

ANTI-MONEY LAUNDERING: THE BASICS

Installment 3: Company Formation



Company (and Trust) formation is one of the services performed by professional accountants that is most susceptible to money laundering risk. This installment looks at how professional accountants can apply a risk-based approach in the company formation process, identify key red flags, and know when to walk away and/or file a suspicious activity report.

How do criminals use company formation services?

Company formation services can include:

- incorporating companies or other legal entities;
- acting or arranging for someone to act as company director, partner, or nominee shareholder; or
- providing a registered office or business address.

Criminals are attracted to anonymity and transience and use corporate vehicles to move and conceal illicit funds.

The use of companies—particularly offshore—to act as corporate directors can distance the criminal from the corporate structure and make it harder for law enforcement to identify the origin of funds.

Criminals may obscure association between corporate structures by using a company formation agent to form multiple companies with different registered addresses.

Criminals seeking a veneer of respectability may purchase shelf companies with established histories.

What does a “risk-based approach” look like in company formation?

Customer Due Diligence

It is important to perform Customer Due Diligence (CDD) on the individuals who will ultimately own, control or benefit from the company or trust being established. This will enable you to assess the risk that the client could be involved in illegal activity, or that you might help to facilitate such actions. If you have concerns about the identity of these individuals, perform more stringent verification of their identity by collecting a range of evidence.

Understand the Commercial Rationale

You should always seek to understand the commercial reasons that a client has asked you to form or help administer a company. Professional scepticism is particularly important to ensure you do not unwittingly enable illegal activity.

Source of Funds/Wealth Checks

If a client asks you to form a company to take part in a transaction, you should ensure you understand where the funds for this have come from. For example:

- General family wealth or inheritance
- Sale of an asset(s)
- Long-term investments
- Business ownership

Politically Exposed Person Check

As part of assessing the risks of forming a company for a client, you should ascertain whether they, or a family member, are a Politically Exposed Person (PEP). If they are, the risk of proceeds of bribery or corruption passing through the company should be considered. An enhanced level of CDD may be required if you establish that your client, or those they are doing business with, are politically exposed.

CASE STUDY ON COMPANY FORMATION*

Othello & Co was approached to set up a UK company. The individual who contacted Othello said that he represented the family office of the prospective shareholders. These shareholders were stated to be ultra-high net worth individuals, residing in Latin America. The company was required as the individuals wanted to use it to distribute perishable food to the UK market.

The shares in the company were to be held by a trust. This trust appeared to be formed under New Zealand law, but the trustees were a Trust company based in Bermuda. Othello & Co could find very little information about the Trust company. The funds to capitalize the company and pay fees and expenses were to be paid by a legal firm based in Miami. Identity documents were provided for the beneficiaries and settlors of the trust, who were apparently the ultra-high net worth individuals. However, they appeared to have an extremely low profile, with no public information about their business or social activities recorded anywhere. Othello could find no evidence of the source of their wealth. It inquired about the name of the business (which was to source and supply the food to the UK company) in Latin America, but although there was a website, there did not appear to be any details of how to purchase goods or even contact details for a sales agent.

Othello & Co politely declined the opportunity.

*Note: names have been changed to preserve confidentiality.

Key Red Flags

Professional accountants should be aware of the key red flags for money laundering risk in the company formation process. While not dispositive, professional accountants should rely on their professional judgment and walk away and/or file a suspicious activity report if necessary. Red flags include:

- Being asked to form a company structure with no clear commercial purpose for the structure.
- Forming companies with complex ownership structures, in multiple jurisdictions, without commercial rationale.
- Prospective clients that are reluctant to provide client due diligence information that is needed in the client acceptance process.
- Prospective clients who are evasive about their source of wealth.
- Prospective clients who appear unnecessarily rushed to form a structure, especially in multiple jurisdictions.
- Prospective clients seeking to purchase a shelf company with banking and/or credit history.

When to Walk Away

- If doubts arise on the authenticity of the documents presented during the CDD process.
- If the client is seeking to falsify director or beneficial ownership details on official records.
- If inquiries into source of wealth identify suspicions that the funds may have a criminal origin.
- If background checks on the client fail to identify the substantive information you would expect for that type or size of client (see case study) and no satisfactory explanation is provided.

Filing a Suspicious Activity Report (SAR)

If you become suspicious that the client or potential client has committed a crime with proceeds, then you may have an obligation to report those suspicions to your local Financial Intelligence Unit.

- A SAR notifies law enforcement agencies of your suspicion of money laundering activity.
- In some countries there is a legal obligation on professional accountants to make SARs.
- A SAR adds to the intelligence picture of law enforcement and can be the missing piece of the puzzle in solving crimes.
- In some countries (such as the UK), SARs can alert authorities to concerns about vulnerable people who are victims of the underlying crime, such as human trafficking.

ADDITIONAL ASSISTANCE



For general anti-money laundering guidance, see the FATFs *Guidance for a Risk-Based Approach for the Accountancy Profession*. For detailed local information, including applicable regulatory requirements, contact your [professional accountancy organization](#).



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