Talk to reliable bookkeepers, advisers or authorities if you can
- Check international accounting databases for straw men, addresses etc.



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Strategy: What indicators to look for







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The Yacht (owned by the company)





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The jet aircraft –owned by the company





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Information from the Annual report:

Income statement:

Exchange loss:

2013: 0 € 2014: 0 € 2015: 20 mio. € 2016: 0 €

Assets:

Property Bonds:

2013: 0 € 2014: 40 mio. € 2015: 20 mio. € 2016: 0 €

Liabilities:

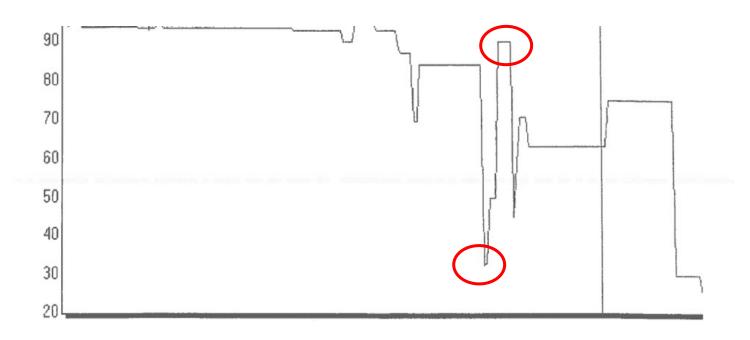
Long-term Debt:

2013: 0 € 2014: 40 mio. € 2015: 40 mio. € 2016: 0 €



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Sum-up: Key elements in comparing expected to actual behavior and circumstances

- Continuity
- Similarity
- Clarity
- Reason
- Risk indicators are everywhere
- OECD handbooks and reports



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Breakout exercise - TC Innovation A/S annual report

What is unusual and what is going on?