



The Eurasian Group on combating money laundering and financing of terrorism (EAG)

Working Group on Typologies (WGTYP)



***“LAUNDERING OF PROCEEDS FROM EMBEZZLEMENT OF
PUBLIC FUNDS”***

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Chapter 1:

Introduction

There is no need to emphasize the relevancy of the subject matter of this study. Crimes involving embezzlement of public funds, followed by their legalization occur in all countries of the world, with no exception for the wealthiest.

The reasons of such crimes are trivial. They are the lucrative interests of corrupted officials and organized criminal groups, aiming at using public funds mainly generated by taxpayers, for their own enrichment.

The global financial crisis and attempts to struggle with its consequences have led to an increased financial activity of many countries. While huge financial resources are allocated from the state budgets to respond to the crisis, organized criminal groups and corrupted officials seek to use it for their own benefit. As you know, the smaller the share of illegal funds in the legal financial flows, the more efforts it requires to be detected. The criminals are here to use this pattern. Therefore, the need arises in stricter monitoring of financial flows.

It should be mentioned that to this day no specific typological studies have been carried out on the issue of theft and further laundering of public funds either in the framework of WGTYP EAG or WGTYP FATF. Analysis of earlier typological studies carried out by FATF, show that the problem of embezzlement of public funds (particularly, in public procurement and subcontracting) as a predicate crime to money laundering was given little concern. The studies were mainly devoted to such predicate crimes as illegal drug trafficking, misuse of corporate vehicles and securities fraud, smuggling, illegal VAT recovery, etc.

At the same time, the public funding sector absorbing huge cash flows is an attractive business sector and a large field of action for criminals of all kinds. It is estimated by the International Anti-Corruption Organization Transparency International¹, that systemic corruption can add 20-25% to the costs of government procurement. Illegal revenues thus obtained are plundered, resulting in a massive loss in public funds every year.

This study is an attempt to consider the problem of legalization of proceeds from embezzlement of public funds², in the context of typological peculiarities of this type of crime. In all conscience, this study is far from being complete, because the subject matter is extremely complex and many-facet, requiring additional analysis that will be probably included in the scope of future typological studies.

This report was developed on the basis of a collective study carried out by Russia, Republic of Belarus, China, Kyrgyz Republic, Republic of Kazakhstan, Armenia, Ukraine, Poland, USA and Italy.

Trends of Studies

The principal trends of the study are:

¹ <http://www.transparency.org>

² It should be noted, that for the purpose of this study the public property (in the form of valuables, inventories and securities) shall be disregarded.

- ***Identifying vulnerabilities in public funding in view of the risks associated with embezzlement of public funds;***
- ***Identifying the most common types of misuse of public funds as a predicate crime;***
- ***Identifying typology of money laundering of public funds (methods, tools and procedures applied);***
- ***Identifying the indicators of suspicious operations involving public funds;***
- ***Assessment of possible methodologies for detection of suspicious operations involving public funds;***
- ***Development of recommendations and measures for prevention of crimes associated with embezzlement and laundering of proceeds from embezzlement;***

The ultimate target of this study is to fulfill two tasks of prime importance: firstly, enhance the general understanding of terms and processes of theft and further laundering of public funds and the risks involved, by the personnel of FIU, law enforcement and financial institutions. Secondly, draw up recommendations and additional measures for efficient detection and prevention of crimes involving legalization of proceeds from embezzlement of public funds.

Information Base

This study is based on four principal data sources. Firstly, we have used the Federal database of Rosinformonitoring, containing the transaction details. The Federal database was used as an in-house source of information for the study. Secondly, we have considered the summary of available literature within the scope of study, Mass Media, publications by the International organizations³, research papers, statements and statistics of law enforcement authorities, etc. Thirdly, it involves collection and analysis of answers to the questionnaire distributed by EAG Secretariat in April, 2009. And, fourthly, these are comments and follow-ups on the summary of the interim seminar of WGTYP EAG.

CHAPTER 2:

Notion of Embezzlement

Embezzlement is one of the most dangerous crimes in the sphere of public funds disposal. In the relevant articles of the Civil Code of the Russian Federation, embezzlement is defined as corrupt illicit uncompensated taking and (or) conversion of someone's property by the guilty individual or any other persons to their own use, causing damage to the owner or any other property holder.

Embezzlement may consist of one or several stages. At the first stage the property segregation may occur, followed by its taking at the second stage and conversion to the use by the guilty individual or any other persons at the third stage. In certain instances, particularly in misappropriation and misuse, there is no property segregation and taking, because the property

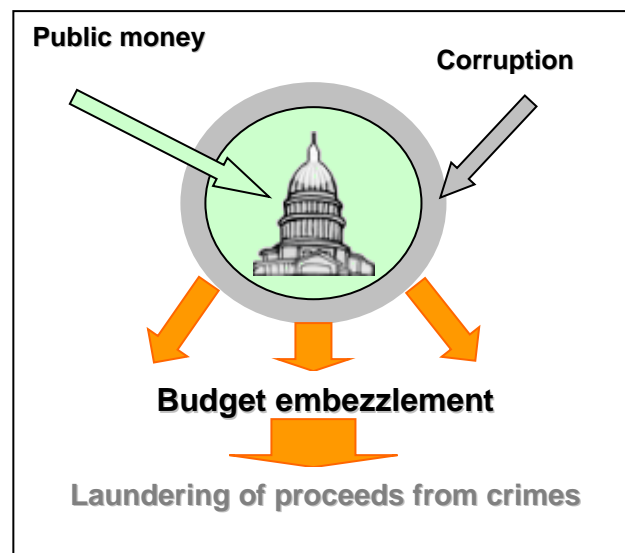
³ Including FATF, Transparency International and others.

is already in legal possession of the guilty individual. There is only the property conversion to the use by the guilty individual or any other persons.

Embezzlement is considered completed only when the guilty individual has an opportunity to dispose of the property stolen, i.e. convert it to his/her own use or to some other persons. Until then there is an attempt to embezzlement. Embezzlement of public funds may take different forms (such as embezzlement by misappropriation or misuse, waste of public funds). Fraud is the most popular among them⁴.

Role of Corruption

A corruption component inherent in most illegal economic acts is, perhaps, the primary driving force in crimes involving embezzlement of public funds. Embezzlement of public funds is almost impossible without an assistance of officials, mainly due to the fact that such embezzlement is effected, as a rule, under the guise or in the course of the legal business activities. Furthermore, such activities may be accomplished or instructed to be accomplished by individuals of certain authority.



According to the Russian law, a corrupt act means an abuse of official position, bribe giving and bribe taking, misuse of authority, corrupt business practices or any other misuse of official capacity by any individual against the lawful interests of the society and the government for the personal gain in the form of money, valuables, other property or property services, or other proprietary rights either for him/herself or any third parties, or illicit provision of such benefit to any designated person by the other individuals, and making of aforesaid acts on behalf or in favour of any legal entity;

Corruption is known to take the form of exchange of services and obtaining privileges of various kinds. The most dangerous manifestations involve misappropriation of monetary and tangible wealth, thus, making monitoring of its flow crucial for anti-corruption activities.

According to the statement published by the International Organization Transparency International⁵ in 2008, Russia and China were listed among the countries with the highest

⁴ According to art.159 of the Civil Code of the Russian Federation, a fraud is a theft of someone's property or taking possession of the property in a fraudulent way or through betrayal of trust.

⁵ <http://www.transparency.org>, (Bribe Payers Index 2008)

corruption level when doing business with the international companies. A full list of countries obtained from TI web-site is given below:

Rank	Country	Index	Rank	Country	Index	Rank	Country	Index
1	Belgium	8.8	3	Switzerland	8.7	5	Japan	8.6
1	Canada	8.8	5	Germany	8.6	8	Australia	8.5
3	Netherlands	8.7	5	Great Britain	8.6	9	France	8.1
9	Singapore	8.1	13	Hong-Kong	7.6	14	Taiwan	7.5
9	USA	8.1	14	South Africa	7.5	17	Italy	7.4
12	Spain	7.9	14	South Korea	7.5	17	Brazil	7.4
19	India	6.8	20	Mexico	6.6	21	China	6.5
22	Russia	5.9						

The same organization ranked the following sectors among the most affected by corruption activities: public works contracts/ construction, public procurement, real estate, residential and commercial property development, oil and gas industries, heavy industry and mining. The sectors of public works contracts/ construction and public procurement are the worst offenders.

Therefore, we can acknowledge that corruption and embezzlement of public funds are inseparable in most cases. Corrupt crimes are virtually a superstructure on the basis of economic crimes. Corruption enables embezzlement of public funds, intents of embezzlement, facilitating corruption development.

Negative impact of corruption and crimes involving embezzlement of public funds

The crimes involving corrupt practices and embezzlement of budgetary funds committed by the executives of the public agencies, above all, undermine the authority of the government, furthering aggravation of discontent in population and negatively affecting the socio-economic situation in the country.

Moreover, they may endanger development of favourable investment climate, stability of the national financial system, international standing of the country, in the whole, raising the volumes of money circulating in “grey economy”.

Vulnerabilities in public funding

Experiences of crime detection involving embezzlement of public funds and property show that almost all sectors of public funding more or less involve the risk of engagement in this type of crime.

The increase in the government allocations for this or that purpose and weakening of monitoring of their use create more opportunities for their embezzlement. Therefore, we have all reasons to

say that potentially vulnerable are the areas of public funding involving the largest government allocations and poor government supervision.

Analyzing the answers to the questionnaires sent by EAG member-countries and observer countries we can identify the top 5 areas of public funding specifically vulnerable to the risks of embezzlement. Among them are:

- **Education**
- **Healthcare**
- **Construction**
- **Public Utility Services**
- **National Defense**

Notably, education is one of the most vulnerable areas, although, this very sector is expected to develop public dislike and intolerance to corruption and corrupt practices.

Furthermore, it was noted by the countries that the government funds allocated for implementation of the national target programs are subject to a substantial risk of embezzlement, as well as the public funds channeled for elimination of the consequences of any natural calamities and accidents, armed conflicts, etc.

Thus, for example, the US noted that in 2007-2008 the Ministry of Justice passed a number of judgments on officials who had illegally obtained the funds allocated by the government for elimination of the consequences of Hurricane Catherine.

In Russia large amounts of public funds are allocated for funding of the federal target programs such as: "Affordable Accommodation", "Education", "Development of Agricultural Sector". Besides, the government actively extends its financial support to the large-scale target programs such as "Sochi -2014" and "Nuclear and Thermal Power Plants -2012". It should be mentioned that recently the Russian law enforcement and supervisory authorities have detected a number of crimes involving theft of funds allocated by the government for the execution of aforesaid programs.

Among the other areas of public funding reported by the countries participating in the study were: **social security, fuel-energy complex, agriculture, public and municipal administration and inter-budget transfers.**

CHAPTER 3:

The most common frauds with public funds

To understand which methods are used for money laundering, we should identify the illegal sources of proceeds from crimes, specific features and peculiarities of committed predicate crimes. Analysis of responses sent by the countries reveals that the most common types of embezzlement of public funds are:

- ***Misappropriation of public funds in the public procurement at the federal, regional and municipal levels;***

According to some expert assessments, in Russia the purchasing prices of public companies are about 19% above the market average. The experts assess the total loss of the overall

volume of public procurement at the federal, regional and municipal levels as amounting to more than 300 bn. rubles (\$10 bn. US dollars) per year.

- ***Misappropriation of public funds in repair and construction works on the government contracts;***

According to IMF⁶, about 70% of the central government expenditures finally take the form of contracts. The risks associated with corrupt acts and embezzlement in the area of government contracts may occur even before the tendering process, i.e. at the time of allocation of public funds, and persist throughout the follow-up process, from selection of the tender winner until the contract completion.

The criminal practices aiming at embezzlement of public funds are:

- ***Procurement for the public companies is carried out at the prices negotiated before (as a rule, overpriced);***
- ***Procurement for the public companies is carried out by manipulations on the quality and volumes of purchases;***
- ***Construction materials and services are substantially overcharged;***
- ***Handover/Takeover Certificates contain the works that have never been performed in fact;***
- ***Pre-defined front companies act as the government tender winners.***

Thus, for example, we know some cases when a formal winner of the government contract tender was a nominal winner, in fact, while the true contractors were some other agencies that could not participate in the tender owing to their connections with organized criminal groups.

Embezzlement of public funds often occurs through the dummy tenders assuming no actual purchase of commodity and services.

Besides, embezzlement of public funds involves, as a rule, corrupt acts, such as bribe taking for provision of unjustified advantages in selection of the tender winner, entering into knowingly unprofitable contracts, decision-making in favour of interested parties, and falsification of documents.

Among the other methods of embezzlement of public funds the following are quite common:

- ***Illegal VAT recovery from the budget;***
- ***Fraudulent activities with loan and credit facilities extended by the foreign countries and international financial institutions, by forgery of financial instruments and reporting;***

⁶ UNPAN Statistical Databases Central Government Expenditures by Type and Function, as percentage of all central government expenditure as of 1997. Uses as source: IMF Government Finance Statistics. Calculations by TI-S. Result comes from excluding wages and interest payments.

- **Coverage of expenditures of third party legal entities and individuals out of the budget funds;**

Among the common methods of stealing funds from the government the following pattern should be also mentioned. The public funds (either purpose or investment loans) are deposited in the bank at the interest rate which is much lower than the market rate. For an underrated deposit of funds with the bank the chief executive of the public company is “paid off” in cash.

Case examples of embezzlement in the public funding areas

Army procurement is one of the most vulnerable areas of public funding. There is an example of embezzlement of public funds in government contracting, involving an officer from the Ministry of Defense.

Case example 1: Embezzlement in government procurement

Jurisdiction: Russia

Area: National Defense

Methods: overstatement of prices and volumes of procurements

On results of the prosecutor’s inspection a criminal case was initiated on embezzlement of funds in government contracting for the coal supplies to the Russian Ministry of Defense. The prosecutor’s inspections revealed material infringements of law committed by the officers of the Main Directorate of the Ministry of Defense of Russia in government contracting. Thus, regardless of law requirements and tender conditions, they allowed commercial intermediaries to participate, although they belonged to neither collieries nor coal refineries, and they had no sufficient resources required to make fuel supplies. Furthermore, these institutions were recognized the tender winners. Some officers from the Russia’s Ministry of Defense were giving orders to their subordinates on acceptance of overpriced coal. Besides, in some instances they entered into supplementary agreements with the suppliers for delivery of this type of fuel in excess of the volumes stipulated by the government contracts. Illegal acts committed by the military officials and commercial partners resulted in the damage to the government were assessed as over 50 mln. rubles.

Case example 2: Attempt at embezzlement in implementation of the government target programs

Jurisdiction: USA

Area: education, construction

Methods: provision of unjustified advantage in tender winner selection

In March, 2009 a former official representative of a Michigan high school was convicted to 46 months imprisonment and a fine of \$1.3 mln. US dollars for his involvement with the fraudulent pattern aiming at embezzlement of several million dollars allocated under the federal educational program and the funds allocated by the municipal educational establishment and one of the national banks. Before that, a convict was an assistant supervisor for the municipal educational establishment.

Among his job functions was supervision over the construction of several new educational establishments in the district. On having concealed the fact of being a founder of the commercial company from Ohio, the convict recommended this very company to the school

board for award of the construction contracts, so that the contracts would have come to the company under his control. These contracts were funded out of the federal educational program, municipal educational establishment and one of the national banks. The convict and his crime partners opened a credit line for \$200 thousand US dollars in the bank through submission of the financial documents in which the status of their financial accounts was materially misstated.

An investigation conducted by the Ministry of Justice to detect the cases of fraudulent activities and unfair competition on implementation of the federal educational program, revealed the total of 7 companies and 18 individuals who admitted or were found guilty in crime commitment. The guilty individuals paid out or were convicted to fines and compensations for the total amount of over \$40 mln. US dollars.

Case example 3: Embezzlement through illegal recovery of funds out of the budget

Jurisdiction: Russia

Area: Agricultural sector

Methods: falsification of financial documents

According to investigation results, in 2002 a criminal group was organized by a founder of the vegetable canning plant, which united the senior management and chief accountants of several other vegetable canning plants. The budget funds embezzled by the criminal group for two years of their fraudulent activities amounted to about 147 mln. rubles.

Using the benefit for reimbursement of costs of the interest payment on investment loans out of the federal budget, the criminal group members applied for loans and executed dummy papers for the purchase of agricultural machinery and equipment. Nonexisting equipment was registered on the balance sheet, and dummy papers were submitted to the Agricultural Committee by the senior management of the enterprises against the government aid.

The criminal activities of the group were found out while it was attempting to misappropriate 101 mln. rubles more. In addition, the group members were incriminated for preparing to embezzle 49.2 mln. rubles. On this case the criminal proceedings were initiated against the Directors and Chief Accountants of several other vegetable canning plants and commercial firms.

Some patterns of embezzlement of public funds mainly applied in the building sector are given below:

Embezzlement of budget funds through an extended chain of intermediaries

This pattern is based on a series of seemingly legal, but economically senseless contracts made by the General Contractor with the actual service providers in construction, who in their turn, enter into contracts for engagement of construction machinery, additional labour resources, etc. In each case the contract payment is made at the maximum rates. Besides, in many instances they use dummy contracts for work and labour. If this is the case, all works are performed by their own workers saving money, firstly, by overpricing of such works, secondly, through manipulations on production expenditures, increasing the costs as required and

reducing the tax base and, thus, understating the taxes, such as: VAT, profit tax, unified social tax, etc.

Misappropriation through engagement of unofficial teams in construction works

The customer organizations usually have unofficial relations with such teams and/or individual members thereof, i.e. the works are carried out subject to no contracts or labour agreements, and the money paid to the teams is not reflected anywhere in official accountancy and, therefore, they evade accrual of tax on individual income and insurance contributions payable to the public extra budgetary social funds. This pattern may involve engagement of the firm registered on the lost passport as a contractor. In this case, they save money, by paying out extremely understated salaries, reflected at the highest pay grade, and full tax evasion.

Embezzlement through overstatement of work scope

This pattern is based on actual non-fulfillment of some construction processes, stipulated by the cost accounting, replacement of expensive materials with the cheap, overstatement of actually completed construction works (in winter period, during the dark hours, labour intensive, etc.). The funds, thus, saved are embezzled. Moreover, this pattern enables commencement of construction phase without the construction documentation, allowing approval of overpriced cost sheets at a later date, and backdated re-approval of cost sheets, etc. Therefore, the funds are partially embezzled by writing off funds for the works that have never been performed.

Embezzlement through avoidance of mandatory quotations in rendering services to public and municipal institutions

This pattern rests on provision of the Law of the Russian Federation #94-FZ adopted on July 21, 2005 "On placement of orders for commodity supplies, performance of works and services to public and municipal institutions" stating that a request for quotation is optional if the contract value is under 250 thousand rubles (\$8 thousand US dollars). In this case, the actual amount of works is split between several contracts, entrusted to pre-defined firms subject to no quotations and tenders, which are usually registered on the lost passports. For performance of works such firms engage unofficial teams and after that they cancel their activities subject to no tax payments. In addition to tax evasion, this pattern involves overstatement of work scope, embezzlement of funds allocated for the material supplies, etc.

Direct theft pattern

This pattern involves direct embezzlement of construction materials delivered to the construction site, use of labour and construction machinery intended for performance of works at the site, outside of the construction site (with the labour payment effected out of allocated budget funds).

It should be mentioned that the criminals invent new methods of embezzlement of public funds all the time, enhancing those they have at their disposal. The methods of embezzlement are difficult to investigate because, as a rule, they may be detected only after the criminal offence

has been committed, and often it takes too long. Besides, such criminal activities are often committed by the organized groups of criminals, so they are well-disguised.

CHAPTER 4:

Typologies of laundering of embezzled public funds (applied methods, tools and procedures);

The process of embezzlement of public funds is by its nature the initial stage of laundering of proceeds from crimes, the stage of their placement. However, unlike the traditional placement of illegal proceeds, the funds are already introduced into the legal system. Thus, we can often observe a reverse process when the money stolen is moved out of non-cash circulation to cash flows.

Of course, embezzled public funds are not only transferred in cash every time. They may be transferred to the foreign bank accounts through pre-arranged channels or used to acquire securities. However, the findings of financial investigations reveal that the funds embezzled from the government are cashed, as a rule, to disguise the audit trail from the criminal offence and introduce the money to "grey" circulation.

Apparently, to launder the funds stolen from the government, the criminals use various methods, procedures and financial instruments. Analysis of investigated crimes involving legalization of proceeds from embezzlement of public funds and review of responses to the questionnaires sent by the countries and considering case examples supplied, allow identifying some of the most popular typological schemes of laundering of proceeds from embezzlement of public funds.

Typology: 1

Laundering of criminal proceeds from embezzlement of public funds by the money transfer through the chain of intermediaries to the bank accounts of legal entities and individuals, followed by cash withdrawal

Usage of front companies, the so called "fly-by-night" companies⁷, in the laundering schemes of proceeds from theft of public funds, have become very popular, particularly, in Russia, Ukraine and a whole range of other countries. The findings of criminal cases and financial investigations suggest that shell-companies are used for theft and legalization of criminal proceeds almost in every case detected.

It is largely facilitated by the absence of proper supervision over the registration of legal entities. Registered on lost passports or the passports of people who have agreed to be registered as

⁷ The "fly-by-night" company means the company with apparent features of a shell company (failure to submit financial reporting, no actual business activities, registration address is an address of mass registration of legal entities, the founders or managers of the company are the managers or founders of a large number of other companies, the minimum authorized share capital, etc.)

legal entities, such firms may function from one week to one year and longer. It was found out, that in some cases the companies were registered using the passport data of unwitting individuals, obtained through the bribe giving to the officers of registration and other services.

Usage of “fly-by-night” companies as front companies in the schemes of money laundering from embezzlement of public funds makes the whole process of embezzlement and laundering easier, hindering efficient investigations of such crimes and identification of origin of such funds. Thus, for example, to transfer the assets received from embezzlement of public funds out of non-cash circulation, the criminals often lend to the use of legal, but false grounds, such as "withdrawal of cash for wage payments", "withdrawal of cash for administrative expenses", "withdrawal of funds for purchase of securities", etc.

Source: Russia

The findings of investigation works contain the data confirming the embezzlement of public funds for the amount of 13 million 682 thousand rubles (about \$500 thousand US dollars) committed by the officials of one of Research and Development Institutes of Russia's Ministry of Defense.

In the course of investigation it was found out that in 2003-2005 the officials made dummy contracts for research and development and publishing works with front companies, having embezzled all allocated funds, while scientific researches and printing works were performed at the in-house laboratory of the government agency. To withdraw the funds they used to create “fly-by-night” companies.

The criminals entered into the contract with a private company, which had committed itself to prepare advertising brochures for the Research and Development Institute and the booklets, posters and memorable illustrated books for the next anniversary of the Institute. The deal value was about 3 million rubles (\$100 thousand US dollars), although dummy-layouts were developed by the Defense Institute designers free of charge, and printed out in the Institute's printing-office for the budget funds.

Later on, the criminals implemented another scheme, related to development of the complex program for disposal of out-dated military equipment and ammunition. The officials paid for this project to some unknown private company which was established something about 10 year ago by the military specialists employed with the same Institute. The criminals just had to request the developments from the archive and put them in operation.

The money transferred to commercial firms was refunded to the criminals in cash net of small commission fee to those who had registered the front companies. Ultimately, the money was used by the criminals for their personal needs. Thus, according to investigation results, the Institute fully covered the costs of tuning and repair of a sports car used by the criminal's son for street racing. For his other son the criminal made a wedding gift, having purchased a one-room apartment in one of prestigious districts of the city with the money stolen.

Applied procedures, tools and methods:

- registering fly-by-night companies to be used for cash withdrawal;
 - bank institutions;
 - falsification of documents
-

Indicators:

- payment for the property acquired in favour of third parties
 - transactions between the public company and a private company, transferring most funds to the foreign accounts shortly after their receipt
-

Typology: 2***Legalization of criminal proceeds from embezzlement of public funds by their transfer through the chain of intermediaries to the bank accounts of offshore companies⁸ and individuals abroad***

Offshore companies are also widely used in the schemes of legalization of proceeds from embezzlement of public funds in Russia and some other countries. It is rather easy to register a legal entity in the offshore jurisdiction and requires a relatively small amount of funds and the minimum package of documents. Besides, there are many intermediaries offering their services in registering offshore legal entities.

It becomes extremely difficult to identify the money origin, the purpose and nature of its further use and the ultimate beneficiary as soon as it is credited to the bank accounts of the offshore companies abroad. It is understood, that anonymity is essential in operation of any offshore companies. Offshore companies allow concealing true beneficiaries of criminal proceeds, who may appear to be the public officials.

Source: Ukraine

The findings of investigation works contain the data confirming the large-scale misappropriation of funds was committed by officials of a national enterprise through abuse of their official position.

Thus, the aforementioned individuals made some knowingly unprofitable contracts for the purchase of Inventories. The total amount of funds transferred to the bank accounts of the supplier pursuant to these contracts was over 79 mln. 922 thousand hrivnas (\$10.4 mln. US dollars). With the money, obtained on the basis of the foreign economic contracts, an entrepreneur purchased the products from non-resident immediate manufacturers for the total amount of over 49 mln. 163 thousand hrivnas (\$6.4 mln. US dollars).

Some money amounting to over 30 mln. 759 thousand hrivnas (\$4 mln. US dollars) obtained from the public company was transferred abroad through the current account of the companies with shell company features, registered for a one-time remuneration by the front parties, to the bank accounts of non-resident companies specifying "purchase of securities" in details of payment.

⁸ An offshore company means a company registered in jurisdictions, granting full or partial tax exemption for the companies owned by the foreigners according to their applicable law.

Applied procedures, tools and methods:

- bank institutions;
- securities brokers and issuers of "Junk shares";
- resident and non-resident companies with shell company features (registered on lost passports);

Indicators:

- transactions between a public company and a private company, transferring most funds to the foreign accounts shortly after their receipt
 - major transactions on accounts of the legal entities recently established;
 - purchase of shares not circulating in the organized securities market;
-

Usage of "fly-by-night" and offshore companies

Well-prepared and organized schemes of embezzlement and laundering of public funds usually include the usage of offshore companies in addition to "fly-by-night" firms.

Criminal scheme organizers form a sort of channels or corridors for unhindered and anonymous transfer of stolen funds to disguise the trail and create conditions when it is very difficult or impossible to find any links between the money and embezzlement committed. Such corridors are, as a rule, created well in advance before the theft takes place.

However, analysis of responses given by the countries participating in the study, application of the offshore companies in the schemes of legalization of proceeds from embezzlement of public funds features some, but not every country.

Thus, for example, neither of eight public money laundering case samples presented by China, involved an offshore company.

For laundering of illegal proceeds the criminals mainly used bank accounts and deposits, purchased securities of major companies and government bonds with the money stolen. In about a half of all cases the criminals transferred illegal proceeds into cash. In more than a half of all cases illegal proceeds were invested in real estate and legal businesses, such as hotels, shops and restaurants. Some funds were invested in acquisition of automobiles and were used to lease expensive apartments.

All individuals involved in embezzlement of public funds in Chinese case examples were high-ranking officials.

Typology: 3***Legalization of illegal proceeds from embezzlement of public funds using the schemes of "grey" banking services***

The presence of credit institutions offering "grey" banking services in the financial market largely contributes to concealment of criminal proceeds from embezzlement of public funds, making the process of their legalization easier.

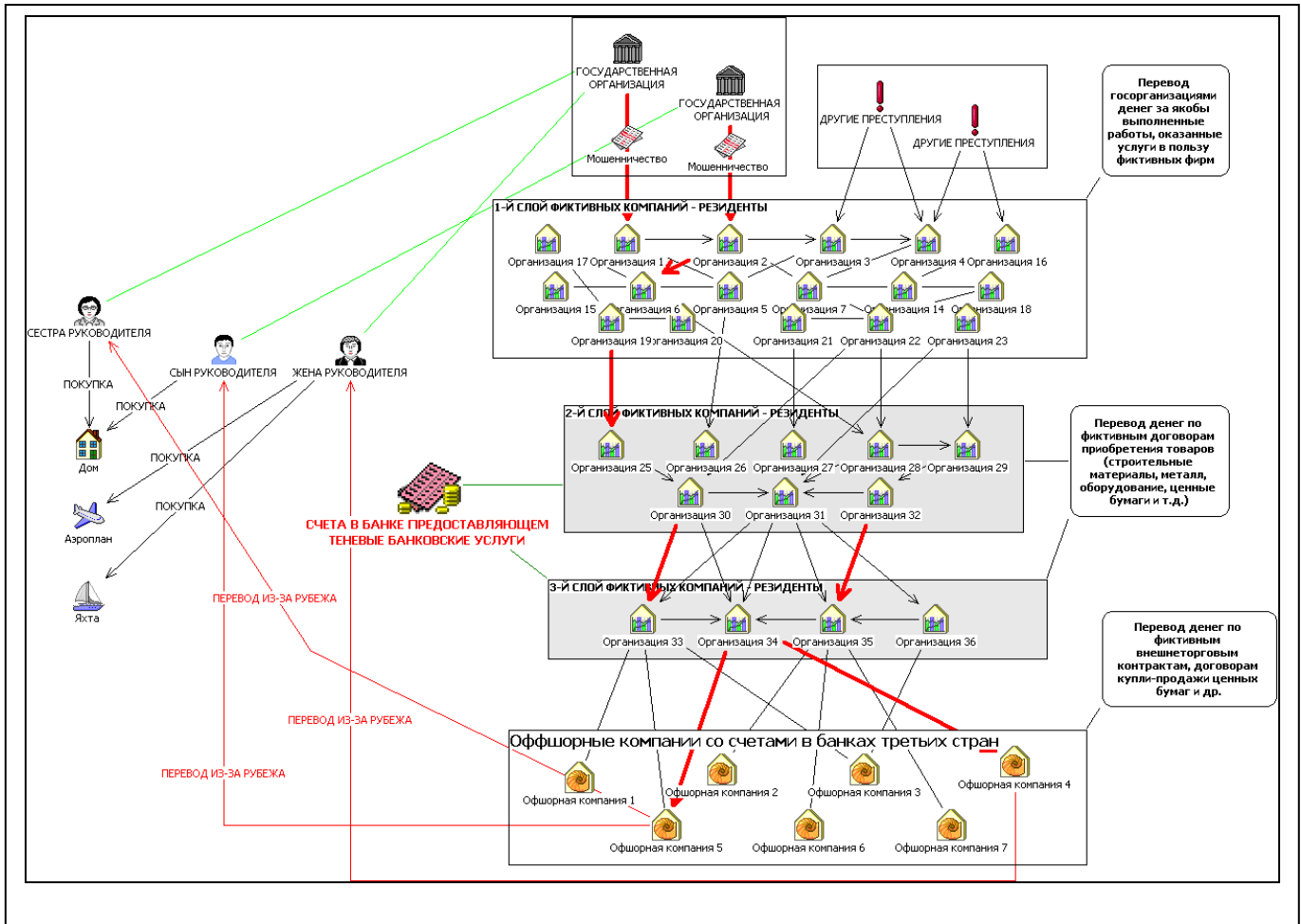
"Grey" banking services are understood as assistance provided by the bank executives and officers to those interested in large-scale transactions of getting cash and transfer of funds

abroad through the financial channels developed for this purpose. Here we mean specially developed options of money transfer chains, required counterparties, including those abroad, certain number of registered "fly-by-night" and offshore companies. In other words, the whole range of services.

Thus, for instance, in Russia the banking licenses of about 70 credit institutions were revoked for gross infringement of AML/FT law in 2008-2009.

Criminal proceeds from embezzlement of public funds may form individual illegal cash flows or may be integrated in the general cash outflow abroad or a cash withdrawal channel. Apart from embezzled public funds such channel may contain the funds allocated for "grey" imports funding, or other criminal proceeds (bribe taking, extortion, smuggling, etc.).

A typical "grey" scheme of legalization of criminal proceeds from embezzlement of public funds by the transfer of money abroad through the bank offering "grey" financial services.



Scheme of laundering of criminal proceeds through the bank offering "grey" financial services⁹

Государственная организация	Public Company
Другие преступления	Other crimes
Мошенничество	Fraud
1-ый слой фиктивных компаний	1 st layer of shell-companies
Организация	Company
Перевод госорганизации денег за якобы выполненные работы, оказанные услуги в пользу фиктивных фирм	The money is transferred by the public company to shell-companies for allegedly performed works or services
2-ой слой фиктивных компаний	2 nd layer of shell-companies
Перевод денег по фиктивным договорам приобретения товара (строительные материалы, металл, оборудование, ценные бумаги и т.д.)	The money is transferred on dummy contracts for purchase of goods (building materials, metal, equipment, securities, etc.)
3-ий слой фиктивных компаний	3 ^d layer of shell-companies
Оффшорные компании со счетами в банках третьих стран	Offshore companies with the bank accounts in the third countries
Оффшорная компания	Offshore company
Перевод денег по фиктивным внешнеторговым контрактам, договорам купли-продажи ценных бумаг и т.д.	The money is transferred on dummy foreign trade contracts, purchase/sale contracts for securities, etc.
Сестра руководителя	Sister of the chief executive
Сын руководителя	Son of the chief executive
Жена руководителя	Wife of the chief executive
Покупка	Purchase

⁹ Red arrows at the scheme underline the stages passed by the legalized monetary funds received as a result of embezzlement of public funds.

Счета в банке, предоставляющем теневые банковские услуги	Accounts in the bank offering "grey" banking services
Перевод из-за рубежа	International money transfer

Layer 1

The funds are transferred by the public companies as payment for allegedly completed works or services rendered, or goods supplied, etc., in favour of several "fly-by-night" companies forming a sort of a first layer separating the funds from the source of their origination.

Layer 2

Further separation from the source of origin and disguising financial trails is achieved by the money transfer to the second layer accounts opened by the "fly-by-night" companies, accumulating financial flows. The payments are split into smaller amounts using dummy agreements for payment for the commodity, services and loan facilities...

Layer 3

Further distribution of "grey" financial flows is carried out by the money transfer to the accounts of the companies in the banks offering "grey" servicing. There the funds split into small amounts at the preceding stage are integrated into large payments totaling to several hundred million rubles each. Again, the dummy contracts are used supposedly related to loan extension, purchase of securities, various commodities, etc.

Layer 4

After the funds have passed through the chain of transfers, they are ultimately transferred abroad to the bank accounts of some offshore companies, or credited to the bank accounts of individuals and legal entities to be withdrawn in cheques and using card accounts, thus, being disguised and leaving no trail for detection. At this stage, there is another redistribution of monetary funds. The funds are transferred to the foreign banks in large trenches (totaling to several billion rubles) under the dummy foreign trade contracts.

Usually the following methods are used to transfer the money abroad:

- **Advance payments under dummy import contracts (non-refundable advance payments under import contracts);**

The terms of such contracts are characterized by three distinctive features – mandatory pre-payments, long period of commodity supply (allowing the importer to disappear) and forwarding of advance payments to the offshore areas. As a rule, a contract is made with a Western affiliated company, usually located in the offshore area, then an advance payment is made from Russia according to the contract terms. Commodities are never supplied and an advance payment made under the contract is never refunded. Six months later the firm winds up its activity (or moves to some other "bank grounds").

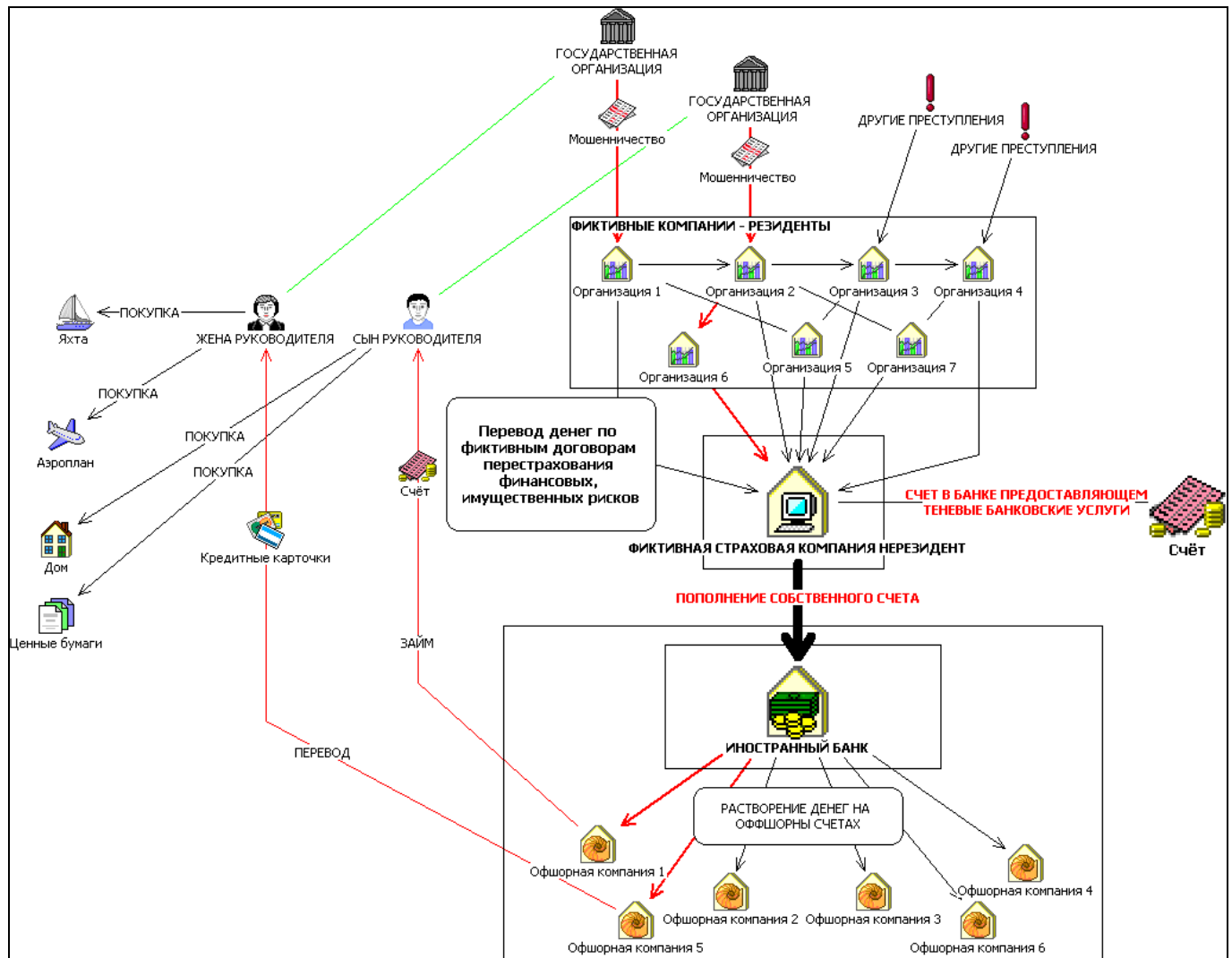
- **Payments and transfers made by non-residents for commodities sold by the resident to a non-resident within the Russian Federation**

In this case, resident legal entities are direct payers of funds to non-residents, entering into dummy contracts for purchase/sale of commodity either within the Russian Federation or abroad, without any import to the Russian Federation. In this case commodity exists only on paper. The funds are easily transferred to the non-resident's bank accounts.

Another type of schemes of illegal transfer of money abroad is the pattern of transactions when the funds are transferred by a resident to a non-resident for any shares of residents alienated by the non-resident, or for any securities acquired from the non-resident, assuming no redemption or payments is expected within the first three years after the issue.

Non-residents may define the period of redemption for their bonds, which may be equal to 10 years. One of the schemes detected by Rosfinmonitoring used the bonds issued by a great number of unknown foreign companies with the period of redemption of 5 to 10 years.

Although to a smaller extent, the schemes of transfer of doubtful monetary funds abroad through the risk reinsurance contracts made with non-residents, using dummy insurance companies, are still applied. The typical scheme of money transfer abroad under the risk reinsurance contracts is given below.



Государственная организация	Public Company
Другие преступления	Other crimes
Мошенничество	Fraud
Фиктивные компании-резиденты	Shell resident companies
Организация	Company
Перевод денег по фиктивным договорам перестрахования финансовых, имущественных рисков	Money is transferred on dummy contracts of financial or property risk reinsurance
Фиктивная страховая компания-нерезидент	Non-resident shell insurance company
Счет в банке, предоставляющем теневые услуги	An account in the bank offering "grey" banking services
Пополнение собственного счета	Adding funds to own account
Иностранный банк	Foreign bank
Офшорная компания	Offshore company
Растворение денег в офшорных зонах	Money dissipation in offshore areas
Сестра руководителя	Sister of the chief executive
Сын руководителя	Son of the chief executive
Жена руководителя	Wife of the chief executive
Покупка	Purchase
Кредитные карточки	Credit cards
Заем	Loan
Перевод	Transfer

Thus, the process of money laundering is becoming complex and multi-staged. Often it is very difficult to trace the whole chain of transfers. Once transferred abroad and withdrawn in cash the monetary funds are further used to acquire real estate and securities, or deposited to the foreign banks. Some money comes back to Russia as loans and investments in commercial and residential property or land, or invested in legal and illegal businesses.

Another case example related to the laundering of proceeds from corruption, obtained by the public official, is given below. The scheme of legalization of criminal proceeds used therein is of particular interest.

Money laundering received for provision of unjustified advantage in a public tender and overstatement of the tender value

Source: FATF¹⁰

Mr. "E", the chief executive of the local telecommunications company have received \$90 thousand US dollars as a bribe for provision of unjustified advantage during the tender winner selection at the pre-defined overstated rate, with the total value of \$1.5 mln. US dollars, to "A" company owned by Mr. "F". Mr. "F" transferred the funds in the amount of the bribe specified to the bank account of private "K" company allegedly for the services rendered. "K" company was also owned by Mr. "F", but in fact was used as a front company with the minimum registered capital. Later on the money was withdrawn in cash from the bank account of "K" company and deposited with the broker's company in the account of Mr. "D", the nominal individual acting on instructions of Mr. "E", who had opened an account on the name of his son with the same broker's company. The money deposited in the account of Mr. "D" was used to purchase securities at the open market, which were later sold to the son of Mr. "E", and the son of Mr. "E" in his turn sold the securities at the open market at a higher price. The money, thus received as legal proceeds was further deposited in banks, a part of funds was used to purchase an insurance policy and real estate registered on the relatives of Mr. "E".

Applied procedures, tools and methods:

- *Using shell companies to disguise true beneficiaries;*
- *Engaging nominal persons (relatives);*
- *Using broker's companies and securities;*
- *Using bank deposits;*

Indicators:

- *Acquisition of real estate registered on the family members*
-

Procedures

Thus, on the assumption of all said above, we have identified the following procedures most frequently used for legalization of proceeds from embezzlement of public funds:

¹⁰ FATF Report on the Misuse of Corporate Vehicles, Including Trust and Company Service Providers, October 2006.

Credit institutions – providing that the funds allocated by the government are usually cashless, it puts the banks in high-risk area of being involved in the schemes of laundering of proceeds from embezzlement of public funds;

“Fly-by-night” companies – as noted above, “fly-by-night” companies often act as one of the critical procedures in the schemes of theft and laundering of public funds.

Offshore companies – like “fly-by-night” companies are frequently used as means for laundering of proceeds from embezzlement of public funds.

Realtors and dealers – the intermediaries in real estate and luxury assets, also fall in the high-risk area. Particularly, it is true about foreign agents. The final laundering stage of stolen public funds and corrupt proceeds usually takes place in other countries, while a lion’s share of them is invested in real estate and luxury assets (yachts, cars, etc.).

Lack of awareness in the origin of funds or neglect of AML/FT rules and standards on the part of realtors and dealers contributes to making the process of laundering of criminal proceeds easier. The countries traditionally attractive for the real property investments, such as France, Spain, Monaco, Italy, Cyprus, etc. are especially vulnerable in this respect. The countries currently experiencing a heavy growth of the market of commercial and residential property, such as Bulgaria, Montenegro, Croatia, Egypt, UAE, etc. are also within the risk area.

Brokers – a tendency to ignore AML/FT rules and standards by the brokers and their firms for the purpose of guaranteed receipt of commissions from the transactions and keeping the client, may also serve the reason for such financial agents to be used in the schemes of laundering of public funds.

Large corporations and manufacturing facilities – analysis of the criminal case materials reveals that commercial enterprises are frequently used as means for laundering of stolen public funds and corrupt proceeds. Laundering is usually achieved by investment of criminal proceeds in the purchase of stocks of the company or stakes in the authorized share capital.

Thus, for instance, as reported by FIU of China, one of the local top-ranking officials have established a mining company with the stolen public funds and acquired shares of this company.

Businesses of the social sphere (restaurants, hotels, cafes, etc.) – analysis of the questionnaires submitted by the countries participating in the study, including China, shows that the public funds embezzled are often laundered by the criminals by means of establishment of cafes and restaurants, hotels and similar businesses;

Financial specialists (professionals) – arrangement of the whole process of embezzlement of public funds requires intellectual efforts of immediate organizers of the schemes, in addition to engagement of a great number of other persons in disbursement of public funds, such as accountants, economists and financial experts. They are the key component in arrangement of efficient theft and laundering of public funds. Accountants and financial experts are vested with special trust, because they are the holders of the information of where, how much, when and by what means the public funds were stolen by the chief executives (in their direct participation). The chief executives and their immediate surrounding collectively form the structure which is defined by the Civil Code as an “organized criminal group”, dealing with theft of monetary funds.

Tools

Among the tools most frequently used for legalization of public funds obtained as a result of theft, it would be reasonable to name the following:

Cash – in the schemes of embezzlement of public funds cash withdrawal is used as one of the most frequent methods to separate the stolen assets from a thief. The most popular (standard) are the schemes involving individuals, when the legal entities transfer large amounts of money to their bank accounts under the dummy agreements to be withdrawn in cheques or using plastic cards;

Bank transfers and deposits – bank transfers and deposit accounts are the first to be listed in the high-risk group because the initial stage of embezzlement of public funds usually involves the bank system;

Securities – purchasing of high-liquidity securities or buying-up of the company stocks, including state-owned enterprises, with the money received from the theft are used at one the money laundering stages. In this case securities may be used either at the stage of layering of criminal proceeds, or at the final stage of their integration;

Promissory notes – the findings of financial investigations show that currently among the crimes committed in security trading area, the economic interests of individual owners and the country as a whole are the most affected by the criminal acts with promissory notes. The promissory note market in Russia is actively developed by criminals, using diversified schemes and patterns to legalize criminal proceeds, specifically, from embezzlement of public funds.

The reasons for the promissory note deals to be preferred by the criminals for laundering of the money stolen from the government are as follows:

- The monetary funds may be taken out of non-cash supervised circulation by purchasing a promissory note;
- The owner of the promissory note may be changes quickly and confidentially through its transfer to the other person;
- The monetary funds may be transferred between the accounts, disguising a true nature of transaction behind the purchase/sale transactions with promissory notes;

Thus, for instance, the schemes involving promissory notes are among others used for tax evasion, owing to illegal tax evasion by disguising of business transactions with the purchase/sale transactions with promissory notes, VAT exempt.

Herewith, the factors set forth below largely contribute in the promissory notes to be applied in the schemes of laundering of criminal proceeds from theft of public funds.

- No limitations in defining a promissory note denomination (the law does not require the amount for which the promissory notes are issued to somehow match the size of tangible assets actually available for the issuer of a promissory note);
- Unlike other types of securities, promissory note transactions do not require state registration, issue and registering of an Offering Circular. It means that the issuer of the promissory note is not obliged to provide any personal details to estimate the likelihood of obligations to the security holders in exercise of rights vested to be fulfilled;

- Abstract nature (no legal binding of the promissory note to the specific contract/agreement in case of its issue to the other person);

Dummy contracts, documents of financial reporting, etc. - dummy documents, such as forged Certificates of completion, cost sheets, contracts, loan agreements and other paperwork are usually a key element of all schemes of theft and laundering public funds. The process of embezzlement of public funds is nearly always followed by forgery of relevant financial documents, while follow-up process of legalization includes the use of dummy contracts of purchase/sale of goods and services, again, to the dummy business entities. The better is the procedure of money laundering in imitating the nature and procedure of lawful agreements, the lower is the likelihood of such crimes to be detected.

The following items should be mentioned among the other tools used in schemes of laundering of public funds obtained by theft: **cheques, debit and credit cards, precious metals (gold, in particular), real estate, and luxury assets.**

CHAPTER 5:

Indicators (criteria) of suspicious financial transactions involving public funds

So, we have identified the basic risk areas of public funding, in general terms, the most commonly used methods of theft, means for laundering of public funds, and most frequently used procedures and tools.

Another step in our study is to define a set of criteria or indicators of suspicious activities based on analysis of responses, findings of financial investigations and other information collected, which could reveal any possible connection between the financial operations with the schemes of theft and legalizations of public funds and possible sources of their criminal origin.

For our purpose the indicators of suspicious activities may be divided into 2 groups:

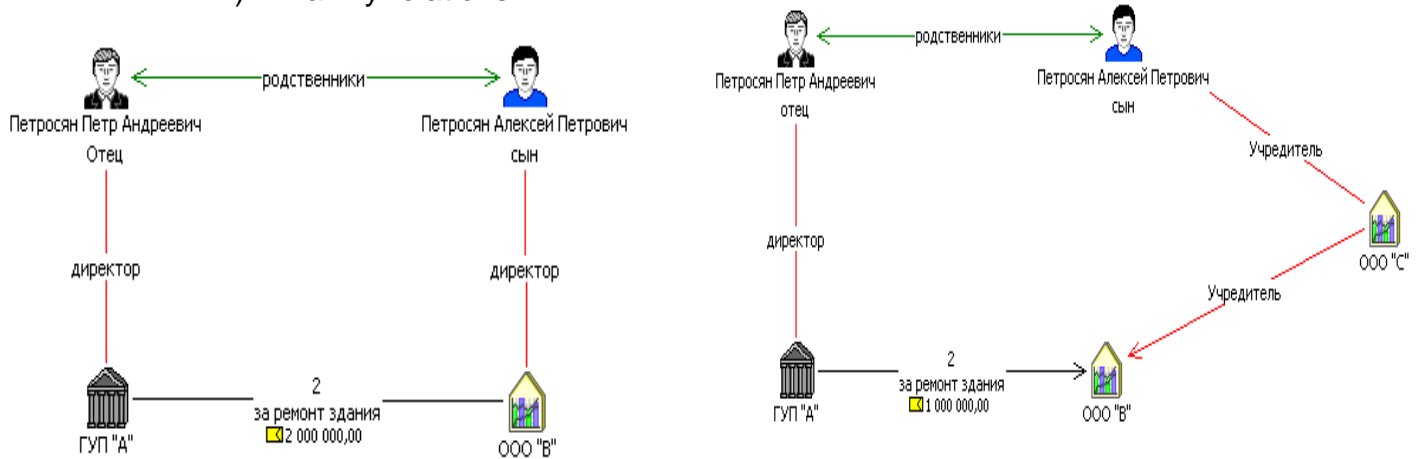
1. Indicators related to financial transactions effected by the state-owned or mixed enterprises, or using public funds;
2. Indicators related to financial transactions effected by the chief executives or founders of the state-owned or mixed enterprises or public officials.

Now let us consider the indicators referred to the first group:

Indicator: 1

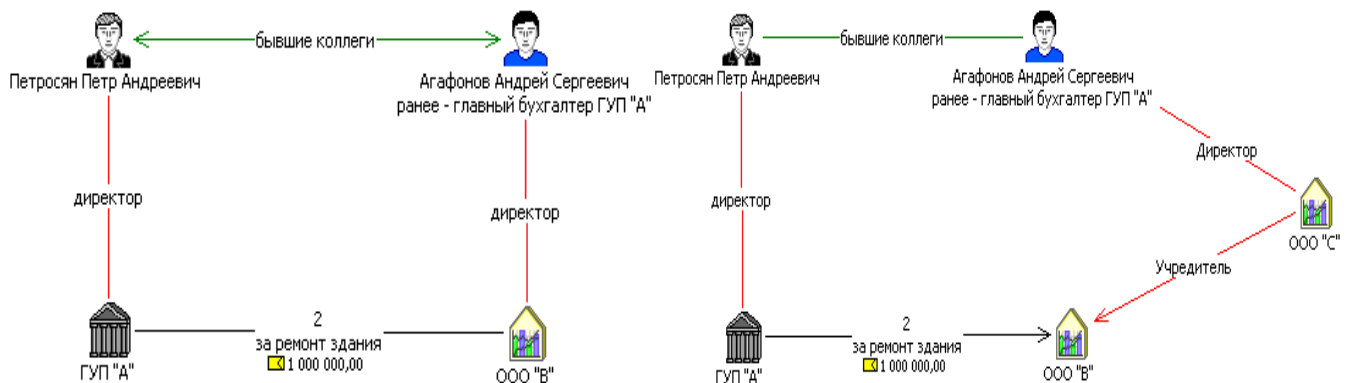
The money transfer is effected by the state-owned company to the private company with the chief executive, the founders (either individuals or legal entities) or the employees thereof being affiliated to the chief executive or founders of the state-owned company. Herewith, the nature of their affiliation may be different:

1.1) Family relations



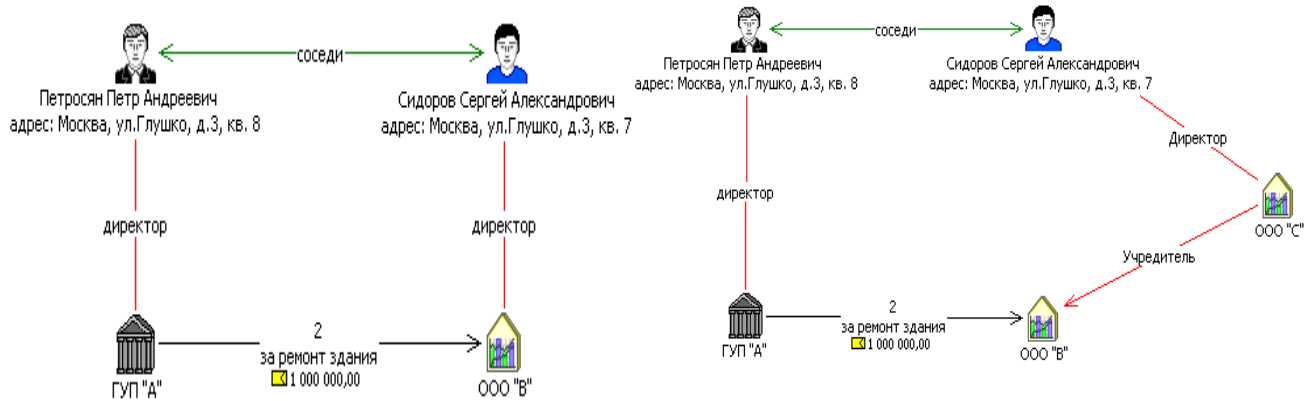
Родственники	Relatives
Отец	Father
Сын	Son
Директор	Director
За ремонт здания	Payment for the building repair
Учредитель	Founder

1.2) common previous place of employment



Бывшие коллеги	Former colleagues
Ранее – главный бухгалтер ГУП «А»	Previously – chief accountant of FSUE «A»
Директор	Director
За ремонт здания	Payment for the building repair
Учредитель	Founder

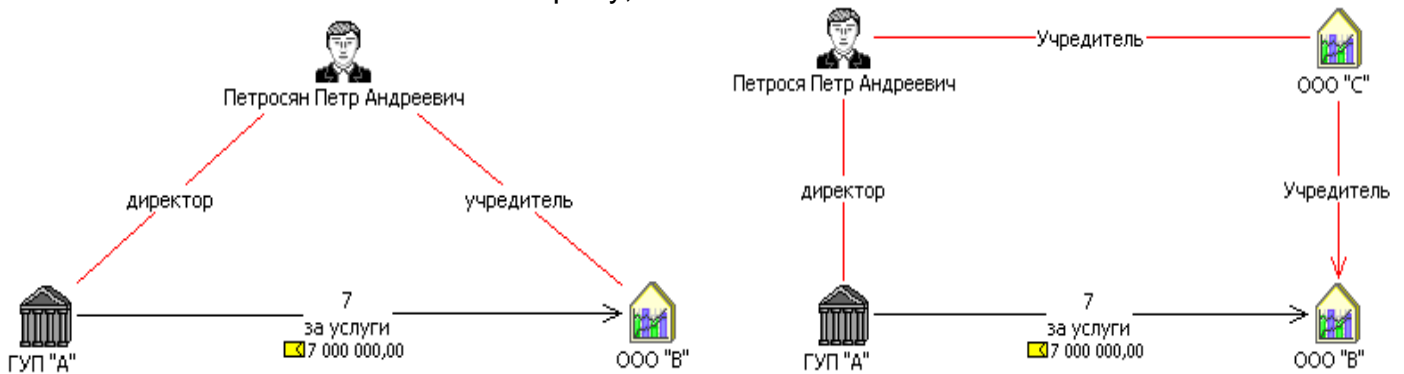
1.3) similar residence or registration addresses;



Директор	Director
За ремонт здания	Payment for the building repair
Учредитель	Founder

Indicator: 2

The money transfer is effected by the state-owned company to the private company, while the chief executive or the founders of the state-owned company are or have been before the chief executives or founders of the counterparty;



Директор	Director
За услуги	Payment for services
Учредитель	Founder

Indicator: 3

The state-owned company is engaged in transactions with the recently registered¹¹ private company, thus, having no positive business reputation;

Indicator: 4

The money transfer is effected by the state-owned company to the bank account of the private company that was out of use for more than 3 months;

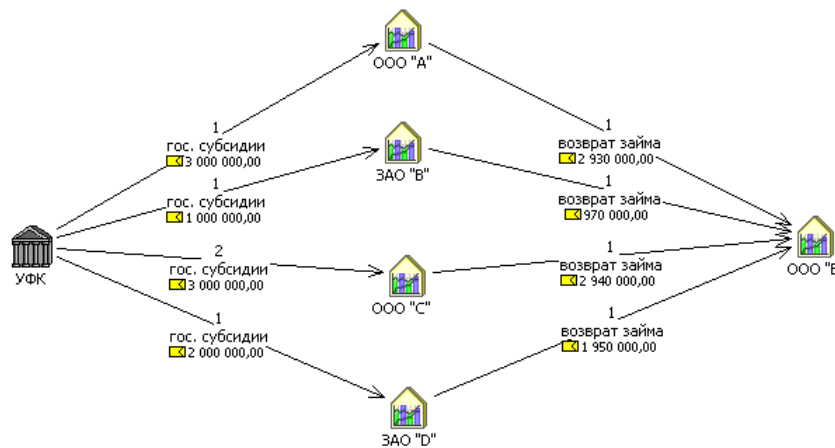
Indicator: 5

¹¹ In Russia a recently registered company, according to AML/FT law, is considered a legal entity registered less than 3 months prior to the transaction.

Significant funds are spent by the state-owned company for interest-free loans, financial aid and charitable contributions;

Indicator: 6

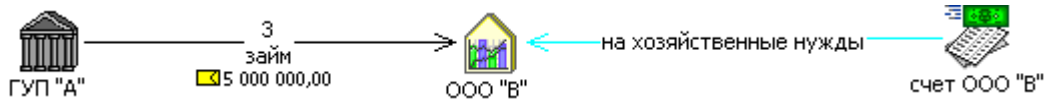
Provision of the government subsidies to the private company, most of which are further transferred to the third party private company, while this third party private company is engaged in similar transactions with a large number of recipients of the government subsidies;



Гос. субсидии	Government subsidies
Возврат займа	Loan repayment

Indicator: 7

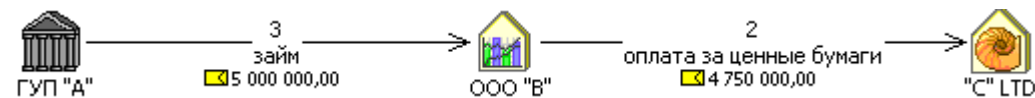
The state-owned company effects transactions with the private company, withdrawing most funds in cash shortly after their receipt.



Indicator: 8

займ	Loan
на хозяйственные нужды	For administrative costs

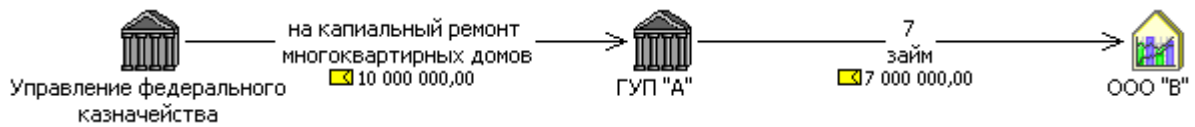
The state-owned company effects transactions with the private company which shortly transfers most of the funds received to the foreign institutions.



займ	Loan
оплата за ценные бумаги	Payment for securities

Indicator: 9

The state-owned company receives the budget funds for achievement of some pre-defined targets and shortly transfers most of the funds received to the private company on different grounds;



Управление федерального казначейства	Federal Treasury Office
На капитальный ремонт многоквартирных домов	Payment for capital repair of apartment blocks
займ	Loan

Indicator: 10

The state-owned company is engaged in transactions with individuals, providing such transactions are usually outside of the scope of the company business activities;



Возврат займа	Loan repayment
За консалтинговые услуги	For consulting services
За услуги	Payment for services

Indicator: 11

VAT is recovered by the private company in the local tax authorities and shortly used for loan repayment; or most funds are transferred to the third party;

Let us proceed to description of the second group of criteria:

Indicator: 12

The chief executive or the founder of a state-owned company or a public officer are engaged in large-scale transactions with non-residents;



Директор	Director
За ценные бумаги	Payment for securities
заем	Loan

Indicator: 13

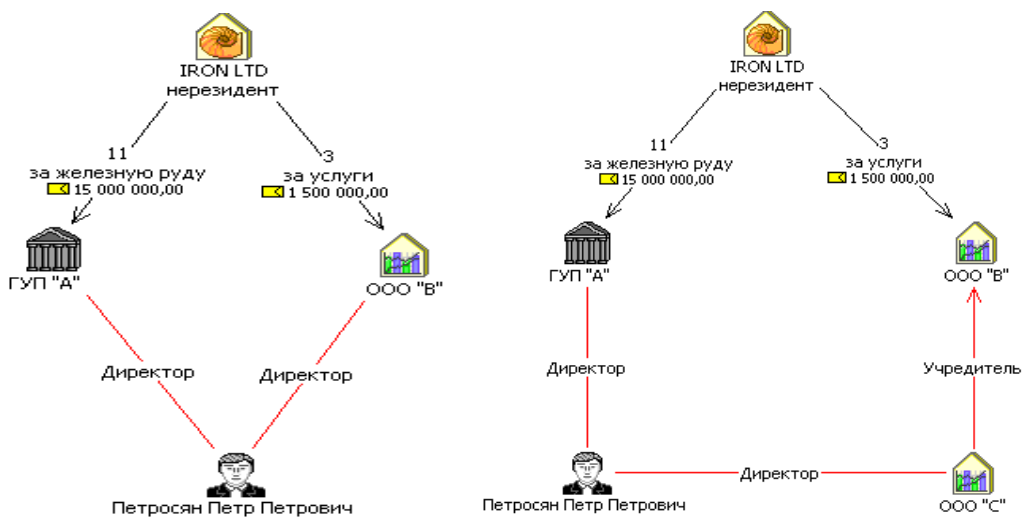
A public officer acts as a chief executive or founder of a commercial organization or a registered private entrepreneur.

Indicator: 14

A chief executive or a founder of the state-owned company or a public officer are engaged in transactions with expensive property or luxury assets.

Indicator: 15

A chief executive or a founder of the state-owned company dealing with foreign economic operations, acts as a manager or a founder of the private company receiving monetary funds from non-resident counterparties of the state-owned company on various grounds.



Нерезидент	Non-resident
За железную руду	For iron ore delivery
За услуги	Payment for services
Директор	Director
Учредитель	Founder

The indicators described herein are also applicable in cases when the scheme is complicated owing to involvement of third party “layering structures”. In this case, for example, indicator 2 of the first group looks like this:



Директор	Director
Учредитель	Founder
За СМР	Payment for construction and installation works
За товар	Payment for commodity

CHAPTER 6:

Methods of proactive detection of suspicious operations

Benefits of analytical tools

Usage of analytical tools available for FIU is one of the methods of proactive detection of suspicious financial operations possibly involving laundering of proceeds from theft from the public companies. In this case we speak of the benefits provided by such well-known analytical products as “12”, “VisuaLinks” and other analytical systems with the same or similar characteristics.

The algorithm of analysis of financial operations involving visual data mining tools (“12”, “VisuaLinks”) is underpinned by the specially developed procedure of automatic search for operations involving state-owned or mixed companies.

The search is carried out throughout the volume of financial operations reported to FIU by financial intermediaries. In Russia this volume is represented by the federal database replenished with electronic messages on operations effected by credit and non-credit institutions on a daily basis.

The automatic search for operations involving public companies is intended to detect the operations that may be defined as high-risk operations by specific criteria or features.

The list of such criteria is more specifically presented in the above discussed chapter of the study "**Indicators of suspicious financial operations involving public funds**". It is obvious, this list is far from being complete and may vary to a certain extent owing to some nation specifics. Although, a range of criteria (or indicators) set forth above, is universal for any country.

FIU has a set of such criteria and a relevant analytical tool enabling the automatic search for operations to be carried out in the database on the basis of these criteria, thus it can detect

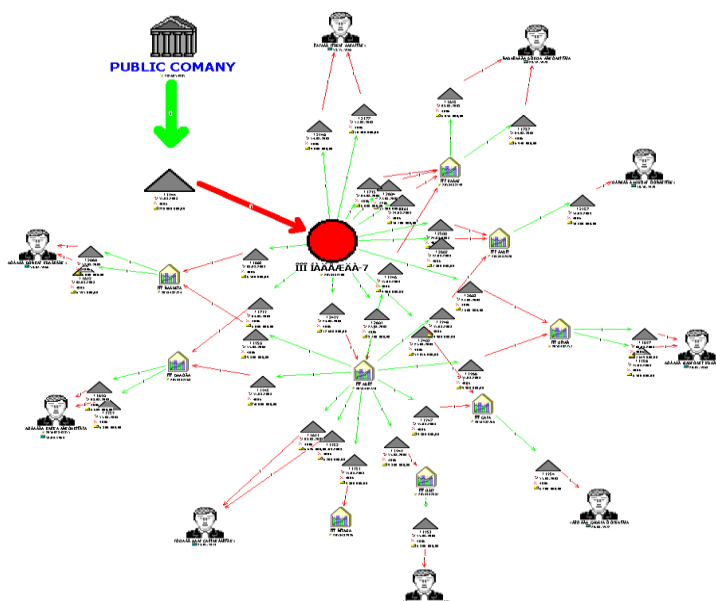
doubtful operations, when, for example, a public company effects a money transfer under the contract to the account of some recently registered private company, consequently, having no positive business reputation.

Thus, for example, today the analysts of FIU of Russia may set-up the search criteria for operations in the analytical system "12" (for instance, money transfer by the public company to the private company founded by the chief executive of the public company having effected the money transfer) to pick up the cases from the database that are likely to deal with embezzlement of public funds.

The example below shows a proactively detected scheme of embezzlement of public funds transferred from the bank account of the public company to the private construction company with shell company features followed by the money transfer to the "fly-by-night" companies and money withdrawal by individuals.

In this case, the critical is the link "public company (payer) – money transfer – recently registered private company (recipient)".

Scheme of embezzlement of public funds in the building sector



Benefits of external information resources

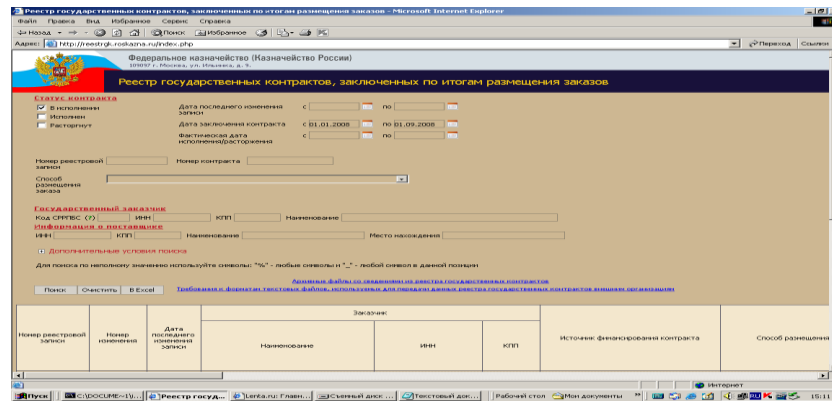
One of available methods of proactive financial investigations aimed at detection of schemes of embezzlement of public funds and their legalization is to use the benefits of the external information sources containing the data on public procurement, contracts, customers, suppliers, etc.

In Russia, for example, such information resources at the federal level are represented by the official web-site of the Russian Federation for publications about the public procurement¹², and registering of federal government contracts¹³. This information resource contains the Federal

¹² <http://www.zakupki.gov.ru>

¹³ <http://www.reestrgek.roskazna.ru>

register of government contracts, including full details of the customer to the contract, suppliers (providers, contractors) to the contract, the scope of the contract, value of the contract and some other details. Besides, this web-site provides the links to the official web-sites for publications regarding the placement of orders by the constituent entities of the Russian Federation.



This approach is based on the search for required contracts, contracting authorities, suppliers throughout an official information resource by the set-up criteria (contract status, number, value, type of placement, time periods).

As soon as the required search criteria are defined, the search is performed by the system reflecting the results on the screen as a column report.

To process the data, thus, obtained one has to save the search results, for example, in Excel format. As soon as the data is saved, the legal entities being the parties to the government contracts, may be checked for operations registered in FIU's database, by the automatic verification of the identification data of the parties, for example, using "Oracle" software, as one of the options.

In addition, the information and process control offices of FIU subject to relevant opportunities, potentially may replenish the database with batch information about the legal entities, parties to the government contracts from the government contracts represented at the official web-sites, providing their availability, of course.

In cases when FIU's database contains the data on transactions in one or another legal entity, such legal entity may be assigned a special identification mark to show that the legal entity is engaged in operations with public assets. Consequently, the marks assigned may be used to search for such operations and legal entities throughout FIU's database.

CHAPTER 7:

Recommendations and measures for detection and prevention of crimes involving embezzlement of public funds and legalization of proceeds from such embezzlement

As we have noted earlier in this work, a corrupt element is one of the principal components of such crimes, if not the main one. In most cases, embezzlement of public funds involved the government officials authorized to dispose of the budget assets. A key factor is the degree of impact of the organized criminals on decisions made by the government officials in terms of disposal of public funds.

Therefore, we are of the opinion that providing response to corrupt practices is a key element in countering the crimes involving embezzlement of public funds. Anti-corruption efforts must be applied at all levels, especially on a political level. Countering corruption should become a top priority in the government program of the country.

Thus, for example, in the US countering corruption is one of the key lines in the government activities, while investigation of corruption crimes is the number one task for the Federal Bureau of Investigations.

Within the range of problems associated with embezzlement of public funds, based on research findings, a number of recommendations and measures for possible detection and prevention of crimes involving legalization of proceeds from theft of public funds were developed. The list of recommendations and measures was defined for four major areas, such as: **financial institutions, Financial Intelligence Units and supervisory authorities, law enforcement system and legislative measures.**

Financial institutions (bank and non-bank institutions)

Providing that banks and non-credit institutions (brokers, dealers, insurance companies) are the first to appear in the risk area of being engaged in the schemes of theft and legalizations of public assets, these institutions have to arrange for a proper internal control system capable of detecting any doubtful operations of the clients which may involve embezzlement and laundering of public funds.

Furthermore, any financial operations effected by politicians and government officials, as well as their family members and relatives or individuals acting on their behalf, should be subjected to comprehensive monitoring. Besides, feasible measures should be taken to detect the origin of money or any other property of public officials.

The practical experience of Financial Intelligence Units operating worldwide shows that one of the crucial factors for successful detection of corruption crimes is efficient implementation of internal controls in credit and non-credit institutions, and "Know Your Customer" procedures, above all. Specifically this issue is addressed in FATF recommendations¹⁴.

A special concern should be given to validation of authenticity of financial documents submitted to the bank, particularly those involving money transfer orders from the accounts of public companies. The criminals often use forged signatures, seals and forms of documents for embezzlement of public funds.

The indicators (criteria) of suspicious financial operations involving public funds, described in Chapter 5, may be applied by the financial institutions in the procedures of internal control services for detection of such operations.

The issue of quality and informative value of transactions reports submitted to FIU by the banks and non-credit institutions is worth of special mentioning. Financial institutions need to move away from a formalist approach to transaction assessment¹⁵, i.e. reporting of transactions to FIU by the formal features.

¹⁴ www.fatf-gafi.org.

¹⁵ For example, in Russia the internal control services in credit and non-credit institutions often use simple and comprehensible codes of transaction types subject to mandatory control to report the transactions. It does not require any additional information in the framework of "Know Your Customer" program.

Provision of more detailed reports on doubtful operations, for instance, could become a possible option of enhancement of efforts for detection of transactions and clients likely to be involved in theft and laundering of public funds. For example, informing that the party to the operation is a chief executive of the public company or a public officer. Perhaps, he/she is a founder of several commercial enterprises, and so on. It is important that financial institutions develop non-formalist approach to the transaction assessment, trying to detect any suspicious features.

Adoption of rigid anti-corruption measures and programs within the financial institutions (suppression and prevention of "white collar" crimes) is another option for countering of this type of crimes.

Financial Intelligence Units and supervisory authorities

One of important lines of FIU's activities in detection and prevention of crimes involving legalization of proceeds from embezzlement of public funds is establishment of efficient bilateral and multilateral partnership.

The information delivered by the international financial intelligence units, including the details of transactions effected by non-residents allows the law enforcement authorities keeping full records of any crimes committed, substantiating legalization of criminal proceeds from embezzlement of public funds and corrupt practices.

To analyze financial operations for their possible connection with embezzlement FIU must know criteria or indicators of suspicious activities peculiar for such operations. Examples of indicators given above may be applied by EAG FIU's analysts either in financial investigations carried out upon requests of the law enforcement agencies, or in proactive financial investigations.

In this respect, formalization of typologies and maintaining their continuous monitoring (automatic search) is crucial. The following aspects are essential to formalize typologies:

1. Procedure for calculation of likelihood of organizations to appear shell-companies (detection of "fly-by-night" companies);
2. Procedure for identification of family and other close connections between the parties to operation.

We could take for example the cases of application of analytical tools and external information resources, described above to review possible methods of proactive financial investigation carried out by EAG FIU. These methods are currently applied by FIU's analysts of Russia. Collection and analytical study of the materials from external information resources is an important aid for the analysts engaged in financial investigations of theft and legalization of public funds.

Speaking about the supervisory function, the most effective measure for detection and prevention of crimes involving theft of public funds and their legalization is probably a regular and unbiased financial audit carried out in the public companies, federal, regional and municipal authorities, private companies under public funding, etc., by the supervision and auditing services.

Close interaction and information exchange between the supervision and auditing services, financial intelligence units and law enforcement authorities will also contribute in improvement of prevention, detection and investigation of this type of crimes.

Law enforcement system

The officers of the law enforcement agencies qualified to counter economic criminal offences are also advised to take into account aforementioned typological schemes and patterns of theft and legalization of public funds and criteria of suspicious financial operations involving public funds.

One of the critical tasks of the law enforcement agencies of EAG countries is to develop an efficient and stable system of specialist training, including the expertise in criminal investigation techniques involving legalization (laundering) of illegal proceeds.

To achieve this objective we have to define base training centers; development of specialized training course and supporting teaching materials, including the option of distant learning; development of procedures for education and advanced for the law enforcement officers.

Legislative measures

Speaking about legislative measures in prevention and countering of corrupt practices, theft and legalization of public funds, we would recommend the following measures:

- Establishment of government monitoring of legality of large expenditures of persons occupying government positions;
- Adoption of provisions for mandatory declaration of income by the public officials and their relatives;
- Introduction of restrictions and bans (freezing of accounts) for the property disposal by the officials charged with criminal offence;
- Wide application of seizure of criminal assets;

Here we mean the maximum extension of the list of crimes subject to property seizure. It would be feasible to apply the sanctions of the property liability for any corrupt practices, including the active use of the civil suit procedures in criminal actions on cases of corruption/embezzlement of public funds.

- Providing the banks with a legal right to refuse from effecting a doubtful transaction, or refuse from opening bank accounts for any doubtful clients;
- Introduction of amendments in the law encouraging non-cash settlements between the companies and individuals;
- Adoption of more rigid criminal and administrative sanctions to any individuals, registering or providing assistance in registration of shell companies;

The government needs to develop the complex measures to improve the government administration in socio-economic sector, monitoring the use of public property according to intended purpose, facilitating the competition at the markets of commodities and raw materials, and improvement of procurement standards for the government and municipal authorities.

Moreover, we need to create conditions for enforcement of human rights for provision of reliable information, improvement of Mass Media independence and taking measures to develop and implement the standards of public services and regulations for fulfillment of state functions, and procedures for provision of public services and fulfillment of public procurement using new (high) technologies.

It is equally important to enhance the quality of academic programs, aimed at formation of the social intolerance to corrupt practices, which is one of the major conditions for embezzlement of public funds.

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