

# GUIDANCE ON FINANCIAL INVESTIGATIONS - 2

## GENERAL PROVISIONS

1. This Guidance has been compiled by the Financial Monitoring Service (FMS) in order to strengthen the capacity of law enforcement agencies (LEA) in the field of combating money laundering and terrorist financing (ML/CFT). This Guidance is a continuation of Guidance No. 1 ([http://www.fiu.az/uploads/content/docs/instructions/MI\\_telimat1.pdf](http://www.fiu.az/uploads/content/docs/instructions/MI_telimat1.pdf)) on Financial Investigations. Guidance No. 1 addresses international standards and theoretical issues on financial investigations. In the current Financial Investigations Manual No. 2, purely practical issues are analyzed and collection of evidence and proving techniques for financial crimes are explained.

2. The primary objective of money laundering (ML) is to cover up the true criminal origin of money or other property by conducting various financial transactions, under the legal curtain. Accordingly, the main purpose of any financial investigation should be to uncover the true nature and purpose of a transaction presented as a normal business practice, daily transaction. During the financial investigation, the answer to what actually happened in the analyzed transactions is sought, the real picture is reconstructed in terms of how the funds that are the subject of the transaction were formed, initial starting and final destination points, movement channels and other parameters.

3. Without conducting a financial investigation, it is extremely perplexing to determine the criminal compound of money laundering (ML) and to carry out criminal prosecution. If the connection is detected between the source of the funds, the beneficiaries, when the funds were obtained, or where they are kept, this can provide us with considerable information about possible criminal activity.

## METHODS OF FINANCIAL INVESTIGATION

4. The investigator conducting the financial investigation should initially focus his resources on 3 main directions:

i. The behavior of the potential criminal (what he wanted to do, what was his real intention);

ii. Movement of money (initial exit and final destination);

iii. The place of the analyzed transaction in the business of the potential criminal or criminal group (transaction network).

5. Depositing a large amount of cash into his bank account by a person suspected by FMS of having involved in drug trafficking may not in itself be sufficient to initiate a criminal case, but when viewed in the proper context and supported by additional information, a different picture can emerge. The information provided by FMS can be verified by the LEA using both traditional operational search and investigative measures, as well as financial investigations.

6. Consider the following example where traditional methods can be used:

**Practical example 1.** A person opens a bank account belonging to a local country and declares that the purpose of opening the account is "personal savings". After a while, during the monitoring of the account, it is determined that the operations carried out by the person do not correspond to his profile and the purpose he declared when opening the account. Thus, the person often deposits various amounts of cash into his account and transfers the deposited funds to the accounts opened in two Georgian banks. In this regard, the Bank submits a Suspicious Transaction Report (STR) to FMS. FMS conducts further investigation and it is determined that the operator travels to Iran once a month, has no convictions and does not have a TIN registered in his name. Also, according to the information obtained from the financial monitoring body of Georgia, it is found that the

accounts in the Georgian banks where the transfer was made belong to "shell" companies that have no activity. As a result of its analysis, the FMS determines the suspicions that the source of the cash received by a person is obtained from the circulation of drugs (as a predicate crime) and its legalization in order to ensure the legal use of these funds, and submits the analysis report to the LEA for a detailed investigation of the relevant suspicious cases.

The information identified in the given example may not, by itself, constitute a sufficient basis for the initiation of criminal proceedings. So, there must be primary evidence to start a criminal case. However, the information identified by FMS can be a significant contribution to a successful criminal case if the additional information and evidence collected by providing very good hints for the initial start are allocated within a right context.

It should also be noted that two main paths can be traced in the financial investigation of ML:

**a.** Identify predicate crime by tracking financial transactions and money flow;

**b.** By identifying the predicate crime, tracking the movement of funds obtained as a result of the commission of this crime. Regardless of which path is followed, a connection must be established between the predicate offense and the financial transactions or funds. The relevant example presented above opens up additional opportunities for predicate crime by tracing the flow of funds.

**7.** The purpose of FMS providing this type of information to the LEA is linked to fact that the LEA's opportunities to gather additional information and evidence (traditional investigative actions and financial investigation) are wider. For example, in the example given above, the LEA can determine where a person is and who they are in contact with immediately before carrying out a bank transaction by using operational search and investigative measures such as tracking people, personal search, controlled delivery, questioning a person, including conducting a personal search while crossing the border, and may apply controlled shipping. In order to determine the origin of the cash deposited by the person in the bank, the LEA can identify the person's close relatives and business relations and analyze not only the person himself, but also the bank and other transactions of the persons he is in contact with. Additional information on this can be obtained from FMS.

**8.** As can be seen from this example, traditional investigative technologies and the specified methods of financial investigation should be applied jointly in financial investigations. FMS collects information from the outside without directly interfering with the subject in accordance with its functions. In this case, FMS cannot directly investigate the area and identify the person's proxies, including informal business and personal connections. In this matter, the field commissioner or operator at the person's place of residence has more opportunities. Once an individual's proxies, business associates have been identified by the LEA, additional inquiries may be made to FMS about their banking transactions, as well as their relationship with the person FMS provides information about and other possible individuals. Only in this way, in the conditions of continuous cooperation of FMS and LEA, it will be possible to determine or clarify the true origin of the funds.

**9.** Financial investigations in which financial transactions are analyzed and accountants and auditors are involved have an undeniable effect mainly in ML transactions involving legal entities. Consider another example below.

**Practical example 2.** Bank observes the intensive inflow of funds to one of the Bank's corporate clients, company "A", under the tender contract from a public legal entity owned by the state. The bank determines that within a week of the receipt of funds, 10% of it is transferred to company "B" under the service contract "with the purpose of carrying out design work". Analyzing

the service contract, the bank's compliance specialist observes a sharp inconsistency between the price (amount) of the contract and its subject matter and submits an STR to FMS about the transaction.

FMS has conducted further analysis and determined that company "B" had no activity other than providing design services to company "A" and that the company consisted of 1 employee (director). FMS further establishes that the founder and director of Company B worked as a driver for Company C, a subsidiary of Company A. FMS sends relevant information to the prosecutor's office on suspicion of corruption and ML.

**10.** In cases where companies are involved, only traditional investigative techniques are not sufficient. A detailed financial investigation should be conducted on each company and its operations. For this purpose, the investigator can involve professional accountants and/or auditors as experts, which is often used in practice. However, the accountant and/or auditor involved doesn't know what you want to prove. It is crucial to ask these experts specific questions that are of interest to the investigation. For this, it is important to have a basic knowledge of how companies' accounting is done. Any crime of corruption, embezzlement, tax evasion, money laundering leaves its traces in paper or electronic systems in one form or another. The main goal of the investigation should be to trace the money flows between the initial exit point and the final destination point of the funds by identifying these traces and to reveal the true purpose and nature of the transactions.

**11.** Traces of operations carried out by the enterprise can be determined in the following accounting systems:

- ✓ the general accounting book of the enterprise (recently it is carried out on various electronic systems);
- ✓ quarterly, annual tax reports;
- ✓ annual audit reports;
- ✓ profit and loss statement prepared for shareholders.

The most reliable of these are the accounting records kept on electronic systems and the profit and loss statement prepared for the shareholders or company owner.

**12.** Knowledgeable about accounting terms such as capital, income, profit, fixed assets, working capital, assets, liabilities, debit/credit, income and expense items of the balance sheet, and the structure of assets and liabilities of the balance sheet in order to find the information you need in the audit reports and accounting books of the enterprise. You may not conduct the forensic accounting examination yourself, but you should initially analyze the accounting documents of the enterprise yourself in order to determine the exact range of questions you will ask the expert (the correct statement of the issue), focus on the transactions that interest you, and ultimately evaluate the reliability of the expert's opinion.

**13.** A general accounting principle is that any figure reflected in an enterprise's accounting balance sheet can be traced back to the original transaction that gave rise to that figure. Thus, each transaction leaves an audit trail, and this trail is included in the report where the financial transaction is written, classified and reflected, in the order determined by the relevant accounting rules, with standard templates. You can get started by following these templates backwards. Auditors conducting audits in enterprises also use this method.

**14.** In case 2, although the FMS provided the LEA with information about one or more related transactions, the LEA's duty should not be limited to verifying those transactions. The entire financial activity of the enterprise, the activities of the officials who lead its economic activities, participate in the adoption of important financial decisions, and if necessary, their personal accounts and business relations should be checked. Thus, experience shows that if an

enterprise is involved in any corruption scheme, such schemes may become systematic in this enterprise. At the same time, in the enterprise involved in the corruption scheme, tax evasion and ML are often used to cover up these corruption schemes as additional criminal acts. Taking all this into account, a complex financial and audit analysis of the activity of the enterprise and its officials, rather than individual operations, can give the desired result. In such complex cases, where hundreds of transactions need to be analyzed, and countless unaccounted requests to banks about the transactions made, success can be achieved with the continuous and flexible cooperation of LEA and FMS.

**15.** Thus, in Practical Example 2, the information provided by FMS should be verified by the LEA, starting from the initial hypothesis put forward by FMS, by analyzing individual accounting entries, financial and banking transactions until a holistic picture is formed. We can recommend that all this large amount of data be analyzed, checked and compared in the following way:

**Analysis:** Analyzing the enterprise's accounting balance by dividing it into component parts (subheadings, items), thereby checking the conformity of the amounts reflected in the balance with the income/expenditure amounts on the account. In relation to practical example 2, see how the funds received from the state tender are reflected in which item of the balance sheet and does the reflected amount correspond to the amount received on the account?

**Inspection:** Inspection of all original documents (contract, invoice, bill, etc.) behind the amount included in the accounting balance in terms of current legislation and business practice. For the purposes of practical example 2, note: Whether the contract is a real contract, in accordance with current business practice or a sham contract with the nature of a cover-up. Is the contract price in line with current market conditions? Was the contract actually executed (to whom, when, in what way?) Has the contract tax been paid, have electronic receipts been submitted and so on?

**Comparison:** Possible falsification and to identify other clues to the crime, matching the original documents behind the transaction with the data entered in the accounting books and electronic systems at all levels. For the purposes of practical example 2, determine the amount of revenue from government tenders in the enterprise's net profit after tax and compare this amount with the original contract amounts. Also, compare the information contained in the accounting records of the enterprise with the information obtained from third sources (bank, FMS, tax authority).

**16.** During the analysis of the financial and business activity of legal entities, a number of indicators you will encounter can form a reasonable conclusion that financial manipulation is taking place in any form (embezzlement, tax evasion, ML). During the analysis, special attention should be paid to the following indicators:

- ✓ having two different accounting books in the enterprise, conducting black accounting;
- ✓ inconsistency between the entries in the accounting book and the entries in the original documents (bills, invoices, account statements);
- ✓ falsification of official documents, signatures;
- ✓ concealment of assets;
- ✓ transfers to offshore zones;
- ✓ payments made to natural persons without specifying a reasonable destination or with a suspicious destination;
- ✓ destruction of accounting records and records;
- ✓ large amounts or frequent cash transactions;
- ✓ payments to fictitious companies or individuals;

- ✓ forged or altered records and documents;
- ✓ fake bills and invoices;
- ✓ purchase or sale of assets that are inflated or undervalued at a price higher than the market value;
- ✓ using nominal shareholders or nominal directors;
- ✓ providing large amounts of internal loans to relevant persons and employees;
- ✓ using copies of invoices or receipts instead of original documents;
- ✓ personal expenses paid with corporate funds;
- ✓ signed checks with recipient's name and date left blank;
- ✓ application of disproportionately large discounts on goods, products and services of the enterprise;
- ✓ making double payments on the invoice;
- ✓ pledging the property of the enterprise for the loans taken from the bank to the relevant persons.

## FINANCIAL INVESTIGATION PLANNING

**17.** During financial investigations and criminal investigation, investigators have to work with very large volumes of documents, make dozens of interrelated decisions, and file petitions before the prosecutor and the court. A well-structured investigation planning is necessary to conduct the entire process effectively. Although each financial investigation is different from the other, the same rules apply to the investigation. In any case, the investigative process is a series of decisions made by the investigator after evaluating the evidence. Who will be the next witness to be questioned? When should I get a search warrant? Should I search for perpetrator or organizer first? How should I coordinate my activities with FMS? Dozens of such decisions must be made during each investigation.

**18.** A well-structured investigative plan will help you organize your work and prioritize your needs. The first thing to do is to determine who will be involved in the financial investigation. Determine to what extent and how you will engage professional auditors, accountants, and banking professionals once the bureaucratic issues of investigative jurisdiction have been resolved. A financial investigation is a process of gathering evidence in each case. You can group your investigative plan into stages of gathering evidence. You can structure your investigative plan into two main areas: a) investigative actions related to predicate crimes and b) investigative actions related to financial transaction and asset movement. However, in any case, we recommend that your investigative plan for a financial investigation include the following components:

- Profiling
- Transaction mapping
- Evidence gathering
- Evaluation and presentation of evidence

### Profiling

**19.** In order to get a clear picture of the overall situation, a profile of the persons who attract the interest of the investigative body in the financial investigation, who are parties to the transactions, who are otherwise suspected or about whom information is provided by FMS, should be formed. The formation of the profile begins with the collection of preliminary intelligence about the subject and its partners from all open and closed sources, FMS, financial institutions, databases. For this purpose, all types of information that characterizes the person himself, his financial

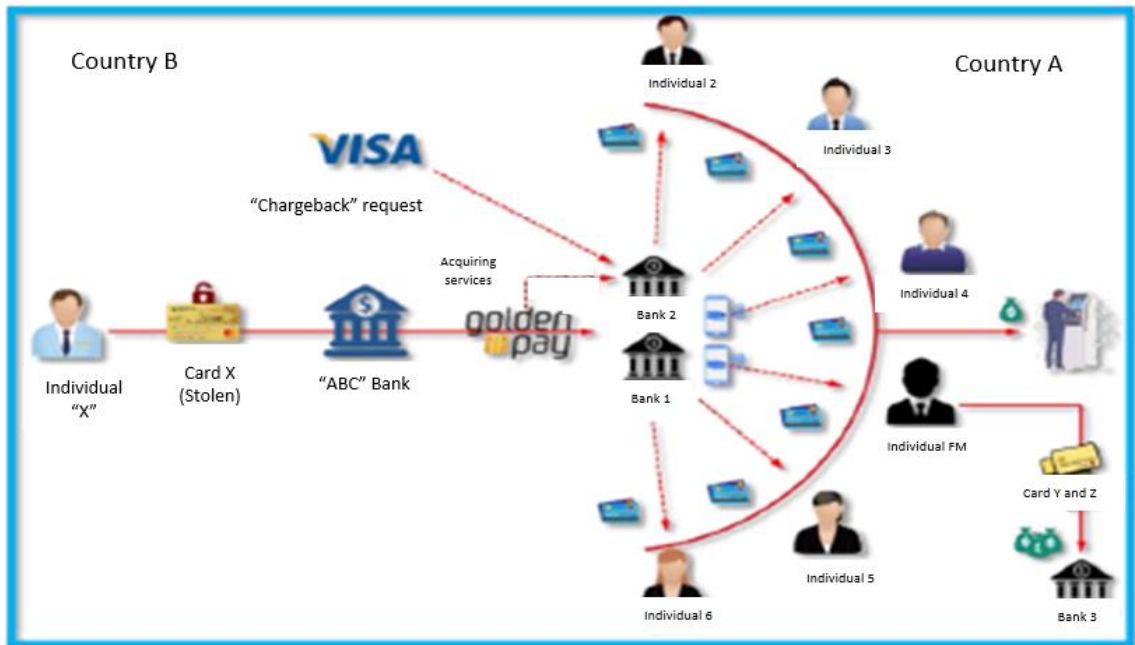
situation, his business, and his relationships, and are of interest for the investigation, are collected in one profile. For this, you can use a 1-2 page profile sheet in the example below:

<b>Profil A (perpetrator)</b>	<b>Name/surname</b>
Example: Brief description: Accountant of company A, founder of company B, no convictions, property registered in his name does not match his personal profile	
<b>Information sources</b>	<b>Notes</b>
FMS	His transactions are not in accordance with current business practice. See transactions map number 1.
Database of LEA	He has no convictions, business relations with _____ persons have been established, he has traveled to Georgia, Iran and Belgium in the last 1 year.
Database of state bodies	He owns shares in companies A, B and C. There are real estates and vehicles in his name.
Open sources	People who bought apartments from company A claim that they were deceived (qafqazinfo.az)

**20.** First, profiles of the main subjects are created. As new subjects are discovered, they should be profiled as well. As new information is gathered during the investigation, additions to the profile should be made. Profiles can be numbered or labeled according to the subject's importance to the case. All profile information for each subject should be kept in an individual file until their role in the scheme is fully defined. As soon as the person's role in the relevant criminal and transactional schemes becomes clearer, relevant notes should be made in his profile.

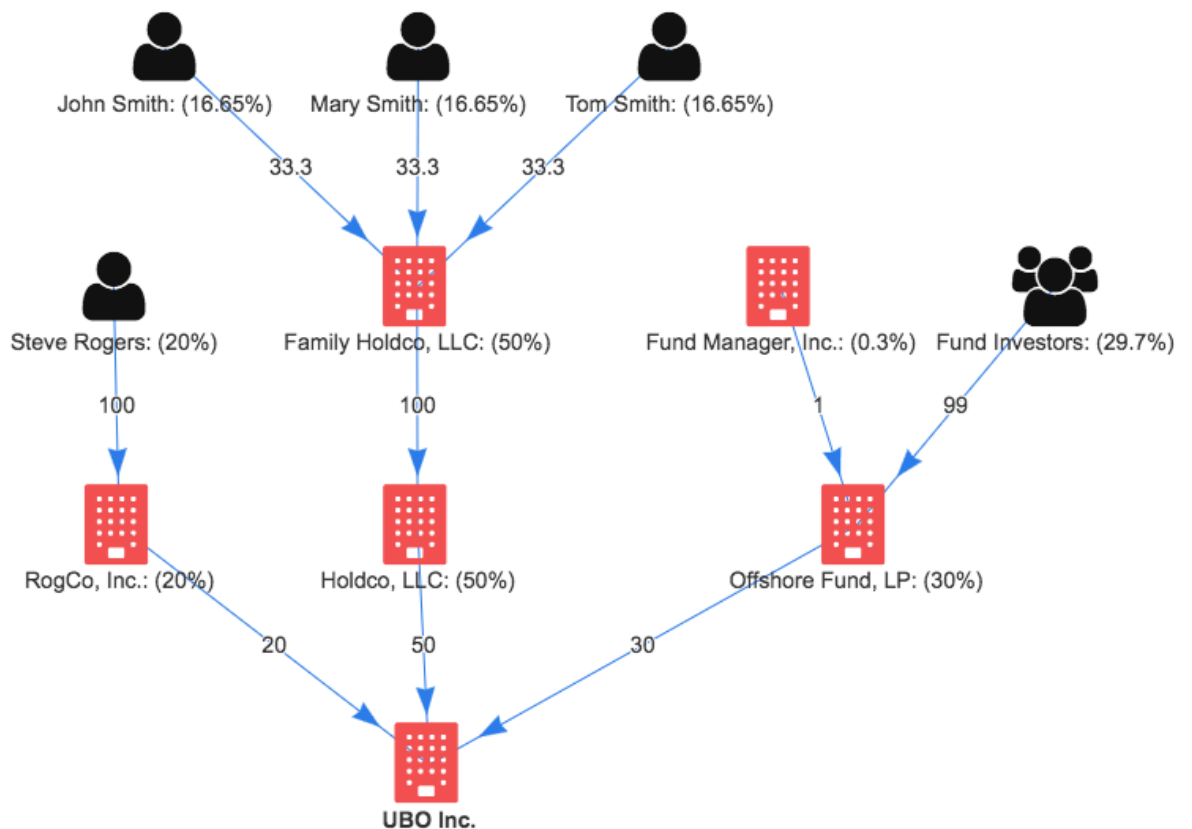
### **Transaction mapping**

**21.** In ML cases, all subjects, regardless of whether they know each other or not, make deals related to various financial/banking transactions, business relations, movement of assets. ML cases might include hundreds of events or transactions. All of these must be placed in the context of the specific predicate crime, subjects and situations. Transaction mapping is used to observe and understand what is actually happening, who is involved in what role, where assets and money are moving, and in general the whole picture in one place. For this purpose, the transactions made are visually associated with pre-prepared profiles (subjects). Let's look at the following example made by FMS.



22. In this example, it is possible to see several subjects whose profiles were prepared in advance in a single picture together with the transactions, countries, financial institutions and banking products that connect them together. This allows us to visually perceive the possible ML scheme that has occurred.

23. Another type of mapping or visualization is link analysis. This analysis is used to identify the relationships of complex structured corporations, beneficial owners, and also to visualize the relationship between companies. Example:



**24.** When using visualization, do not forget to record the exact time of important events in the crime and transactions made. Timelines, profiles, and visualized transaction schemes will make your work much easier when questioning witnesses and suspects, including when comparing and evaluating evidence. You can also use off-the-shelf software to help you create link analysis graphs and timelines. You can also use such visual schemes when presenting evidence in court.

### **SPECIFICATION OF PRESENTING EVIDENCE IN ML CASES**

**25.** The main specific feature of the ML investigation is that both the predicate crime from which the funds were obtained and the ML crime must be proven. However, these two directions should not be considered as separate processes. Evidence must be gathered under the same process for both the predicate crime and the ML. Because in many cases, the evidence of these two different crimes supports and complements each other.

**26.** In order to collect evidence in the investigation of ML cases, in addition to traditional operative search and investigative actions such as tracking people; eavesdropping; opening mails; search and seize; interrogations; controlled shipment you can also use financial investigation techniques such as monitoring of bank transactions through FMS; conducting accounting examination and audit in the enterprise; submitting requests to financial institutions, FMS, tax authorities to determine the beneficial owner of a legal entity; submitting requests to obtain information on financial transactions and the status of bank accounts. Main principle to follow is to direct both traditional and financial investigation techniques to a single goal and achieve their complementarity. Evidence obtained from the investigation of predicate crime will support the investigation of ML crime and the movement of funds, while evidence obtained from the analysis of financial transactions will in turn facilitate the investigation of predicate crimes.

**27.** According to the FATF Recommendations, the suspect's awareness of the origin of the proceeds of crime and the implementation of financial transactions or other transactions in order to hide the origin of the funds or other property or to disguise it as legal must be determined from the factual circumstances of the case. In other words, these types of subjective elements that are difficult to prove must be able to be proven by circumstantial evidence, such as the behavior of the suspect during or immediately after the commission of the crime, the wealthy lifestyle and transactions that do not correspond to his legitimate income, the movement of funds that do not correspond to normal business practices, and so on.

**28.** ML is such a crime that, unlike predicative crimes, can only be proven as a result of intensive use of indirect evidence and, for this purpose, financial investigation by specialized experts, and in many cases parallel financial investigation.

**29.** The standards of proof should also be taken into account in proving the ML crime. If you are filing a civil lawsuit as part of a criminal proceeding, the level of evidence is sufficient to be "clear and convincing." On the other hand, in proving a criminal act, the evidence must be "beyond reasonable doubt". This includes circumstantial evidence as well. To meet such a high standard, you can succeed in proving the subjective elements of an act not by a single piece of circumstantial evidence, but by a series or bundle of related circumstantial evidence.

**30.** If there is even a slight doubt about the source and credibility of the evidence, the court will interpret this doubt in favor of the defendant. If you use an indirect method of the source of funds, such as the net worth method, the standard followed should be "with reasonable certainty". Evidence analysis is an ongoing process. The purpose of a ML scheme is to hide and obfuscate. The purpose of evidence analysis is to uncover this scheme - to lift the cover carefully constructed by the criminal.



**31.** Proving the criminal source of the funds is the most important element in a successful ML investigation and conviction. Traditional investigative measures can determine the likely origin of the funds - drug trafficking, corruption or other predicate crime. But successful proving will require more than probabilities. In this regard, it is advisable for you to obtain straight evidence about the criminal source of the funds. In this regard, the best evidence tool is documents kept by the subject itself that leave a written trace of the movement of funds, various accounting records, material evidence. The second best evidence tool is physical evidence and original documents (contracts, receipts, invoices, etc.) in the possession of third parties (through financial institutions or databases). If you have not been able to obtain evidence of the 1st and 2nd degree, or the evidence you have obtained is not sufficient to prove the criminal source of the funds, then you can use the "net worth" method, which is widely used in international practice.

**32.** According to the net worth method, the subject's assets, liabilities and living expenses are determined. Briefly, what a person has and what he spends is determined. In this regard, a person's net worth is the difference between his assets and liabilities. The same methods and sources of information used in financial investigation are used to determine the wealth of a person. People leave paper trails of their activities, and many of these trails include clues about assets, liabilities, and expenses. You can track this information using the same methods you use in a financial investigation.

**33.** According to the net worth theory of evidence, the increase (or decrease) in net worth from year to year must be the result of some legitimate income (or loss). In other words, a person's annual expenses should be adequate to his annual reportable income. If there is a disproportionate imbalance between a person's income and expenses, the unexplained net worth itself can be used as indirect evidence in the investigation of a ML crime. For example, during a search of a person's house, a notebook was found. Here, the names of various persons and settlements related to the purchase and sale of drugs with them were registered. In addition, you have witnesses who can verify many of the sales recorded in the notebook and confirm that they were drug transactions. In addition, if you identify this person's Ferrari and yacht, luxury properties, who does not work in any specified place, whose legal income cannot be determined, this property itself can be used as evidence in court and confiscated under the net worth method. The net wealth method allows the LEA to confiscate not only the subject of the crime identified during the operation, but also all the unexplained wealth of the subject in drug trafficking, corruption and other criminal cases.

**34.** The most significant problem you may encounter in applying the net worth method is the individual's cash. The most common argument used by criminals against this method is "my deceased father, my friend gave me this money in cash and I collect it under the mattress and slowly spend it." Since you technically have no access to the bequeather and the deceased person, it becomes difficult to apply the net worth method in such cases. However, on all theses of the defendant, it is still possible to formulate counterarguments by gathering direct and indirect evidence. A complex of related evidence, if not isolated, can establish the existence of any fact material to the case. The main principle to be followed here should be a comprehensive approach to the issue.