



APPLIED FORENSIC ACCOUNTING – EXPERIENCES FROM THE
PAPUA NEW GUINEA FINANCIAL INTELLIGENCE UNIT

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| **John Chevis and Bernard Barrum**

The opinions expressed in this paper are those of the authors and do not represent those of the Australian Federal Police, The Papua New Guinea-Australia Policing Partnership or the Royal Papua New Guinea Constabulary.

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Overview

This paper details some of the innovative methods that the Papua New Guinea Financial Intelligence Unit has developed using anti-money laundering legislation to address large-scale grand corruption.

In an environment where many Government systems are affected by corruption, these methods have had a measure of success where other changes attempted have had a more limited impact.

It is likely that the problems experienced by Papua New Guinea are also seen in other developing countries and, as such, these processes are presented here in the hope that they may be of interest to other countries battling corruption. Equally, they are hopefully of interest to those working in the field of forensic accounting research and teaching, as it is in this context that Forensic Accounting may potentially be able to make a direct and real contribution toward the alleviation of poverty and suffering in developing countries.

About the Authors

Federal Agent John Chevis is a member of the Australian Federal Police. John holds a Bachelor of Commerce Accountancy and Economics, qualified as a CPA in 2000 and was awarded a Masters of Forensic Accounting in 2009. As part of the AFP

International Deployment Group, John was advisor to the Papua New Guinea Financial Intelligence Unit (PNGFIU) from May 2009 to August 2011.

Detective Senior Sergeant Bernard Barrum is the Officer-In-Charge (OIC) of the PNGFIU. Bernard has over 30 years experience in the Royal Papua New Guinea Constabulary, 21 of those years specialising in fraud and corruption investigation. Bernard has been the OIC of PNGFIU since its inception in 2007.

PNG – A Brief History and Description

Papua New Guinea (PNG) is an independent¹ country of approximately 6.8 million people (World Bank, 2009), occupying the Eastern half of the island of New Guinea.

PNG is richly endowed with natural resources but has an under-developed economy leaving it ranked 137 out of 169 countries in the 2010 United Nations Development Programme, Human Development Index (UNDP, 2010) the second lowest in the Asia-Pacific Region. In 1996, the latest date for available information, 57.4% of the PNG population were estimated to be living on less than US\$2 a day (World Bank, 1996) with about 87 % living in rural areas in an agricultural subsistence lifestyle.(CIA World Factbook)

In 2008 only 33 % of the rural population were estimated to have access to an adequate water supply (World Bank, 2008) and over half of the population did not have access to adequate sanitation. (World Bank, 2008)

¹ PNG achieved independence in 1975, having been variously under French, German, UK and Australian since 1885

Politics

Politics in Papua New Guinea are highly competitive but fractured down ethnic lines with many members of parliament elected on a personal or ethnic basis rather than as a result of ideological or party affiliation. There are several political parties, however party allegiances are unreliable, and winning candidates are often courted (and it is alleged, bribed) in efforts to forge the majority needed to form a Government.

It has been observed by Transparency International that a significant number of politicians (or potential politicians) view political life in terms of the opportunity for self enrichment. *‘Contesting elections has become a god-sent opportunity to wealth creation...most medium scale business activities in PNG are owned by politicians and ex-politicians’* (Transparency International, 2003)

Allegations exist of vote buying and of public servants funding election campaigns involving vote buying from corrupt activities undertaken while in Government employment.

Economy

The PNG Government Budget for 2011 was approximately K9.328 billion (O’Neill, 2010) (AUD 3.886 billion) of which K7.331 billion (AUD3.054 billion) is sourced from taxation revenue with the balance coming from resources. In 2009 Gross Domestic Product was estimated at US\$7.89 billion (K18 billion) (World Bank, World Development Indicators, 2009) and a GDP per capita estimated at US\$1,172 for the same year.

In 2011-12 it is estimated that Papua New Guinea will receive AUD482.3 million in Official Development Assistance from Australia (Ausaid) (Ausaid, 2011) which

represents approximately 6% of GDP.

Corruption

Corruption in Papua New Guinea is generally perceived to be systemic and systematic. There is barely a day goes by when the print media, radio and television news don't mention corruption as a topic. The 2010 Transparency International Corruption Perception Index (CPI) ranked Papua New Guinea at 154 out of 178 (Transparency International, 2010) surveyed countries, with a score of 2.1.² this ranks Papua New Guinea equal with countries such as Kenya, Congo, Russia, Laos and Cambodia and below countries such as Indonesia, India, Colombia and Mexico.

Perhaps the most definitive indication of the scale of corruption in PNG comes from the Papua New Guinea Parliamentary Public Accounts Committee (PPAC) Inquiry. The PPAC is (at the time of writing) conducting inquiries into the public accounts from the years 2004 onwards. The Inquiry's latest available report, released in 2009³, covers the Public Accounts for 2006. In this report the PPAC states:

- *(The) collapse of accountability and responsible, lawful and competent fiscal management was, and remains, a direct threat to the viability and civil stability of the Nation and the health and welfare of our citizens; (p1)*
- *There (is) a culture of impunity (where) fiscal mishandling and misappropriation has prospered There is, no fear or risk of detection or*

² CPI score relates to perceptions of the degree of corruption as seen by business people and country analysts, and ranges between 10 (highly clean) and 0 (highly corrupt).

³ The PPAC is known to have released a report in 2011 into the accounts for 2007 but this report is not yet available on the Parliamentary website.

punishment for those who would act illegally with public funds; (p2)

- *The Department of Finance, (has) arrogated to itself sovereign power over the use and application of public monies, often in open defiance of Government appropriation, policy and directive. and intentionally refused to render account or assistance to this Parliament. (p4)*
- *The failure of service and development delivery will, and has already, resulted in significant social unrest. In other words, the loss of Parliamentary power and fiscal control, and thereby policy implementation, has created an increasingly angry, impoverished and disillusioned citizenry, deprived of the services that they have the right to receive (p5)*
- *(There) is no detectable will or ability in the Public Service – particularly in the Department of Finance – to change or reform. The huge amounts of money misappropriated in that Department clearly displace any ability or wish to change or to comply with the duties imposed on that Department; (p6)*
- *Illegal and/or and improper practices (are) rife - particularly in the very Department responsible for fiscal management, the Department of Finance, but also across the entire spectrum of Government at every level – National, Provincial and Local. Governments and law enforcement agencies failed to grapple with the problem and this failure emboldened the misusers, who moved in a few years from small scale opportunistic misappropriation to the organized diversion of huge sums of public money – with apparent immunity and impunity. (p11)*
- *misappropriation, theft, misapplication, fraud and illegal and improper handling of public monies (have) become an incident of Governance in Papua New Guinea; (p157)*

- *This Committee has made many referrals in the past four years with no action taken by any law enforcement agency and if we were to refer accountable Public Servants for failure to perform their duty or fiscal mismanagement, there would scarcely be an officer who would remain. The Royal Papua New Guinea Constabulary seems incapable or unwilling or both of investigating or prosecuting complex fiscal crime The very culture of impunity that we have identified in this Report means that any referral by us would be a hollow gesture – and it is high time that the National Parliament realized the extent and terrible effect that this collapse of law enforcement has had on our National Institutions (p173)*

The PPAC report into the 2006 accounts is 178 pages and ends with the following;

The National Parliament must address this National state of failure immediately. The future, viability and reputation of the Government of Papua New Guinea and the welfare of its citizens demand it.

The claim that malfeasance there is “*a direct threat to the viability and civil stability of the Nation and the health and welfare of its citizens*” appears to indicate that the losses observed are significant. Estimations of quite *how* significant those losses are range from about 10% of the Government budget in 2002 (Holden et al, 2003) to 50% of the Government budget in 2010 (Radio New Zealand, 17 Feb 2011) (The National 17 Feb 2011) (Post Courier 16 Feb 2011) equivalent to about 20% of GDP.

Further indications of the quantum of fraud and corruption are provided by such reports as the 14 July, 2011 announcement by the RPNGC that it was commencing an investigation into the alleged misapplication of K1.9 billion (AUD 700 million) of the

development budget (equivalent to 20% of the total Government budget) by the former secretary of National Planning paid out over three months to June 2011. (The National, July 14, 2011)

Background on the Papua New Guinea Financial Intelligence Unit

The authors' recent involvement in combating corruption in PNG arose out of their placement in the PNG Financial Intelligence Unit (PNGFIU). One, as the Officer-In-Charge, and the other, as an Adviser to the PNGFIU under the Papua New Guinea-Australia Policing Partnership.

The PNGFIU was created within the Royal Papua New Guinea Constabulary, PNG's National Police Force, by Section 13 of the Proceeds of Crime Act (POCA) 2005. It has an approved organisational strength of 6 members but actual strength had not exceeded 4 members in the two years to July 2011. It was established on 16 July 2007 and commenced operations in November 2007 with its functions detailed in the POCA which positions the PNGFIU as the AML/CTF regulator and supervisor. Among its functions are the requirement to train Cash Dealers, conduct investigations, issue guidelines, compile statistics, make recommendations, advise the Minister and receive and analyse financial intelligence.

The legislation which created the PNGFIU, was introduced in 2005 as part of a package of 3 Acts to give effect to PNG's obligations under certain declarations⁴ by the South Pacific Forum (SPF) on law enforcement cooperation to combat transnational crime. It

⁴ Declaration by the South Pacific Forum on Law Enforcement Cooperation (the Honiara declaration) 1992, & the Nasonini Declaration on Regional Security adopting the FATF 40 recommendations.

was not enacted to combat domestic corruption or prevent other domestic financially motivated crime but was part of a broader promulgation of FATF recommendations in many countries around the world –recommendations that were originally drawn up in 1990 ‘*as an initiative to combat the misuse of financial systems by persons laundering drug money*’ (FATF, 2003) and are only relatively recently being viewed (and reviewed) in light of their potential use in the fight against corruption.⁵

The drafting of Papua New Guinea’s POCA was based upon a generic proceeds of crime Act⁶ (somewhat) tailored to PNG conditions, such as they were then understood, by the Papua New Guinea Director of Public Prosecutions, with the assistance of a deputy commissioner of the Royal Papua New Guinea Constabulary⁷.

If the PNG POCA has limitations they perhaps arise from its inception as a tool to prevent PNG financial systems from being used to launder drug money from other countries. ⁸Issues such as focus on “cash transactions” and “Cash Dealers” for example, ignores the fact that much of the grand corruption in PNG is conducted using government cheques. Similarly suspicious transaction reporting under the PNG POCA requires Cash Dealers who have reasonable grounds to suspect that information that they hold may be;

⁵ In 2010 FATF produced a reference guide to on the use of the FATF Recommendations to support the fight against Corruption in response to a request by G20 leaders to the FATF to help detect and deter the proceeds of corruption by strengthening the FATF Recommendations

⁶ Produced for the Pacific Islands Legal Officers Network with assistance from the Australian Attorney-General’s Criminal Justice Division, and the Office of Legislative Drafting and Publishing.

⁷ Information provided to PNGFIU by PNG Department of Justice 31 May 2011

⁸ the same observation perhaps could be made of the FATF Recommendations themselves.

'relevant to the investigation or prosecution of a person for a serious offence, it must take measures to find out: the purpose of the transaction; the origin of the funds; and where the funds will be sent'

This appears to assume that the money is merely transiting the customer's account and furthermore may be read to suggest a level of implied passivity on the part of the Cash Dealer in with respect to their identification of such suspicious transactions. Additionally, the Section may be read to suggest that the Cash Dealer need not ensure that the source and application of the funds is consistent with their knowledge of the customer.

Also, the Act's focus on "*proceeds of crime*" potentially hinders the prevention of corruption where the criminality presents during the disbursement of the funds as opposed to being apparent at during its placement into the financial system. Such a situation might exist where, for example, a deposit is made of a large Government cheque for an infrastructure project into a company account followed by large disbursements into accounts controlled by public servants employed by the department issuing the cheque or large cash withdrawals made in locations geographically distant from the stated location of the project.

These issues with the legislation could clearly be addressed through amendment. Ongoing political issues however have resulted in the Parliament of Papua New Guinea sitting for less than 60 days in the period from December 2009 to July 2011. Little in the way of legislation of any type was passed during this time and unfortunately, examples of legislation proposed over the last 2 years would tend to indicate a legislature interested in curtailing the effectiveness of oversight bodies such as the

Ombudsman Commission (and by implication, probably the PNGFIU) rather than enhancing anti-corruption processes.

The Fraud Triangle at Work ?

Exactly why Papua New Guinea is suffering such high levels of corruption is difficult to explain. The proximate cause for the losses to fraud and corruption are perhaps best described by the former Treasury and Finance Minister, now Prime Minister Peter O'Neill, when in May 2011 he was quoted as speaking of "*the systematic breakdown in the public service*" (Kolma, 2011). The ultimate cause however may be far more complex and possibly due to cultural and historical influences upon which Donald R. Cressey's 'Fraud Triangle' potentially sheds some light.

The average wage for a public servant in PNG, including police officers, is approximately K23,000 per annum with many private sector employees such as bank employees earning not much more. This disparity between the cost of living and salaries, coupled with family or 'wantok' obligations, appears to place many public servants in a situation where the temptation to engage in corrupt behavior to supplement income is likely to far outweigh any individual considerations of integrity.

The Fraud Triangle suggests there are three factors likely to be present in every situation of fraud:

- Motive (or pressure) – the need for committing fraud (need for money, etc.);
- Rationalization – the mindset of the fraudster that justifies them to commit fraud; and

- Opportunity – the situation that enables fraud to occur (often when internal controls are weak or non-existent).

Wolfe and Hermanson (2004) add to the triangle a fourth element, that being ‘Capability’ – the necessary traits and abilities to commit the fraud.

An examination of the circumstances of many Papua New Guinean public servants shows that many of them are in situations where at least the first three factors are present - Low relative wages and family pressures providing the *motive* for fraud. A *rationalisation* that ‘everyone else is doing it’ or ‘if I don’t take it someone else will’, and lax governance, poor oversight and a less than diligent banking sector providing ample *opportunity*.

The lens of the fraud triangle/diamond undoubtedly provides useful insights into individual instances of fraud which is certainly useful when applied on an organizational level to prevent fraud. The application of such insights, on a macro or country level, to provide effective methods of countering widespread corruption however appear less certain.

In formulating methods for the PNGFIU to counter corruption the authors’ observed that there was little that they could achieve in the terms altering the environment to reduce motive, or capability. Reducing ‘motive’ would most likely require an increase in public service salary, a reduction in the cost of living and alteration of cultural norms to reduce ‘wantok’ obligations – all unfortunately outside the capacity of the authors.

Reducing ‘capability’ as regards individuals’ personal abilities would appear to be an impossibility and/or counter- productive, as those capable of engaging in corruption are also likely to be the most capable workers.

The theoretical basis for the actions taken by the authors over the past two years have, as a consequence, focused on altering the ‘*rationalisation*’ of fraud by reducing the perception that corruption is going unnoticed and increasing the deterrent through increasing the perceived risk of being detected. With this went a focus on reducing ‘*opportunity*’ through a restriction of the avenues to place the proceeds into the banking system. ‘Opportunity’ certainly presents itself regularly to public servants in terms of poor legislative control, lax governance and poor management oversight. There is little on this side of the equation, however, that offered an apparent, viable solution in the short term.

Using AML Legislation to Address Corruption

The solutions developed in the PNGFIU using the AML legislation provided in the POCA. They were ‘flag shipped’ by two processes; one to raise the perceived risk of being detected or caught, and another other to reduce opportunity to place funds into the banking system. They were a departure from traditional methods of dealing with corruption in PNG which would typically be based upon deterrence through investigating and prosecuting offenders. The methods themselves are described below, but it is perhaps worth noting a couple of points about the POCA and the PNG environment prior to discussing them.

The POCA’s stated purpose is to provide measures against “money laundering”, and to ‘*deprive persons of the proceeds of, and benefits derived from, the commission of offences*’ (Proceeds of Crime Act 2005 Preamble)

The impetus for criminals to launder money, that is, hide or obfuscate the illegitimate source of funds however, only occurs when the offender perceives a reasonable risk of

being caught and/or suffering some sort of punishment. The observations in the PPAC (2009) that The Royal Papua New Guinea Constabulary '*seem incapable or unwilling or both of investigating or prosecuting complex fiscal crime*' hints at an environment where offenders most likely perceive little risk of being caught and therefore little need to 'launder' their funds.

It may come as little surprise then to know that the greatest challenge facing the PNGFIU has not been in detecting the offences and/or offenders but in determining an effective strategy to disrupt the very large numbers of identified offenders and prevent repetition of their offences. The PNGFIU believes that it would be unlikely to have any measurable effect by using the process of criminal prosecution - The number of offenders is too large, the resources of the PNGFIU too few and the court system too slow. It is also apparent that investigation of offences committed by Government employees is very often hampered by the inability to obtain even basic documentation regarding the offending transactions and events.

A potential alternative to criminal prosecution is the process of restraint and forfeiture of proceeds of crime. This process is sometimes viewed internationally as one of the more effective methods of preventing money laundering and its predicate offences such as corruption⁹, particularly so, when it concerns a country that has a 'non-conviction' based forfeiture regime, such as that found in Papua New Guinea. The view that restraint of proceeds of crime is a potentially effective method of deterring corruption is possibly based upon the assumption that restraint of proceeds of crime can and will achieve a deterrent effect. For this to occur however, a 'critical mass' of cases would probably need to be progressed through the court system to provide criminals (or

⁹ Chapter V of the UN Convention Against Corruption states 'The return of assets pursuant to this chapter is a fundamental principle of this Convention'.

would-be criminals) with sufficient cause for concern that they would modify their behaviour. This critical mass of cases would likely require motivated and adequately resourced authorities from the police through to the courts, as well as access to sufficient information, intelligence and evidence to identify and support cases. All of this, assumes a functioning public service.

PNG has (at the time of writing) seen four ‘restraint of proceeds’ actions under the POCA since commencing such actions in December 2009. These have generated little in the way of media coverage or apparent deterrent effect¹⁰. Furthermore, restraining proceeds of crime in an environment like PNG can place the people conducting the investigations at risk of personal injury.

After much consideration of alternatives, the PNGFIU assessed that the most practicable method of addressing corruption and fraud might be to address the largest (though perhaps unwitting) facilitators or ‘gatekeepers’ of corruption and fraud – the commercial banks.

PNG has only four commercial banks. The largest of these holds most of the personal accounts of Government employees and many of the Government trust accounts, which are a regular victim of fraud.

¹⁰ The company that forfeited the PGK1.3 million by consent received a further PGK 2 million Government payment only a few months later.

In support of this method, is the work of the International Centre for Asset Recovery (ICAR)¹¹. The ICAR Practitioner's Handbook on Tracing Stolen Assets suggests that, in relation to the use of the criminal offence of money laundering, with regard to financial institutions;

'If they know, or if they must assume that the assets entrusted to them are the proceeds of a (serious) crime and do not refrain from accepting or transferring them they will be held criminally liable Reminding them of their possible criminal liability for money laundering can be a powerful tool....' (ICAR,2009)

This advice is offered by ICAR was in relation to encouraging cooperation in asset tracing investigations, the PNGFIU used this concept in a rather more direct fashion by relying on sections 34 and 35 of the POCA.

In December 2009, the PNGFIU sought advice from the Department of Justice and Attorney General on whether a Cash Dealer that receives a suspicious Government cheque could be prosecuted under S35 of the POCA. Specifically, whether a bank that receives a cheque, 'receives', 'possesses' or 'disposes of' the funds. The response was in the affirmative, and the advice went on to say that the FIU could consider issuing a guideline detailing when the FIU would be likely to seek prosecution ie. *when it would be reasonable to suspect* (that money is the proceeds of crime).¹² - Advice that the PNGFIU made use of in formulating a guideline which is the basis of 'Method 2', discussed below.

¹¹ Part of the Basel Institute on Governance

¹² Email from PNG Department of Justice and Attorney-General to PNGFIU 4 December 2009

Method 1: Significant Cash Transaction Reports

The first method of addressing corruption was to use Cash Transaction Reports to identify public servants conducting transactions indicative of corruption and raise the perceived risk of being identified and detected. Specifically to identify public servants who were repeatedly making large deposits well in excess of their legitimate earnings and inform them that their transactions had been observed.

The PNGFIU convened a series of meetings with the commercial banks under the banner of an “AML Working Group”,^{13, 14}. This Working Group provided the platform for commencement of receipt of cash transaction and international funds transfer reports. The reports were then analysed to identify people who had their addresses recorded as ‘C/-’ a Government department. This analysis provided a significant number of Government employees who were repeatedly depositing amounts well in excess of their yearly salary directly into their own accounts with no attempt to hide the transactions. Additionally, some of the people identified through this process had come to notice previously for their involvement in non-legitimate disbursements from Government accounts which had been the subject of successful restraint action by the PNGFIU.

Having identified these transactions the PNGFIU needed a method of definitively differentiating legitimate from illegitimate transactions and, more importantly, a method

¹³ so named to engender a sense of shared responsibility amongst the banks for preventing money laundering – an attempt that was reasonably successful

¹⁴ The AML Working Group provided the direction for a number of initiatives the PNGFIU put into practice over the next two years. These included electronic reporting of STRs; sharing of STRs with all of the banks to reduce ‘bank shopping’ by offenders; working with the Central Bank on enhanced due diligence; provision of a Fraud Methodology Report; and the Guideline on Government Cheques and Payments

of raising the perception that these transactions were being observed and to continue them might be a risky prospect.

With offenders spread across the country, and insufficient resources to travel, the PNGFIU decided to request that the banks question their customers. The PNGFIU sent the list of names to the relevant bank and provided the impetus for the banks to undertake questioning of their customers by advising the bank that the PNGFIU suspected the transactions to involve the proceeds of crime –thereby triggering the potential for prosecution of the bank under S35 of the POCA¹⁵ if the bank facilitated similar transactions by the same customers without first ensuring that the transactions are legitimate.

The banks were requested to interview the customers to assure themselves (and the FIU) that the funds were legitimate. After some further negotiation, the most affected bank placed a number of the identified accounts on alert, questioned a number of account holders and commenced reporting STRs on the identified persons.

The banks first questioned their customers in early May 2010, around this same time a number of newspaper and television advertisements on the Proceeds of Crime Act were run in the three national newspapers. A number of people identified and questioned about their transactions by the banks modified their transaction behaviour immediately, with some ceasing the suspicious transaction activity entirely.

¹⁵ Section 35 states “A person who receives, possesses, conceals, disposes of or brings into Papua New Guinea money, or other property, that may reasonably be suspected of being proceeds of crime is guilty of an offence”.

The newspaper advertisements that ran were placed by the PNGFIU and funded by the Department of Justice. The advertisements explained the reasons why the banks were querying customers on their transactions and had the dual effect of modifying the behaviour of bank staff and customers – encouraging bank staff to be active in identifying and rejecting suspicious transactions and providing them with a basis upon which to do it. Attachment 1 is a copy of one of these advertisements and 2 the same advertisement in Tok Pisin. One of the banks later turned this advertisement into posters displayed in their branches.

Unfortunately the bank didn't close or suspend any accounts at this first stage and it rejected only a few transactions. Some of the Government employees conducting these transactions continued for many more months and some of those who stopped initially, later re-commenced and were again the topic of discussion between the PNGFIU and the bank. On 3 June 2011, senior management of the most affected bank agreed to commence a process of suspending and closing offender's accounts and on 23 June put in place a process to prevent cashing of Government cheques over a certain threshold by Government employees or their representatives.

At the time of writing the PNGFIU is still providing list of Government employees to the banks, however, the names seen in the early stages no longer appear and the amounts being deposited are significantly smaller. The amount of corruption disrupted through this process is difficult to determine as offenders may have merely changed their methodology but is estimated to be in the vicinity of K20 million to date.

Method 2: Guideline on Government Cheque Due Diligence

Despite the large and frequent transactions conducted by Government employees being a problem, that issue pales in comparison to the issue of fraud and corruption conducting using Government issued cheques.

As the APG and World Bank noted during the AML/CTF mutual evaluation process;

“Laundering the proceeds of large scale public sector corruption in PNG consistently indicate direct placement in the banking sector” (APG/World Bank, 2011, P103)

From meetings with banks in the AML Working Group the banks made it clear that, while they may have been processing Government cheques that had been obtained through illegal means, they did not have the staff, skills nor systems to allow them to do otherwise. They were not able to effectively differentiate between the legitimate and illegitimate cheques and were not in a position to vet every transaction involving a Government cheque. (One bank suggested on more than one occasion that perhaps they could report every Government cheque as a Suspicious Transaction and let the PNGFIU sort them out)

The PNGFIU is vested with both the requirement to enforce the Proceeds of Crime Act as well as train banks and other Cash Dealers, however it is somewhat hampered by an inability to impose any form of effective sanction on a Cash Dealer other than criminal prosecution.

The PNGFIU is mindful that prosecution for a money laundering offence is a very blunt tool and could place a bank's correspondent banking relationships in jeopardy, possibly

leading to the collapse of the bank.¹⁶ Under these circumstances prosecuting a bank for money laundering did not present a feasible solution without first attempting to modify banking processes through other less confrontational means.

Wearing the twin hats of regulator and trainer the PNGFIU offered to prepare a guideline outlining some basic methods for identifying illegitimate transactions and conducting due diligence on Government cheques. The guideline outlined the minimum processes that a bank would have to undertake to be able to show that it was acting in good faith in attempting to ensure the cheques they processed were legal. The intention of the PNGFIU in issuing the Guideline was to encourage the banks to cease facilitation of fraudulent transactions without having to prosecute them.

Drafting of the guideline started in late 2009, went through 8 drafts, was discussed at numerous meetings and was the subject of considerable correspondence and debate.

Attachment 3 is a copy of the '*Guideline on 'Due Diligence In Relation To Government Cheques and Payments'*' issued by the PNGFIU on 2 June 2011. It applies to Government cheques and payments with a value of more than K2 million (AUD 800,000).

The banks did not accept the guideline without negotiation – understandably so, as the Guideline enunciates the increased burden the banks were now being placed under in order to avoid committing offences under the POCA.

¹⁶ FATF Recommendation 7 states “Financial institutions should, in relation to cross-border correspondent banking and other similar relationships, in addition to performing normal due diligence measures: a) Gather sufficient information about a respondent institution to understand fully the nature of the respondent’s business and to determine from publicly available information the reputation of the institution and the quality of supervision, including whether it has been subject to a money laundering or terrorist financing investigation or regulatory action. b) Assess the respondent institution’s anti-money laundering and terrorist financing controls.

After reading the first draft the banks expressed some concern about the volume of documentation to be retained and subsequently an amendment was made to reduce this burden. The banks also expressed concern that they were 'becoming policemen'.¹⁷

Later, one of the banks responded that while it had '*no reservations in adopting the guideline*' however they expressed the opinion that the POCA '*does not impose any obligation for compliance of these guidelines by cash dealers*'. Furthermore, '*the only obligation under the POCA is for cash dealers to report suspect transactions to the PNGFIU*' and '*it is the PNGFIU and the police generally who are empowered to take action relating to proceeds of crime*'.¹⁸

The PNGFIU's response¹⁹ highlighted to the bank in question that the PNGFIU did indeed intend to take action on the proceeds of crime, though perhaps not by the traditional methods envisaged by the bank when drafting their response.

The PNGFIU response included advice that the PNGFIU considered that a bank not only had the right but the obligation to seek any and all information and documentation sufficient to ensure itself that the funds it receives are not sourced from the proceeds of crime.

The response also indicated that the requirement imposed by the POCA on the Cash Dealers to know a customer's business, identify the ultimate beneficiary, and to train staff to recognise money laundering transactions placed Cash Dealers in a position

¹⁷ The PNGFIU were advised in late 2010 in a meeting with an IMF consultant that banks expressing an opinion that they are doing the work of the police is not uncommon in jurisdictions with newly introduced or enforced AML legislation.

¹⁸ Letter to OIC PNGFIU dated 4 March 2011

¹⁹ Letter from OIC PNGFIU dated 17 May 2011

where they are required to actively identify transactions relating to proceeds of crime not merely report suspicious transactions that may become aware of.

The issuing of the Guideline had an immediate impact. On 23 June 2011 senior management of the most affected bank issued a notice to its branches that no cash transactions relating to Government payments would be paid to Government employees or representatives. On 30 June the same bank placed an advertisement in the newspapers advising that ‘special clearance’ on cheques would no longer be allowed and that all cheques would have to clear in the normal timeframe²⁰. (The National Newspaper, 30 June 2011, page 10) (‘special clearance’ having been identified as a ‘red flag’ in the guideline).

The issuing of the Guideline triggered a response in the media commencing with an article titled “*Banks Join Fraud War*”²¹. The article observed ,

‘Commercial banks and financial institutions are being corralled in to assist in the fight against fraud and corruption in government’. (Kolma, July 19, 2011)

A later article stated that the Guideline was:

“actually aimed at abrogating the responsibility and liability of the government in terms of ensuring good governance” (Kolma, 29 July 2011, The National Newspaper)

A later radio interview included the opinion that:

²⁰ The advertisement stated that *‘this change is to assist us in protecting your interests’*

²¹ 19 July, The National Newspaper

“it's not the role of the banks to ensure there is transparency and accountability with government expenditure”(Radio Australia, 1 August 2011)

Further media articles questioned whether the guideline sought to:

“abrogate the governance responsibility of government and the duties of the Financial Intelligence Unit (FIU) to investigate money laundering into the financial system”

(Kolma, 5 August 2011)

The legitimate point of contention alluded to in these reports relates to the level of responsibility that banks might be required to bear to ensure that the transactions they process are not facilitating crime.

It is arguable that in an environment where corruption is not systemic this responsibility is low. However, in an environment like PNG where *‘huge sums of public money’* are misappropriated by all levels of Government, the responsibility of a bank to ensure it isn't facilitating corruption perhaps should be a little higher.

Furthermore, the consequence of not acting to prevent transactions in each of the circumstances is very different. A bank in a developed country like Australia that fails to prevent the placement of drug proceeds into the banking system is less likely to impact on the *‘viability and stability of the nation and health and welfare of its citizens’*. For a bank that facilitates (or is used to facilitate) grand corruption in a country like PNG, that risk is considerably higher, particularly where such transactions are repeated week after week, year after year. As such banks in such environments should arguably be held to a higher standard of accountability.

Ultimately, however the question of the level of responsibility of banks for the transactions that they engage in may have to be resolved, in Papua New Guinea at least, by the courts. The Guideline provides a direction to the banks, as the Department of Justice put it, as to *'when the FIU would be likely to seek prosecution'* and when it is *reasonable to suspect* that the funds they handle are the proceeds of crime. It also, as the APG and World Bank noted;

'reflects the priority on combating the proceeds of corruption through the banking sector and while it does not create new obligations, it does provide guidance on high risk scenarios and makes explicit a number of implicit primary obligations contained in POCA. The draft Guideline provides further in-depth guidance on practical implementation of the CDD obligations included in the POCA in the context of accepting government cheques and payments, including 'red flags'.

(APG/World Bank, 2011, p102)

It is therefore not unreasonable to expect that the courts may refer to the Guideline in deciding whether a particular transaction was money laundering.

It is acknowledged that Cash Dealers in PNG (as in many countries) are placed the difficult position of appropriately responding to transactions that they suspect to be the source or application of proceeds of crime. Legislation requires them to identify such transactions but simultaneously makes handling such funds illegal.

At the time of writing the PNGFIU had not yet commenced process to prosecute any of the banks under the POCA. That option always remains an open but will no doubt be a last resort dependent due to the potential catastrophic effect such action could have upon the bank.

The most affected bank and the PNG central bank (the Bank of Papua New Guinea) responded to the Guideline by commencing a process to implement elements of the Guideline which at the time of writing had lead to the identification and disruption of several tens of millions in illegitimate payments. No attempt has been made to quantify the ongoing deterrent effect of such disruption however it is believed to be significant.

Conclusion: Lessons Learned - Merging Forensic Accounting Practice with Teaching and Research

The PNGFIU is attempting to break the cycle of systemic corruption in Papua New Guinea in an environment pervaded by a ‘collapsed public service’ using innovative processes developed from anti money laundering legislation that don’t rely on the criminal justice system or cooperation from the agencies of the public service; or require significant funding. The skills and knowledge to do this have covered the forensic accounting spectrum, from technical investigative skills, data manipulation and analysis, legislative interpretation, legal analysis, and negotiation.

The legislation available to the PNGFIU suffers from having been drafted based upon laws intended to prevent laundering of the proceeds of international drug crime. That has not prevented the PNGFIU using it with good effect and hopefully providing the catalyst for a longer-term reduction in corruption.

PNG shares problems such as lax governance and high levels of fraud and corruption with other developing countries. As such, the processes developed by the PNGFIU may be transferable to them with some modification. In this context, the assistance that forensic accounting research and teaching might offer has the potential to significant. To be really useful, solutions developed to address corruption need to be context-

specific and embody an appreciation of the difficulties that face practitioners operating in the environment.

There is no doubt that the authors of this report have benefited from skills learned in formal training, including studies in accounting, financial investigation and forensic accounting. Obtaining this sort of training, however, has its challenges. There is a scarcity of research and courses available that deal with the investigation or disruption of corruption in developing countries using AML methodology.

Research conducted by groups such as the Asia Pacific Group on Money Laundering and FATF is, quite rightly, focussed on laundering typologies and prevention of corruption through application of the FATF Recommendations. At the other end of the spectrum, groups such as Transparency International focus on methods of deterring corruption by exposing corrupt practices and informing civil society. Between these two styles of corruption fighting there may be a niche for forensic accounting to fill by providing methods of deterring corruption through means similar to those developed by the PNGFIU.

It is acknowledged that the processes currently being used in Papua New Guinea to begin to address corruption will need to be constantly modified as criminal behaviour changes. Successful modification will require a detailed knowledge of current criminal behaviour, the application of relevant legislation and, more problematically, identification and implementation of effective methods of disruption.

Some of the training that is available on AML methodology is based on the assumption, for example, that offenders will have used complex methods of laundering as found in developed countries. Less often is training provided that gives practitioners skills to

generate strategies and methods of preventing, disrupting or reducing large-scale grand corruption as found in Papua New Guinea. Research into forensic accounting in the developing country context has the potential to produce the types of valuable insights required to assist future practitioners to develop these skills. Improvements in forensic accounting practice through the teaching and sharing of these insights may have the potential to contribute significantly to the fight against corruption and a reduction in poverty and suffering in developing countries such as Papua New Guinea.

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