ASSESSMENT OF RISKS OF MONEY LAUNDERING AND TERRORIST FINANCING AND INFLUENCE ON FINANCIAL AUDIT OPINION

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Abstract:
Almost half of the Romanian companies have been victims of economic crime in the last two years, and over 50% of the economic crimes committed globally were caused by the inefficiency of internal control mechanisms, according to a PwC Report of May 2018. Under these conditions, it was necessary for economic entities to develop procedures that prevent, combat, but also report fraudulent behavior. The financial auditor has an important role to play in this direction, both for assessing the risk of fraud, in general, and for assessing the risks of money laundering and terrorist financing, in particular. In this regard, recent changes were made to regulations issued at European and national level on the obligations of financial auditors for the establishment of measures to prevent and combat money laundering and terrorist financing in the missions in which they are involved. This article aims, on the one hand, to highlight the financial audit procedures for assessing the risks of money laundering and terrorist financing identified in the audit missions of companies listed on the BSE, and on the other, to test the influence these risks on the reporting by the financial auditors of the suspicious transactions, but also on the audit opinion.

1. INTRODUCTION

According to the PwC Global Economic Crime and Fraud Survey Report (PwC, 2018) from May 2018, 42% of Romanian companies have been victims of economic crime in the last two years, as found in their reports. In addition, more than half of economic crimes committed globally were caused by the inefficiency of internal control mechanisms (Cascarino, 2013), the same report reported. The PwC survey also showed that a significant percentage of economic crime is mainly due to people inside organizations.

In these circumstances, it is very important for entities to develop procedures that prevent, combat, but also report fraudulent behavior. An important role in this direction belongs to *the financial auditor*, both for the assessment of the risk of fraud (Montesdeoca, *et. al*., 2019), in general, and for the assessment of the risks of money laundering and terrorist financing, in particular. For the implementation of these steps, the normative acts (EU, 2014a, 2014b, 2018, Law no. 129/2019, Law no. 535/2004) issued at European and national level present the legal framework regarding *the obligations of financial auditors for the establishment measures to prevent and combat the financing of terrorist acts* in the missions in which they are involved. The responsibility of professional accountants cannot be reduced only to meeting the individual needs of a client, but must be related, first and foremost, to the public interest (Vasile, *et. al.*, 2018; Özşahin, *et. al.*, 2017).

2. REVIEW OF THE SPECIALIZED LITERATURE

Although regulatory measures to prevent and combat money laundering and terrorist financing are increasingly adapted to the requirements, it is found that not all entities are aware of the risks of fraud they face and their consequences. Regarding the consequences, in addition to damaging the reputation and criminal liability, the financial impact is not negligible (Zhang, X., *et. al.*, 2018) given that in the last two financial years, 20% of organizations in Romania have estimated damages from economic crime of up to one million dollars, and 16% reported damages of more than one million dollars (PwC, 2018). The same PwC Report highlights the fact that the financial impact is even greater globally. In addition, there are intangible costs associated with fraud, but also costs for investigations and other types of analysis that greatly increase the losses resulting from economic crime.

For preventing and combating acts of economic crime, an important role belongs to *the financial auditor*, both for the assessment of the risk of fraud (Bunget, *et. al*., 2009; Robu, 2014), in general, and for the assessment of money laundering and terrorist financing, in particular. The national rules issued for this purpose set clear tasks for financial auditors, who will place clients in certain risk categories after their assessment. Despite all the rigors imposed, an important component of placing clients in a certain risk category, from the point of view of money laundering and terrorist financing, is the auditor's experience.

2.1. Obligations of financial auditors on preventing and combating money laundering and terrorist financing

According to the regulations issued at national level (Law no. 129/2019), the obligation to institute measures to prevent and combat money laundering, as well as to prevent and combat the financing of terrorist acts rests with *financial auditors* in their missions.

Although that regulation contains a broad definition of *money laundering*, it can be used to mean the conversion of income from criminal activities in such a way as to conceal its illicit origin (Accountancy Europe, 2018). Three stages of the money laundering process are identified, according to the International Financial Action Group - IFAG (Accountancy Europe, 2018), namely: *the placement, stratification and integration* of money in the circuit of economic activities. Although the methods of money laundering are varied, certain vulnerable points can be identified during the mentioned stages, such as: placing cash in the financial system, crossing cash across borders or transferring cash to and from the financial system (CFAR, 2016).

As is already known, terrorism is the set of actions and/or threats that pose a public danger and affect national security (Law no. 535/2004 updated). *Terrorist financing* refers to either the allocation or collection of funds to be used for terrorist activities (Accountancy Europe, 2018). Compared to money laundering, which involves the introduction of illicit amounts into the financial system to finance terrorism, the money can come from legal, illegal or both sources. Whatever the situation, the techniques used, either to launder money or to hide the terrorist financing operation, are similar.

In this context, financial auditors fall into the category of *reporting entities*, having all the obligations arising from legislation to prevent and combat money laundering and terrorist financing (CFAR, 2015). Specifically, financial auditors are required to develop their *own customer knowledge policies and procedures* to prevent money laundering and terrorist financing and to *implement mechanisms and measures to prevent and combat money laundering and terrorist financing*, imposed by CFAR, in accordance with with regulations. A first step in this direction is that by an internal act, audit firms must designate one or more persons within the entity responsible for enforcing the provisions on preventing and combating money laundering and terrorist financing. Their names will be communicated to the National Office for Prevention and Combating Money Laundering (NOPCML) (CFAR, 2015).

Four elements are considered regarding *the client's knowledge* in the matter of preventing and combating money laundering and terrorist financing, from the point of view of financial audit, namely: accepting clients according to the degree of risk, but also monitoring during missions; establishing standard measures and additional customer knowledge measures for each category; identifying suspicious transactions by checking unusual customer transactions; preparation and retention of documentation by the auditor and establishing criteria for accessing reports on preventing and combating money laundering and terrorist financing.

2.2. Customer acceptance policy and measures to prevent and combat money laundering and terrorist financing instituted by financial auditors

As mentioned above, in accordance with regulatory requirements, financial auditors are required to develop and apply *appropriate procedures in the customer knowledge* phase to prevent money laundering and terrorist financing when accepting an audit engagement. The elaboration of customer knowledge policies will take into account the fact that the volume of information obtained about the client and the verification of their identity will depend on the risk assessment and on the classification in a certain *category of clients*, depending on the risk class (CFAR, 2015).

Depending on the risk category to which clients fall, financial auditors will take various measures to prevent money laundering and terrorist financing, namely: *standard measures, simplified measures and additional customer awareness measures.* The classification of clients in *a certain risk category*, depending on the existing suspicions related to money laundering and terrorist financing, is based on an estimate of the degree of risk related to new clients and those existing in the portfolio (CFAR, 2016). International practice (CFAR, 2016) recommends the use of *a specific risk questionnaire* through which a score or score will be given to the client, based on its characteristics, which will place it in the risk categories provided by law, respectively: *high risk, medium or small.* EU Directive no. 849/2015 presents *lists of potentially increased and potentially reduced money laundering risk factors*, structured according to three criteria: *customers, activity carried out and from a geographical point of view*. For example, the table below shows an extract of these factors.

Table 1. Factors of money laundering risks

Factors of money laundering risks on customers	
Potentially increased	*Potentially reduced*
- *the business relationship takes place in unusual circumstances;* - *customers residing in high-risk geographical areas;* - *customers who have mandated shareholders or bearer shares;* - *cash-flow activities;* - *the structure of the client's shareholders is excessively complex.*	- *customers: listed companies that have the obligation to publish information of public interest, including the beneficial owner;* - *customers residing in low-risk geographical areas.*
Factors of money laundering risks for products, services, transactions or distribution channels	
Potentially increased	*Potentially reduced*
- *products or transactions that may promote anonymity;* - *business relationships or distance transactions, without certain protection measures;* - *payments received from unknown or unrelated third parties;* - *new products, practices, distribution mechanisms and technologies.*	- *life insurance policies with low premiums;* - *products for which the risks of money laundering and terrorist financing are managed by other factors, such as financial constraints or transparency of ownership.*
Factors of geographic money laundering risks	
Potentially increased	*Potentially reduced*
- *customers operating in countries that do not have effective anti-money laundering and anti-terrorist financing systems;* - *clients operating in countries with a high level of*	- *customers operating in the Member States;* - *customers operating in third countries with effective anti-money laundering and anti-terrorist financing systems;*

| corruption or other criminal activity;
 - customers operating in countries subject to sanctions, embargoes by the EU or the UN;
 - customers operating in countries that provide financing or support for terrorist activities. | - clients operating in countries with a low level of corruption or other criminal activities;
 - customers operating in third countries that have laid down anti-money laundering and anti-terrorist financing requirements, in accordance with the revised IFAG recommendations. |

Source: own processing according to EU Directive no. 849/2015

The best practice guide presents examples of clients who may be involved in money laundering. These are "off-shore" audit clients, audit clients from tax havens, "shell" companies or even listed companies. All of these entities, insofar as they represent audit clients, present greater or lesser risks in terms of money laundering or terrorist financing. In this direction, the OECD Report (OECD, 2015) on the means of *using companies for illicit purposes* identified a number of measures to improve the transparency of legal entities such as companies. In order to prevent and combat money laundering and terrorist financing, in addition to the policy of accepting customers, financial auditors must focus on the most appropriate procedures and tests, so as to collect sufficient and thorough audit evidence.

2.3. Procedures, tests and audit evidence on the assessment of the risks of money laundering and terrorist financing

Even if an audit client has been accepted, passing the "proof" of involvement in acts of money laundering and terrorist financing at the stage of its knowledge, the financial auditor must rely on professional skepticism in this regard (Yao, et al. ., 2019), during the entire mission, as a mandatory requirement.

The procedures used by the auditor to collect audit evidence on the assessment of the risks of money laundering and terrorist financing are directed at the stages following the client's pre-planning/acceptance, namely: audit procedures related to mission planning, audit procedures related to actual control of accounts and audit procedures related to the completion of the mission. In *the planning stage of the financial audit mission*, a series of clues can be identified that may raise the auditor's suspicion of money laundering acts that lead him to investigate further in certain areas (CFAR, 2016). These are, for example, clients who have canceled an audit engagement and want to resume it without any specific reason, or *clients who decide to conclude a statutory audit contract very late*, due to an unexpected exceedance of the audit criteria. In addition, there may be other situations that raise the auditor's suspicion from the planning stage of the mission, namely: *changes in key personnel in the executive management or shareholding structure, but also sudden redirections of the business*.

There are situations in which the professional reasoning of those responsible within the client entity is more than present (such as accounting estimates) and then it is difficult for financial auditors to determine whether the distortions in these areas are caused by error or fraud (Sadaf, *at. al.,* 2018). Regarding the audit procedures related to the completion of the mission with a focus on identifying and assessing the risk of money laundering, the most important aspect is to review all information related to customer knowledge, potential suspicious transactions and which may generate a possible report to Office.

Based on the results identified at the level of the consulted literature, in the present study the following research hypotheses are proposed for testing and validation:

Research hypotheses:
1. At the level of Romanian companies listed on the BSE on the regulated market, one can identify a company profile according to the object of activity, the adoption of a Code of Ethics and Integrity and anti-corruption policies, compliance with the Corporate Governance Code, adherence to the National Anticorruption Strategy and transparency in remuneration policy for board members.

2. At the level of Romanian companies listed on BVB on the regulated market, a profile of the audited company can be outlined, depending on the object of activity and the size of the company, by reference to the audit opinion, the auditor's membership and the independence of the audit committee.

3. Key audit matters, identified as money laundering risk factors, influence audit opinion.

3. RESEARCH METHODOLOGY: POPULATION, SAMPLE, VARIABLES, DATA SOURCE, DATA ANALYSIS METHODS

To test and validate the proposed research hypothesis, the study follows a statistical approach (Jaba, 2002), which involves identifying the analyzed population and selecting the sample, choosing variables, establishing data analysis methods and proposing econometric models to analyze, collecting and processing data, and, finally, obtaining the results of the research and their interpretation.

In the study, the analyzed *population* is represented by all the companies listed on the Bucharest Stock Exchange - BSE, and the selected sample includes only the companies on the regulated market. From the 81 companies listed at the end of the financial year 2019, a number of 9 companies were excluded for which the data were unavailable. Thus, the analyzed *sample* includes 72 listed companies, for which data were collected for the financial year ended at the end of 2019. The chart below shows the distribution of companies by business objects.
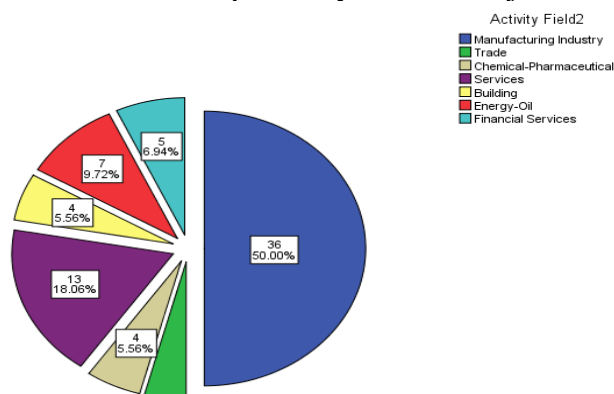
Figure 1. Distribution companies in the sample after the activity

For testing and validating the proposed research hypotheses, the study aims, first of all, to identify a profile of the Romanian company listed on BVB on the regulated market, at the end of 2019, depending on the object of activity, the adoption of a Code of Ethics and Integrity and anti-corruption policies, compliance with the Corporate Governance Code, adherence to the National Anticorruption Strategy and transparency in the remuneration policy of board members. Secondly, the research is aimed at outlining a profile of the Romanian company listed on the BSE on the regulated market depending on the object of activity, the number of employees, the auditor's affiliation, the audit opinion and the independence of the audit committee. Finally, the research hypothesis is tested, which tries to demonstrate that the key aspects of the audit, identified as risk factors for money laundering, influence the audit opinion.

Thus, to identify the associations between the object of activity and the other variables included in the models, the Factorial Analysis of Multiple Correspondences (FAMC) is used, as a method of multivariate data analysis (Pintilescu, 2007). Then, to test the influence of key audit aspects, identified as money laundering risk factors, on the audit opinion, the multiple linear regression model (Jaba, 2008) used is:

$$Audit\_Opin2_i = \beta_0 + \beta_1 Affil\_Trans_i + \beta_2 App\_Auditor_i + \beta_3 Reorg\_Plan_i + \beta_4 Changes\_Acc_i + \beta_4 Inf\_Access_i + \beta_5 Inf\_Access_i \quad (1)$$

$+ \beta_6 Own\_Shares_i + \varepsilon_i$

where:

- *Audit_Opin2$_i$* represents the audit opinion issued for the company *i*, with *i=1,..., 72,* which can be taken in one of the four forms described in the table below;
- *Affil_Trans$_i$, App_Auditor$_i$, Reorg-Plan$_i$, Changes_Acc$_i$, Inf_Access$_i$, Own_Shares$_i$* are the risk factors: transactions with related parties, late appointment of the auditor, reorganization plan, changes in the financial-accounting department, limitation of access to information, redemption of own shares - indicating the existence or not of these risks for the company *i*, with *i=1,..., 72*;
- *$\beta_{i=0,...,6}$* represents the parameters of the regression models;
- *ε_i* represents the error component, *$\varepsilon \sim N(0, 1)$*.

The table below shows the identified variables and their description, which are the basis of the processing performed.

## Table 2. List of identified variables and their description

Variable symbol		Variable description
Act_Field2	Activity Field2	Manufacturing Industry
		Services
		Energy-Oil
		Chemical-Pharmaceutical
		Financial Services
		Building
		Trade
Auditor	Auditor	Big4
		NonBig4
Audit_Opin1	Audit Opinion1	Unmodified opinion
		Modified opinion
Audit_Opin2	Audit Opinion2	Unmodified opinion
		Opinion with reservations
		Contrary Opinion
		The Imposiblity to Exprees on Opinion
Code_Ethics	Code of Ethics and Integrity	Non/Yes
Anti_Corr_Pol	Anti-Corruption Policies	Non/Yes
Decl_NAS	Declaration of Adherence to the NAS	Non/Yes
Affil_Trans	Affiliated Parties Transactions	Non/Yes
Int_Ctrl	Inefficient Internal Control	Non
		Yes
App_Auditor	Appointment of Auditor after Dec 31	Non
		Yes
Reorg_Plan	Reorganization Plan	Non
		Yes
Changes_Acc	Changes Accounting Department	Non
		Yes
Inf_Access	Information Access Limitation	Non
		Yes
Own_Shares	Redemption of own Shares	Non
		Yes
CG_BVB	Compliance - Governance Code BVB	Non
		Yes
Audit_Comm	Independent Audit Committee	Non
		Yes
Remun_Pol	Transparency in the Remuneration Policy	Non
		Yes

Source: own processing

The data were collected manually from the annual and audit reports of the companies included in the analyzed sample, and the data analysis was performed with SPSS 22.0 software.

4. RESULTS AND DISCUSSIONS

To test the first research hypothesis - *At the level of Romanian companies listed on the BSE on the regulated market, one can identify a company profile according to the object of activity, the adoption of a Code of ethics and integrity and anti-corruption policies, compliance with the Governance Code adherence to the National Anticorruption Strategy and transparency in the remuneration policy of board members* - the variables taken into account concerned the codes and policies adopted or not, as well as the strategies to which the sampled companies adhered or not, so that they be classified in certain risk categories. Starting from the specialized literature, but also from the requirements imposed by normative acts regarding the prevention of money laundering and terrorist financing, from the reports published by the sampled companies information was extracted on the steps taken by companies in this regard. Thus, the adoption or not of the Anti-corruption Policies, of the remuneration of the members of the Board of Directors and of the Codes of ethics and integrity, the full or partial observance of the Corporate Governance Code of BVB, the adherence or not to the National Anticorruption Strategy; all these being associated with the object of activity, as can be seen in the Figure below.
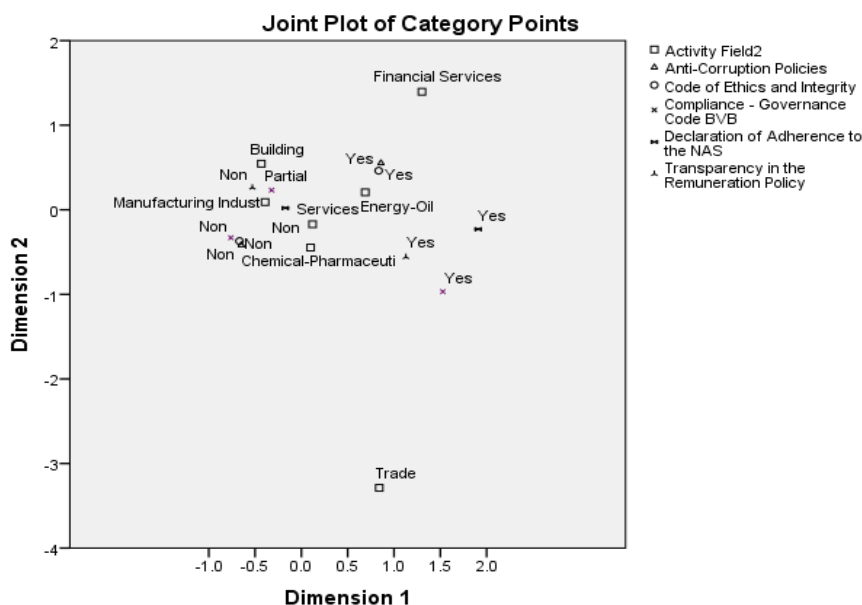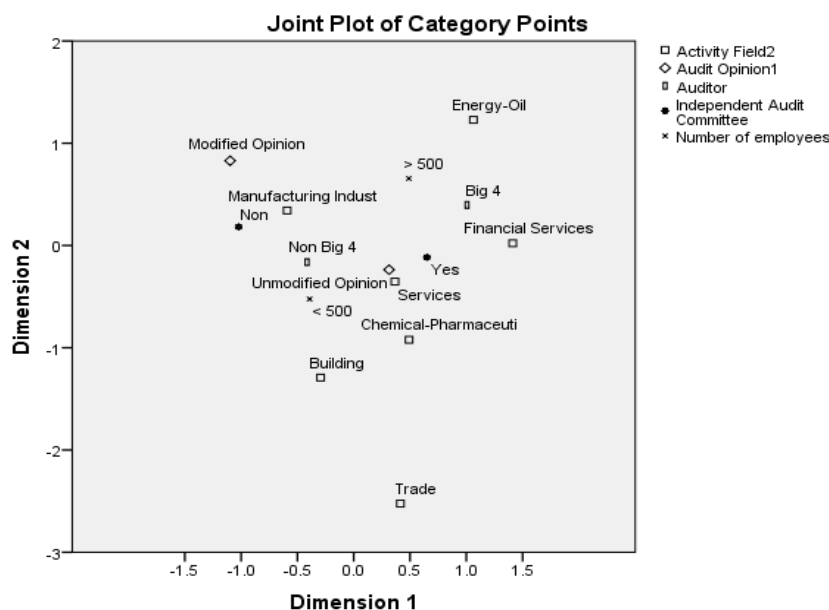

Figure 2. Associations between the object of activity, Codes and Policies adopted by companies
Source: own processing in SPSS 22.0, using Factor Analysis of Multiple Correspondences

From the previous Figure, it can be seen that the entities in the sample studied operating in the fields: financial services and energy-oil comply to a greater extent with the conditions listed above, while companies operating in the field of manufacturing comply more small established criteria. The middle position is occupied by construction and service companies in general. The entities that carry out their activity in the field of trade are in a more distant position, because they also have a very small share in the sample, of only 4% (3 out of 72). At the top of the ranking are companies in the energy-oil field, which have adopted Codes of Ethics and Integrity, Anti-Corruption Policies, Transparent Remuneration Policies of Board Members and, in addition, have joined the National Anticorruption Strategy.

To test the second research hypothesis - *At the level of Romanian companies listed on BVB on the regulated market, a profile of the audited company can be outlined, depending on the object*

of activity and the size of the company, by reference to the audit opinion, auditor membership and independence audit committee - the variables identified were: the object of activity, the auditor's membership in Big4 or Non Big4, the type of opinion (unchanged or modified), the number of employees (greater than or less than 500), and the independence of the audit committee. From the Figure below, it can be seen that significant differences also appear between companies operating in the energy-oil field, but also financial services and those in the manufacturing and construction industries. More precisely, the companies in the energy-oil field are audited by auditors who are part of Big4, the opinions issued are without reservations, they have independent audit committees, but there are also companies that exceed the number of 500 employees. Amended audit opinions are issued to some companies operating in the manufacturing and construction industries by Non Big4 auditors. Areas: chemical-pharmaceutical and services, in general, lie between the two extreme categories.
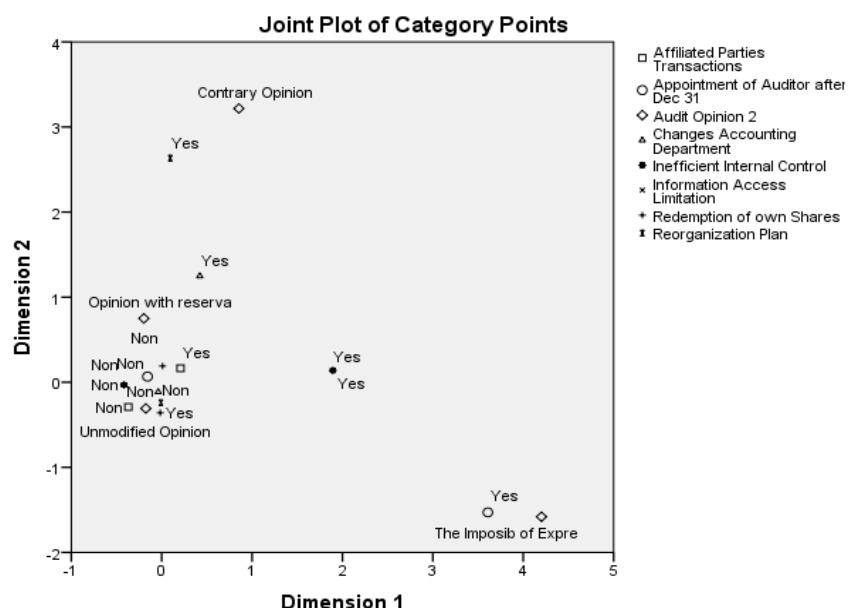

Figure 3. Associations between the object of activity, the size of the companies, the auditor and the audit opinion
Source: own processing in SPSS 22.0, using Factor Analysis of Multiple Correspondences

To test the third research hypothesis - *Key audit matters, identified as money laundering risk factors, influence the audit opinion* - first, the associations between the type of audit opinion and the variables considered money laundering risk factors were identified , namely: transactions with related parties, appointment of the auditor after the closing date of the financial year, changes in the Financial-Accounting Department, inefficiency of internal control, limited access to information of the auditor, repurchase of own shares and the existence of reorganization plans. These aspects can be seen in the Figure below.

Figure 4. Associations between audit opinion and risk factors
Source: own processing in SPSS 22.0, using Factor Analysis of Multiple Correspondences

From the presented Figure, it can be seen that: the contrary opinion issued by the auditor is based, in particular, on the reorganization of companies, the impossibility of expressing an opinion is caused by the fact that auditors were appointed after the balance sheet date, the reserved opinion is justified by changes in the Department of accounting, and the redemption of own shares did not cause any change in the auditors' opinion. The inefficiency of internal control and the limitation of access to information do not appear to have influenced the audit opinion.

Following the application of the proposed Multiple Linear Regression Model, it can be seen that the type of audit opinion depends 57% on the risk factors identified, as can be seen in the Table below. The difference is explained by the variables not included in the model.

Table 3. Estimates of the regression model parameters

Variables included in the model	β	S.E.	Sig.	R^2
Affil_Trans	.366	.128	.001	.569
App_Auditor	.1664	.325	.006	
Reorg-Plan	.1084	.211	.000	
Changes_Acc	-.021	.217	.000	
Inf_Access	.177	.172	.924	
Own_Shares	-.385	.124	.308	
Constantă	-.1842	.503	.003	

Regression model:
$Audit\_Opin2_i = \beta_0 + \beta_1 Affil\_Trans_i + \beta_2 App\_Auditor_i + \beta_3 Reorg\_Plan_i + \beta_4 Changes\_Acc_i + \beta_4 Inf\_Access_i + \beta_5 Inf\_Access_i + \beta_6 Own\_Shares_i + \varepsilon_i$

Variable: the inefficiency of internal control was excluded from the model, from the very beginning, and smaller influences had the variables: limiting the access to information of the auditor and redemption of own shares, justified influences and the size of Sig. The biggest influences are due to the late appointment of the auditor and the existence of reorganization plans of some of the companies that were included in the sample.

CONCLUSIONS

As it is known, it is legislated that when the financial auditors suspect that the transactions carried out by the clients aim at money laundering or terrorist financing, they have the obligation to

send NOPCML a report of suspicious transactions (Law no. 129/2019) , a fact also brought to the attention of CFAR by a notification. However, financial auditors have an obligation not to disclose to third parties information held in connection with money laundering and terrorist financing, outside the conditions provided by law. However, in relation to the Office or CFAR, the provisions on professional secrecy cannot be invoked.

It was noted in the content of the paper that financial auditors must submit to the NOPCML a report of suspicious transactions when they have suspicions about the audited entities regarding money laundering and/or terrorist financing, according to the regulations. However, a weak point of the report is that the Office is not obliged to send a reply justifying whether the suspicion is well-founded or not. In addition, access to data on companies' involvement in money laundering and / or terrorist financing is very limited.

In this context, in our study we tried to identify the risk factors regarding the possible actions of money laundering and terrorist financing in which the companies included in the sample were involved based on the information published by them. Considering the identified factors, three research hypotheses were tested. Testing the first research hypothesis - *At the level of Romanian companies listed on BVB on the regulated market, one can identify a company profile according to the object of activity, the adoption of a Code of ethics and integrity and anti-corruption policies, compliance with the Corporate Governance Code, adherence to the National Anticorruption Strategy and transparency in the remuneration policy of the members of the board of members* - highlighted the fact that the entities in the field of financial services, but also those in the energy-oil sector present a lower risk in terms of money laundering, having adopted Codes of Ethics and Integrity, Anti-Corruption Policies, Transparent Remuneration Policies of the members of the Boards of Directors and, in addition, they have joined the National Anticorruption Strategy. The second research hypothesis tested - *At the level of Romanian companies listed on BVB on the regulated market, a profile of the audited company can be outlined, depending on the object of activity and the size of the company, by reference to the audit opinion, the auditor's membership and the committee's independence. audit* - led us to conclude that significant differences also exist between companies operating in the energy-oil field, but also in financial services and those in the manufacturing and construction industries, in the sense that for the former are generally issued opinions of unmodified audit. The third research hypothesis - *Key audit matters, identified as money laundering risk factors, influence audit opinion* - was tested using two methods of data analysis - FACM and multiple linear regression - and reported that the contrary opinion issued by the auditor is based, in particular, on the reorganization of the companies, the impossibility of expressing an opinion is caused by the fact that the auditors were appointed after the balance sheet date, the reserved opinion is justified by changes in the Financial-Accounting Department caused changes in the auditors' opinion. The result obtained highlights the fact that the type of audit opinion depends in proportion of 57% on the identified risk factors. The limitation of this study is that access to data on companies' involvement in money laundering and/or terrorist financing is very limited. This is because financial auditors must submit to the NOPCML a report of suspicious transactions when they have suspicions about the audited entities regarding money laundering and/or terrorist financing, but the Office is not required to send any response to justify whether the suspicion is well-founded or not.

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