

# FINANCIAL CRIME REVIEW OF ACCOUNTING, AUDIT AND INSOLVENCY FIRMS (DNFBP SECTORAL REVIEW)



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# EXECUTIVE SUMMARY

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In the second quarter of 2018 the Dubai Financial Services Authority (DFSA) commenced a review of Designated Non-Financial Businesses or Professions (DNFBPs) in the Accounting, Audit, and Insolvency sector (referred to in this report as the sector). More specifically, the DFSA conducted a review of the anti-money laundering/counterterrorist financing (AML/CTF) and sanctions compliance programs put in place by firms operating in the sector to mitigate the risks of financial crime (the Review). The Review also enabled the DFSA to gain a greater insight into firms operating in the sector to evaluate the financial crime risks posed by such services.

Overall, the Review revealed sound practices, but also identified some areas for improvement in the sector with respect to AML / CTF and sanctions compliance:

- Where firms had implemented customer risk assessments better systems and controls were evident. Overall a more formalised risk-based approach is required in order to assist in the identification of relevant AML/ CTF risk factors, rationales to support assessments, documenting and rating mitigating controls, and corresponding methodology,

- We were pleased to note the use of automated sanctions screening tools for customers but firms need to ensure they are screening beneficial owners and related parties as well as documenting the rationale for false positive hits,
- AML training programs were in place for employees but further measures should be considered for understanding the source of funds for potential money laundering, terrorist transactions or sanctions breaches,
- We were pleased to note all firms had appropriate frameworks in place for reporting suspicious activity reports (SARs).

This report considers these areas in further detail. Firms are encouraged to consider this report in light of their own practices and implement appropriate actions where necessary to ensure compliance. Additionally, the report findings may apply to other sectors. Accordingly, firms in these other sectors are encouraged to consider the report and take necessary action as appropriate.

# BACKGROUND AND IMPETUS FOR THE REVIEW

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The DFSA is the sole independent regulator of financial services conducted in and from the DIFC. As at 1 January 2019, the DFSA was responsible for the oversight of 491 Authorised Firms, 116 DNFBPs, and 16 Registered Auditors.

The DFSA is also the competent authority for the administration of Federal AML/CTF legislation in the DIFC, which means it has administrative responsibility for oversight of all AML/CTF legislation and direct supervision of Relevant Persons for compliance with the AML/CTF legislation, including the AML Module of the DFSA Rulebook (DFSA AML Module).

In line with the DFSA's regulatory priorities, the DFSA conducted a sector based review of the accounting, audit, and insolvency firms registered as DNFBPs in the DIFC in the second quarter of 2018.

The main objectives of the Review were to: (i) gain a greater insight into the firms operating in the sector and the nature of the accounting, audit and insolvency services being offered in and from the DIFC; and (ii) evaluate the financial crime risks posed by such firms, by reference to the AML/CTF sanctions, operations, policies, procedures, systems and controls implemented by each firm.

Accountants are generally considered gatekeepers of the financial system. They provide a wide range of services to a diverse client base, including facilitating transactions and navigating the complexities of the financial system. Additionally, due to the nature of the services offered, accountants are often privy to the inner financial workings of their clients.

Given their role as a gatekeeper, accountants must be vigilant in ensuring that their services are not used for, or in connection with, any criminal purposes. It is generally understood that criminals are using more sophisticated and opaque techniques to launder illicit money and are increasing their use of professional service providers with this goal in mind, including legal and accounting services.

Certain elements of the functions performed by accountants may be exploited for those engaged in financial crime activities, including:

- Financial and tax advice;
- Creation of corporate vehicles or other complex legal arrangements;
- Buying or selling of property;
- Performing and/or facilitating financial transactions; and
- Gaining introductions to financial institutions.

Accordingly, it is imperative for accountants, auditors and liquidators operating in and from the DIFC to comply with all applicable AML/CTF and sanctions legislation and be vigilant in preventing financial crime within their business and generally within their sphere of influence.

# SECTOR PROFILE

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As of the date of the review all of the firms in the sector are registered as DNFBPs and are physically located in the DIFC. The firms in this sector have a global geographic reach, although their main business focus is the Gulf Cooperation Council (GCC) region.

The makeup of the firms in this sector are partnerships and/or companies forming part of a global group. Certain firms operate as an integrated service offering and including other services, such as legal, company service providers, and auditors.

The nature of the services offered by the sector cover: audit, payroll, general accounting, forensic accounting and training.

The DFSA is aware that inherent AML/CTF risks in the broader accountancy sector are usually higher where such services involve handling client funds and/or conducting transactions for or on behalf of clients. However, the DFSA observed that firms in the sector currently conduct minimal activities involving client funds and transaction related dealings.

The customer profile serviced by the sector in the DIFC varies and includes individuals, Authorised Firms, small and medium-sized enterprises, and large publicly listed companies in the DIFC, United Arab Emirates (UAE), and globally. In the 2017 Annual AML Return, the sector reported that services were provided to 578 customers with approximately 5% reported as having an exposure to PEPs.

The DFSA observed an even allocation between one-time customer engagements and ongoing customer engagements. The type of engagement is determined by the nature of the service offering. For example, training services or VAT registration is a one-time engagement, whereas payroll services and internal audit work is an ongoing engagement.

The DFSA observed that the majority of business relationships reported by firms were described as being directly with customers with an engagement service focus. The DFSA also noted the sector does not rely on intermediaries or third parties to conduct CDD on their behalf. Additionally, there is very limited or no need to utilise sophisticated technology in providing engagement services. The ML/TF risks for these types of service offerings are considered minimal.

The DFSA observed that there are limited transactional service offerings in the sector.

***Based on the above, the DFSA believes that the inherent ML/TF risk for the DNFBP firms in the accounting, audit, and insolvency services sector is low.***

# METHODOLOGY

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THE DFSA CARRIED OUT THE REVIEW IN THREE DISTINCT PHASES:

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## PHASE 1

**Desk-based review:** Phase one of the Review was conducted in the second quarter of 2018. The first component of phase one consisted of a desk-based review of each firm's 2017 Annual AML Return. The responses were analysed for any anomalies and assisted in creating a high-level AML profile for each firm and a general overview of firms in the sector. The second component of phase one was to request key AML/CTF program documents from each firm.



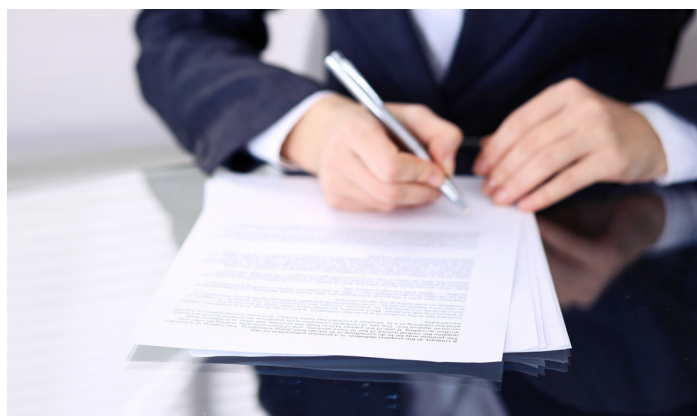
## PHASE 2

**On-site visits:** Phase two of the Review was conducted in the second and third quarter of 2018. This phase consisted of on-site inspections of each firm, including interviewing key staff and in-depth client file reviews.



## PHASE 3

**Analysis and reporting outcomes:** Phase three of the Review was conducted in the fourth quarter of 2018 and the first quarter of 2019. Phase three involved analysing the findings and observations from the on-site visits, communicating findings to each firm and preparing this general report.



# FINDINGS AND OBSERVATIONS

## BUSINESS AML RISK ASSESSMENT

The DFSA assessed each firm's responses set out in its 2017 Annual AML Return. Each firm certified that it had adequately assessed its business AML/CTF risks and that this certification was approved by the firm's senior management. All firms stipulated, as a minimum, that they had considered: (i) the types of their customers and customer activities; and (ii) the countries and geographic areas in which the firm carries on business. The DFSA observed that the majority of the firms had completed or updated their Business AML Risk Assessment within the last 12 to 18 months. The DFSA considers this a positive outcome where the Business AML Risk Assessments are reasonably current and are approved by senior management.

The desk-based review of each firm's Business AML Risk Assessments revealed that the sector could improve the quality of its Business AML Risk Assessments. The issues identified ranged from firms' failures: (i) to consider relevant AML/CTF risks, and (ii) to only addressing certain AML/CTF risks at a high level. Each firm's Business AML Risk Assessment was further considered as part of the on-site visits and interviews conducted by the DFSA with senior management.

### RISK-BASED APPROACH – AML RULE 4.1

#### A RELEVANT PERSON MUST:

- Assess and address its AML risks under this module by reviewing the risks to which the person is exposed as a result of the nature of its business, customers, products, services and any other matters which are relevant in the context of money laundering and then adopting a proportionate approach to mitigate those risks; and
- Ensure that, when undertaking any risk-based assessment for the purposes of complying with a requirement of this module, such assessment is:
  - i. objective and proportionate to the risks;
  - ii. based on reasonable grounds;
  - iii. properly documented; and
  - iv. reviewed and updated at appropriate intervals.

### THE DFSA'S EXPECTATIONS

- Having in place a properly documented methodology of how the firm conducts Business AML Risk Assessments for clients and prospective clients;
- Firms are expected to identify and assess the inherent money laundering and terrorist financing risks to which a client's business is or may be exposed to;
- Vulnerabilities to ML/TF must be considered;
- Firms must assess the likelihood that each vulnerability identified will be used for ML/TF; and
- Firms must ensure appropriate measures are implemented to manage the identified risks and identify any new risks.

### METHODOLOGY

As a first step, the methodology should take into consideration, to the extent relevant, any vulnerabilities relating to:

- Its type of customers and their activities;
- The countries or geographic areas in which it does business;
- Its products, services and activity profiles;
- Its distribution channels and business partners;
- The complexity and volume of its transactions;
- The development of new products and new business practices, including new delivery mechanisms, channels and partners; and
- The use of new or developing technologies for both new and pre-existing products.

### APPROACH TO VULNERABILITIES

Once the vulnerabilities are identified, firms should then consider each vulnerability and analyse the likelihood that the business will be used for money laundering or the financing of terrorism. The assessment of likelihood will allow the business to apply appropriate measures in the AML/CTF program in order to manage and mitigate the identified risks.

# FINDINGS AND OBSERVATIONS CONTINUED

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## AML/CTF POLICIES AND PROCEDURES

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The DFSA considered its review of the Returns as positive with all firms confirming they had appropriate AML/CTF policies, procedures, systems, and controls in place.

As part of the desk-based review, the DFSA reviewed each firm's key AML/CTF documentation and tested a number of components including: Customer risk assessments; CDD processes; reporting processes; and, sanctions screening. The DFSA observed that AML policies and procedures were not always customised to some firms particular business operations. There were also a number of instances where the DFSA AML Module was interpreted incorrectly.

During firm on-site visits, the DFSA was encouraged to observe that firms were able to correctly articulate the practical application of the requirements set out in the DFSA AML Module in most instances. There were, however, certain elements of the AML program that required further clarification by some firms in order to be fully compliant with the DFSA AML Module.

## THE DFSA'S EXPECTATIONS

Firms are required to establish and maintain policies, procedures, systems, and controls to prevent opportunities for money laundering and the financing of terrorism in relation to the risks identified through the Business AML Risk Assessment process. Additionally, it will assist employees in understanding the AML requirements and will form a key reference point, if the firm's policies and procedures clearly outline the requirements. In instances where firms do not fully understand the DFSA requirements, they should seek guidance or clarification from the DFSA.

Each firm must ensure that its systems and controls include the provision of regular reporting to the firm's senior management on the operation and effectiveness of its AML framework. This information is necessary to assist senior management in identifying, measuring, managing and controlling the firm's money laundering risks and ensure that regular risk assessments are carried out on the adequacy of the firm's AML systems and controls. This will help ensure that firms continue to identify, assess, monitor and manage money laundering risk adequately in a way that is comprehensive and proportionate to the nature, scale and complexity of its activities.

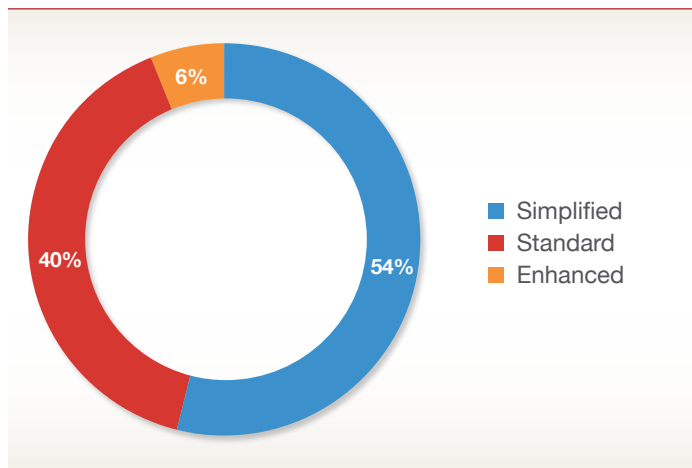


# FINDINGS AND OBSERVATIONS CONTINUED

## CUSTOMER RISK ASSESSMENT

The DFSA's review of the Returns revealed that the majority of firms, when risk rating their clients, considered all relevant factors of the customer risk assessment. The DFSA also observed that all firms utilised a customer risk assessment template which was completed for each client, however, for the majority of firms, there was no accompanying methodology to support the assessment.

The following chart outlines the risk ratings allocated by firms as part of their Return.



Phase one (the desk-based review) identified that 54% of clients in the sector were assessed as low risk and as such, firms only conducted Simplified Due Diligence on these clients. During phase two, some firms were able to articulate the rationale for their assessment. However, there were certain other firms who were not able to justify why they had rated their clients as low risk given the services provided.

During firm on-site visits, the DFSA further assessed the application of the Customer Risk Assessment when conducting a review of client files.

The DFSA identified the following issues with the overall Customer Risk Assessment:

- Instances of client risk rating classifications being too subjective and unsubstantiated, and no clear documented methodology or guidance for the particular firm to assist with its risk rating of customers. As a result, it was difficult for the DFSA to ascertain how firms reasonably determined risk ratings for their clients; and
- Instances where certain firms were continuing to apply a semi-automatic 'low risk' risk rating to their customers, in particular, where the customer is a DFSA regulated entity.

## THE DFSA'S EXPECTATIONS

Customer risk assessments must be undertaken by a firm on each customer and the proposed business relationship, transaction or product. The outcome of this process is to produce a risk rating for a customer, which determines the level of CDD which will apply to that customer as set out in the DFSA AML Rules.

CDD in the context of AML refers to the process of identifying a customer, verifying such identification and monitoring the customer's business and money laundering risk on an ongoing basis. CDD is required to be undertaken following a risk-based assessment of the customer and the proposed business relationship, transaction or product. Each firm is subject to an ongoing obligation under DFSA AML Rules to ensure that it reviews a customer's risk rating to ensure that it remains appropriate in light of the AML risks.

The DFSA expects that the Customer Risk Assessment Framework includes a clear methodology that incorporates guidance on each customer risk factor that is considered as part of the customer risk assessment.

The DFSA is aware that in practice, there will often be some degree of overlap between the customer risk assessment and CDD. However, firms are required to carry out a risk-based assessment on each customer. The firm must not apply an automatic risk rating or a "one size fits all" approach when assessing the risks of customers.

# FINDINGS AND OBSERVATIONS CONTINUED

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## CUSTOMER DUE DILIGENCE (CDD)

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The DFSA's review of the Returns revealed that all Firms had adequate systems and controls in place to conduct initial and ongoing CDD.

The DFSA's desk-based review revealed the following positive outcomes:

- CDD during the customer on-boarding phase - All the firms had adequate policies and procedures to meet their CDD obligations. Key CDD areas were addressed such as: identification and verification of customers, beneficial ownership, PEP screening, source of funds and source of wealth.
- Ongoing CDD - All firms had adequate policies and procedures to address their ongoing CDD requirements. Key areas of ongoing CDD were addressed such as: maintaining accurate and up to date customer information, and reviewing the appropriateness of the customer's risk rating.
- PEPs - All firms were using a form of automated screening for PEPs.

During firm on-site visits, the DFSA further assessed each firm's approach to initial and ongoing CDD when conducting reviews of client files. With regard to initial CDD, the DFSA observed that the majority of the firms had instances where they failed to identify the ultimate beneficial owners (UBOs) of legal persons. As a result, these firms were unable to demonstrate that they had screened UBOs for PEP or sanctioned status (see Sanctions Screening on pg 11). In addition, certain firms failed to maintain appropriate information to evidence source of funds and source of wealth for high risk clients. This is a serious concern for the DFSA.

The DFSA wishes to emphasise the following for ongoing CDD:

- Service offering in the sector are mainly assignment driven (audit, valuation, payroll etc.) with minimal activities involving transactions for and on behalf of customers, or, handling customer funds.
- A small percentage of the sector conducted transactions for and on behalf of its customer. This was in a limited capacity i.e. providing payroll services.

- The remaining firms undertaking engagements did not monitor transactions, as they were not providing any transactional services for customers.
- The DFSA was encouraged to observe that customers subject to a periodic review by the firm, included a review of the appropriateness of the particular customer's risk rating.

### THE DFSA'S EXPECTATIONS

In relation to beneficial ownership, firms are expected to identify customers and any beneficial owner(s). Beneficial owners are the actual individuals [natural persons] that directly or indirectly own or control the legal person.

In relation to PEPs, firms are expected to be able to identify and risk assess exposures due to PEPs connected to legal persons. Enhanced CDD measures must be applied in the case of identified PEPs.

In relation to source of funds and source of wealth: firms are expected to identify and verify the customers' source of funds and wealth to fully understand the customer's profile, resources and business and associated risks posed to the firm.

### IN RELATION TO ONGOING CDD:

- Firms must verify the identity of a customer, verify and monitor the customer's business and ML/TF and Sanctions risks on an ongoing basis. This applies to the customer, their business, transactions and products.
- Firms must periodically review the customer profile holistically and ensure that any risks posed by that customer are managed by the appropriate level of due diligence, particularly for customers with a high risk rating.
- Firms must ensure that they review each customer's risk rating to ensure that it remains appropriate in light of the ML/TF and Sanctions risks.

# FINDINGS AND OBSERVATIONS CONTINUED

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## SANCTIONS SCREENING

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The DFSA's review of the Returns revealed that all firms have implemented systems and controls to monitor resolutions and sanctions issued by the United Nations Security Council (UNSC) and the UAE Government. Additionally, the DFSA was encouraged to observe that sanctions lists from other jurisdictions were included as part of the firms' sanctions screening policy.

The DFSA's desk-based review was consistent with the findings from the Returns. The DFSA observed that firms have established and maintained systems and controls to ensure that they are properly informed on an ongoing basis of sanctions issued by the UNSC and the UAE Government.

During firm on-site visits, the DFSA was encouraged to observe that all the firms were utilising an automated form of screening for sanctions, but firms need to ensure they are screening beneficial owners and related parties as well as documenting the rationale for false positive hits.

### THE DFSA'S EXPECTATIONS

#### IN RELATION TO SANCTIONS SCREENING:

- All clients must be screened at on-boarding and on an ongoing basis.
- This includes: beneficial owners, directors, controllers, guarantors, beneficiaries, trustees, settlors, and those with power of attorney.
- Customers, their business and transactions must be reviewed against United Nations Security Council sanctions lists and any other relevant sanctions lists to comply with DFSA Rules.

#### IN RELATION TO FALSE POSITIVE HITS:

Firms are required to conduct a thorough investigation of potential matches and appropriately document the findings of its investigation as part of the customer risk assessment and during the customer due diligence processes. This includes the results of false positives and true matches.

# FINDINGS AND OBSERVATIONS CONTINUED

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## SUSPICIOUS ACTIVITY REPORTS (SAR)

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The DFSA's review of the Returns revealed that firms had implemented policies, procedures, systems and controls to monitor and detect suspicious activity or transactions.

The DFSA's desk-based review was consistent with the findings from the Returns. All firms had implemented suspicious activity reporting processes consistent with the DFSA AML Module requirements.

During firm on-site visits, the DFSA assessed responses provided by the MLROs on their respective firm's SAR processes. This revealed that MLROs were able to articulate the requirements for generating and filing a SAR. The DFSA observed a further positive outcome of firms with larger employee numbers implementing a formal internal notification mechanism to alert the MLRO of potentially suspicious activity.

## TRAINING

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The DFSA's review of the Return indicated that a majority of firms conducted AML/CTF and sanctions training on a periodic basis from annually to 18 months, as a minimum. The DFSA observed that firms use a variety of formats to train employees, including:

- Presentations by the MLRO;
- Presentations by an internal trainer or external consultant;
- Computer-based training / E-learning course; and
- Self-study by employees.

The DFSA's desk-based review of each firm's training framework included AML/CFT and sanctions training content and training logs. The DFSA observed that the training content covered key areas including: AML laws and regulations; customer risk assessment; PEP screening; sanctions screening; CDD/EDD processes and SAR reporting. The DFSA was encouraged to observe that firms' training content included UAE and DFSA obligations and relevant case studies.

During firm on-site visits, the DFSA observed that training was provided to firms' employees through a variety of means. All firms expressed the importance of AML/CTF and sanctions training for their employees in identifying suspicious activity and combatting financial crime.

# FINDINGS AND OBSERVATIONS CONTINUED

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## RECORD KEEPING

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The DFSA's desk-based review assessed each firm's record keeping framework. The Review revealed that all firms have sufficient coverage of the record keeping requirements, including:

- CDD, both initial and ongoing;
- Supporting records;
- Internal SAR reporting;
- External SARs;
- Communications with the FIU;
- Business Risk Assessments;
- Customer Risk Assessments; and
- Training.

The six year record keeping requirement specified in the DFSA AML Module was explicitly stated in each firm's policy documents.

During firm on-site visits, firms demonstrated a general understanding of the record keeping requirements under the DFSA AML Module. However, as a consequence of certain CDD deficiencies referred to in the CDD section above, a majority of the firms were not able to demonstrate full compliance with DFSA AML Module for record keeping.

## THE DFSA'S EXPECTATIONS

In relation to record keeping requirements, the DFSA AML Module requires Relevant Persons to maintain records for at least six years from the date on which the notification or report was made, the business relationship ends or the transaction is completed, whichever occurs last. Records maintained include:

- A copy of all documents and information obtained in undertaking initial and ongoing CDD; and
- Records (consisting of the original documents or certified copies) in respect of the customer business relationship, including:
  - i. business correspondence and other information relating to a customer's account; and
  - ii. sufficient records of transactions to enable individual transactions to be reconstructed; and
  - iii. internal findings and analysis relating to a transaction or any business, such as if the transaction or business is unusual or suspicious, whether or not it results in a suspicious activity report.

The DFSA also requires that all Relevant Persons provide to the DFSA or a law enforcement agency immediately on request a copy of the above mentioned records. The DFSA expects such records to be made available within 24 hours of the request.

# FINAL COMMENTS

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The DFSA would like to extend our thanks to all firms who contributed to the Review by providing the requested documentation and participating in our on-site visits.

Although the firms in this sector provide a diverse suite of services, there were some common AML/CTF Program weaknesses across the sector, particularly with the Business Risk Assessment and CDD processes. The DFSA expects firms to take into account the general findings of the Review when assessing their specific AML/CTF Program deficiencies and remediate any identified gaps.

Combatting financial crime is, and will continue to be, a key regulatory priority for the DFSA and accordingly, will continue to feature in the DFSA's future supervisory agenda. As key gatekeepers to the financial system, the DFSA would like to remind firms (in this sector) of the importance of the role that they play in detecting and deterring financial crime.