Public Finance and Anti Money Laundering

A FRAMEWORK ON DEVELOPING AN INTELLIGENT DISCRIMINATING SYSTEM OF ANTI-MONEY LAUNDERING

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Abstract

Anti-money laundering (AML) has attracted highly focus from the mainland China government recently since it has been deeply involved with the faiths of the nation, economic stability, combating the serious flooding of nationwide corruption offences, especial the field of organized crimes. Due to the backward situation of AML mechanism in China, it is of great significance to develop a set of AML intelligence collecting and analyses system to reinforce the countermeasures fighting the ever-raging money laundering activities among local financial networks. Based on the business characteristics of Chinese financial systems, the paper proposed a framework of self-adaptive AML system which is composed of a 4-layer structure including 3 modules. Related procedures of feature selecting and strategies of analyzing and discriminating are discussed.

Keywords: *data mining, anti-money laundering, self-adaptive, decision support system*

1. Introduction

Anti-money laundering (AML) has attracted a high focus inside main land China financial and judicial fields nowadays. It has become a symbol of the capability of the central government and the faith of the nation, as well as an important measure fighting organized crimes and forestalling the flooding of nation-crossed corruptions. However, the construction of an effective AML mechanism is just at its startup which is far from perfect. Most of relevant technical tools, the developing and applications of monitoring and analyzing system are nearly blank, while legislation work is relative coarse and primitive, given the opportunities for the launders to evade the detections. For example, the threshold for the reporting of large-value foreign exchange transaction payment stipulated by the regulator is: as to cash payment, single transaction or accumulated to above US$10,000 per day; as to credit payment, single transaction or summed up to US$100,000 for individuals or US$500,000 for enterprises. Such data reported by local financial institutions compose the main sources for AML intelligence database while other data below the threshold will escape from data collection. It is easy to infer that the launders will split large value funds into smaller pieces and disperse them into different bank accounts as an effective strategy, while a lot of clean and honest transactions above the amount given by the rule will be reported as enormous noises to the analytical procedures day by day and constitute the main body of the database. Though the board will keep perfecting the legislations to adapt the situation, both sides of regulators and offenders will obviously repeatedly play the game. Thus the main requirements of AML information system developing are: to pre-cleanse the immense data reported nation-wide everyday to refine the most valuable clues, to embed a mechanism of self-learning and self-adaptive into the information system to meet the continuously changing strategies of the launders. In this paper we propose a framework to construct an intelligent suspicious financial transaction discriminating system considering the complex situation in mainland China. The paper is organized as follows: Section 2 sets forth three urgent problems the self-adaptive system should solve. Section 3 proposes a whole framework based on the experiences of world-wide AML practices. Section 4 gives a group of preliminary algorithms and data structures to realize the self-adaptive requirements mainly based on statistical theory. The last section is a conclusion and further research jobs are listed.

2. Three Urgent Requirements an Effective AML System Should Meet

Three urgent requirements are listed below that an effective AML system should solve. Such requirements are all derived from the status quo of AML practices among financial networks across mainland China.

2.1 Providing automatic data filtering and checking functions for data reporting jobs of bank branches

The monitoring and analytical data sources are reported by every commercial bank branch to the regulator—the People's Bank of China. The data are generated from hand written cash payment dealing reports or electronic reports of SWIFT remittance system shared by all commercial banks. Far different from the credit payment style dominated in the western countries, Chinese people prefer cash payments which take a proportion of more than 80% over all transactions. Credit payments level in small or medium cities and rural areas is even lower than those in big cities. As a result it's very difficult to pursue the trace of fund flow procedure for the investigators. Considering other factors existing in the commercial bank braches, including the shortage of professional AML talents, the procedures of suspicious data discriminating, collecting, analyzing is surely under an uncertain supervisory. A sound solution is to equip all such bank branches with data collecting computer software providing automatic data filtering and checking functions to ensure the quality of data reporting.

2.2 Self-adaptive or self-evolving technologies

Self-adaptive technologies in AML system are mainly adopted in two procedures:

First, the system will apply such technologies to regularly extract the data that can feature the customer's financial transaction behaviors in different local areas, industries, organizations in order to reflect a real and continuously changing image of local economic development. The uniform reporting threshold of large-value payment stipulated by the Central Bank has obviously ignored the serious economic unbalances across mainland China. There exists a remarkable gap between the eastern coastal area and the middle and western areas, where the eastern coastal areas enjoy much higher economic development level. Enormous legal and normal large-valued transactions data are reported unconditionally in the southeast coastal developed areas while lots of abnormal data may be omitted in those backward areas just by the reason they do not reach the reporting standards though they have been apparently beyond the local economic normal level and show notable unusualness. Thus the reporting data filtering standard

should be stipulated by an overall statistical analysis based on local area or industries historical databases instead of a uniform nationwide standard. Furthermore this filtering standard should be self-adjusted along with the local developing level.

Second, achieve a data-mining ability to find out suspicious clues through series normal-likely transactions data. A critical characteristic of money laundering is that the launders will try all efforts through series complex and normal-likely transactions to explain the legitimacy of dirty funds. Their laundering strategies will be also continuously revised by the new AML policies. It is an essential requirement for a successful AML system to provide a learning mechanism which could automatic adjust the analytical and discriminating strategies to reflect the AML offenders' changing activities.

2.3 Link analytical tools to promote the concentration of suspicious intelligences

Most money-laundering cases are related with the investigations of law enforcement departments such as the Public Security Bureau, the Custom, the Tax Office and the Business Administrative Office, etc. It is proved to be a short cut to notably reduce the processing job size applying a link analytical tool embedded into the system which could tracing the transactions related with those accounts, suspects, corporations being investigated by law enforcement departments. Most literatures of international AML practices all recommend that an effective link analytical tool plays a key role in AML intelligence system.

3. A Macro Framework of AML Intelligence System Designing

A macro framework of AML intelligence system is given as below based on experiences of leading AML countries joined with the status quo in mainland China.

3.1 A 4-Layer Analytical Model

The analysis procedures shall be divided into four layers from micro to macro, from local pieces to a wholly aggregation so as to acquire a particular and comprehensive results.

From inner to outside the four layers include: transaction layer, account layer, organization layer and link layer (link layer is also designated as ring layer in some literatures).

3.1.1 Transaction layer*:* separated or isolated single transaction records, such as cash deposits and withdrawals, cheques, electronic remittance, etc. Such records provide few analytical context because they don't constitute a data chain.

3.1.2 Account layer: A serial transaction activities should have all happened through a specialized account in a bank set up by a specialized person.

3.1.3 Organization layer: a main body of money laundering activities is more likely a corporation or an organization, covering multiple accounts and persons.

3.1.4 Link layer: investigation to a money-laundering mostly involves multiple levels of corporations, organizations and persons.

Different layers play different roles during the analyzing procedure. Data of Transaction layer and Account Layer are submitted from the root bank branches and have composed the fundamental sources. Only isolated intelligence may be derived from the perspectives of both inner layers. Organization layer and Link layer provide perspectives to take a comprehensive and aggregate discriminating and analyzing procedure to all data involved by multiple banks, areas and departments, to check, contrast, mine, judge and derive in all those data collected from varied channels. The later layers have much more advantages during macro situation judgment and relevant cases investigation.

3.2 Three Main Bodies of the System

3.2.1 Data collecting and filtering system

The system will be applied in the root bank branches to aid the suspicious data collecting, filtering and transmitting job. It belongs to Transaction layer and Account layer.

3.2.2 Data integrating and analyzing system

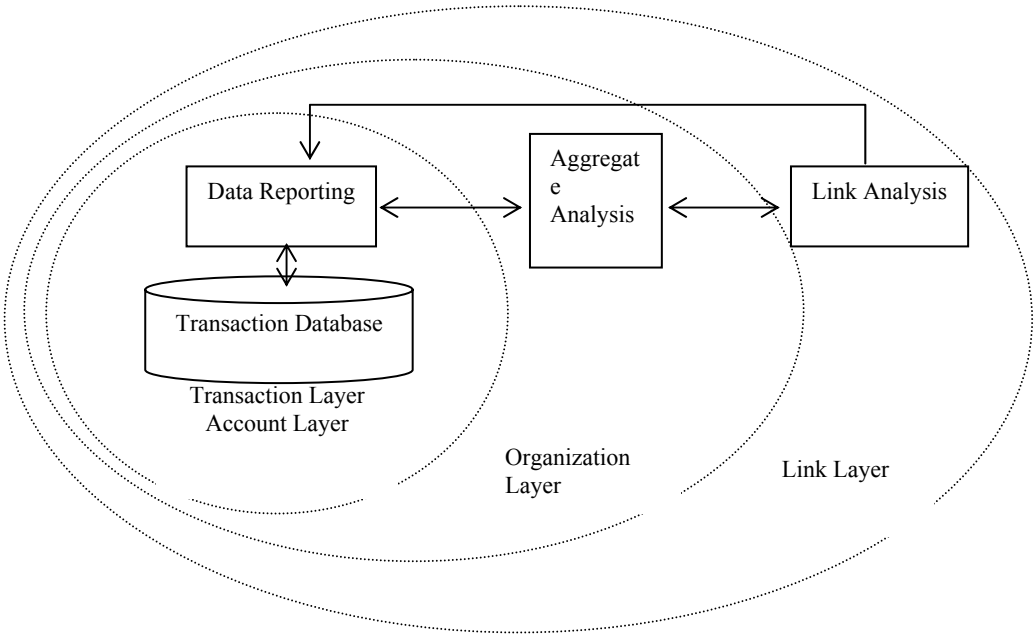
It will give a comprehensive analyzing process to the data collected from different channels at a integrative perspective to pick out most suspicious-like intelligence, as well as provide a wholly study from a macro and strategical perspective to derive the trends, migrations, and countermeasures of AML.

3.2.3 Link Analytical System

The system can take advantages of the intelligence provided by law enforcement departments to tracing relevant persons, organizations and their accounts and transactions. The link tracing function may be integrated into

other systems to acquire an ability of automatic monitoring and analyzing given accounts and persons. The framework is shown as Figure 1.

Figure1 Framework of AML Intelligence System



4. Main Algorithms

4.1 Data Filtering

Data filtering is the essential function of data reporting system for local bank branches. The key technology is feature selection based on expert knowledge database. Feature selection job should give a relative accurate behavior profile reflecting the normal level standards of local financial transaction activities. A simple but practical algorithm is the famous Bayes decision method based on statistical theory. The central bank has set forth series unusual financial norms featuring money laundering in its suspicion reporting rules. But the standards are all ambiguous to operate. The judgment features include capital flow sum in a given period, frequencies of in and out the account, etc. But they are not recorded in the reporting database. Such features could be derived out by statistical method. Relationship may be described through a linear regression model.

Tag the register capital sum with f the sum of in and out the account during given period is s f_i and s_i are corresponding attributes of account i. Assume that f and s have an approximate linear relationship: f=α+βs+ε□α□β are constants, ε obeys normal distribution N(0,σ2) α β may be estimated using least square method so we will get

$$\hat{\beta}=\frac{n\sum_{i=1}^{n} f_i s_i-(\sum_{i=1}^{n} s_i)(\sum_{i=1}^{n} f_i)}{n\sum_{i=1}^{n} S_i^2-(\sum_{i=1}^{n} s_i)^2} \qquad \square\alpha=\bar{f}-\hat{\beta}\bar{s}$$

The relationship between register capital of a given industry and the periodical flow sum in and out from its bank account could be estimated by above equation so as to filter out the abnormal data.

For those time series data from given bank account, the behavior profile could be also be inferred through statistical method as below:

Assume the periodical flow sum nearly obeys a normal distribution X~N(μ,σ2)□the parameters μ,σ may be estimated by median and range. The theorem tells that:

If Me is the median of samples series X1□X 2□… Xn, then for any

$$\lim_{n\to\infty} P\left\{\sqrt{\frac{2n}{\pi}}(Me-\mu)\le x\right\}=\frac{1}{\sqrt{2\pi}}\int_{-\infty}^{x} e^{-\frac{t^2}{2}}dt$$

x, , we could assume μ=Me if n is big enough.

Besides, the expectation and variance of range R are:

E(R)=dnσ□D(R)=vn2σ2,

So we could infer $\sigma=\frac{R}{dn}$.

As the parameters have been concluded, give the single side degree of confidenceα, the confidence interval is $(0,^{\mu+\mu\alpha\frac{\sigma}{n}})$. If the given transaction sum is big enough which has been located outside the interval, the transaction may be considered as unusual.

4.2 Algorithms of aggregate analysis

Money laundering is a three-stage process that requires: placement--launderers place the dirty money into financial system. Layering, that is, disguising the trail to foil pursuit, with such techniques as shares, bonds, loans and other conduits. It usually consists of a series of transactions

designed to conceal the origin of the funds. This is the most complex stage of the process, and the most international in nature. The money launderers might wire transfer funds from one country to another, and then break them up into investments in advanced financial options or in overseas markets. The final stage of money laundering is termed integration, making the money available to the criminal once again with its occupational and geographic origins hidden from view. The aggregate analysis focuses on the layering stage by collecting all related data from different accounts, persons and transactions. Almost every mature data mining and pattern recognition algorithm such as neural network, genetical algorithms, etc. has been adopted in the financial analyzing systems in AML leading countries. Two solutions are put forward in this paper to meet the requirements during designing the analysis system: how to describe the relationships between different accounts, and how to reduce the immense data search range.

4.2.1 Directed map data structure

A directed map structure can easily describe the relationship and the transaction details between two accounts as shown in Figure 2. Each node represents an account; each line links two accounts, what's more, it also records their transaction features such as frequency, sum, etc. The structure is described as below:

Node structure:

node{

Accountid:long; //account no

accountAttr:string;//description of attribution

N:int;// count of out

Out[1…N]:line;//line of out

}

Line structure:

line{

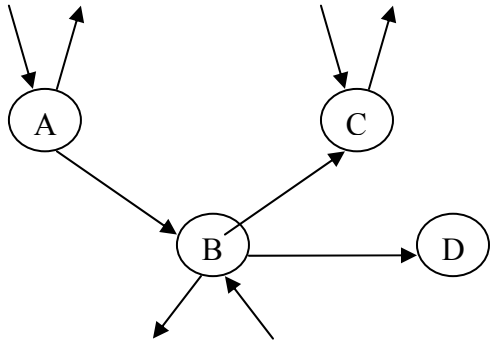
Node:node;//direction node

monSum:int;//monthly average sum of account

monFreq:int;//monthly average frequency of dealing

monFreqs:float;// variance of the monthly frequency }

Figure 2 An illustration to directed map data structure



4.2.2 Suspicious score ranking method

In order to effectively reduce the immense processing size on reporting records, we adopt a suspicious score ranking method. Construct a table of account score, give each account an initial score 0. Then construct a scoring rule table which provides the scoring value or norms given by professional experts or derived by statistical experiences. Suspicion scores can be computed for each record in the database (for each customer with a bank account), and these can be updated as time progresses. The table can then be rank ordered, and investigative attention can be focused on those with the highest scores or on those which exhibit a sudden increase.

5. Conclusion

AML system designing and constructing is at it infancy now in China. The AML intelligent prototype proposed here is mainly based on the practical algorithms based on statistical theory. A further research work will introduce more effective self-learning capability, integrated with the training data set acquired from AML applications, and perfect the data storing structure for analyzing procedures.

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EU FIGHT AGAINST MONEY LAUNDERING

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Abstract

International integration produces many positive effects. Nevertheless, every coin has two sides. Liberalizing of international capital flows and making money transfers easier has also enabled new ways of legalizing dirty money. Fight against money laundering became a discussed topic mainly after terrorist attacks in September 2001. EU has followed the world struggle to stop money laundering and terrorist financing by creating a new anti-money laundering directive. The directive is in conformity with international conventions and standards related to that topic. It reflects the revision of FATF 40 recommendations. New directive proposes three forms of due diligence. It also deals with the role of national financial intelligence units. Aim of the paper is therefore to present the fight of EU against money laundering and terrorist financing and the influence of the fight on the financial sector. Institutional provisions regarding anti-money laundering rules will be also mentioned, i.e. role of financial intelligence units and international institutions that focus on money laundering.

Keywords: *EC anti-money laundering directive; FATF; due diligence; financial intelligence unit*

1. Introduction

Integration processes have their positive and negative aspects. Single European market is based on the principles of non-discrimination, market access and competitive federalism. Thus the aim is to create market similar to domestic market. As to the free movement of capital and payments, EU has liberalized capital flows between EU member states and between EU and third countries. EU shall therefore take necessary measures to hinder money laundering as a negative aspect of integration process. European Union naturally follows international processes and standards of fight against money laundering. This shouldn't however mean that all the standards and measures should be adopted automatically without critical consideration of cost and effects of the measures.

2. Definition of money laundering

Most proper definitions give international agreements. Because of the topic of the paper, I have chosen EC directive whose definition follows international standards.

'Money laundering' means the following conduct when committed intentionally:

- the conversion or transfer of property, knowing that such property is derived from criminal activity or from an act of participation in such activity, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such activity to evade the legal consequences of his action;

- the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from criminal activity or from an act of participation in such activity;

- the acquisition, possession or use of property, knowing, at the time of receipt, that such property was derived from criminal activity or from an act of participation in such activity;

- participation in, association to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the actions mentioned in the foregoing indents.

Knowledge, intent or purpose required as an element of the abovementioned activities may be inferred from objective factual circumstances.Money laundering shall be regarded as such even where the activities which

generated the property to be laundered were carried out in the territory of another Member State or in that of a third country.[1]

As can be seen from the definition, money laundering is not only conversion or transfer of property but even possession or use of property that was derived from criminal activity, if the person knew that such property stems from criminal activity.

Money laundering has three stages: placement, layering and integration. In the placement stage, the aim of the launderer is to introduce the money into financial system, typically by breaking large sum to be laundered into smaller sums. The aim of this phase is to hide illicit origin of the money. In the second stage, the money is transferred from the accounts, used to set up shell companies so that the origin of the money appears clean. Last stage of the process is integration of laundered money into legitimate economy.

Total laundered volume can be only estimated. International Monetary Fund for instance estimated the volume as 2-5% of world GDP[2]. Money launderers don't use only bank sector to conceal the true origin of the financial sources, they use also currency exchange houses, wire transfer companies etc.[3]

2.1 Why should we fight against money laundering?

When talking about anti- money laundering (further in text "AML") rules, natural question arises. Is the fight against this phenomenon effective and shall we matter about this activity? When considering this topic, we should name negative effects of money laundering. From macroeconomic point of view, money laundering changes the demand for cash and thus influences monetary policy. Money laundering is a process of financing consequent criminal activity. Money laundering has also negative effect on financial institutions. Money laundering increases the probability that financial institution becomes corrupt or controlled by criminal interests and increases the probability of financial failure as a result of the institution being defrauded[4]. Money laundering also goes hand in hand with corruption[5].

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[1] Directive 2001/97/EC of the European Parliament and of the Council of 4 December 2001 amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering

[2] see European Parliament. Money laundering. Access from <www.europarl.eu.int/comparl/libe/elsj/zoom_in/26_en.htm>

[3] see Money Laundering. Access from: <www.pctc.gov.ph/edocs/papers/MoneyLaundering.htm>

[4] see Bartlett, B. L. The negative effects of money laundering on economic development. Economic research report for the asian development bank. May 2002 Access from:

Money that stems from corruption must be laundered and to lauder money, one sometimes has to corrupt employees of financial institutions. These are the most important arguments for pursuing illegally gained money.

There are also several arguments contra tracing dirty money. Some anti money laundering rules are in conflict with fundamental human rights (e.g. right to privacy, right to fair trial). To detect illegal money, financial institutions have to gather relevant information on financial transaction and on the customers. Data protection and breach of bank secrecy becomes a relevant problem in this context. Other problem is effectiveness of the activity of tracing illegal money. The effectiveness cannot be precisely measured and anti money laundering measures appear to be very costly.

There are however strong arguments for AML fight. When tracing criminal money, we can trace criminal activity as such and reveal criminal acts. AML fight also hinders development of criminal activity (illegal money serves as source of consequent financing of criminal activity). It gives a strong signal for potential criminals that "crime doesn't pay[6]". Another question is if money laundering shall be considered as a criminal act (in other words, if it is not punishing twice for one crime). It is to emphasize that many famous criminals have been convicted because of other crimes – tax evasion, money laundering[7]. Fight against money laundering is therefore not meaningless; the important question is scope and method of the fight.

2.2 International standards of fight against money laundering

Money laundering is an international problem. To cope with it in an effective way, it is necessary to cooperate on international level. Hence, international organizations try to set out world-wide standards for fight against money laundering. These standards shall include definition of money laundering as a criminal activity, measures taken by institutions in which money laundering occurs, state measures against money laundering and international cooperation in this field. Quality institutional and legal framework is essential.

<http://www.adb.org/Documents/Others/OGC-Toolkits/Anti-Money-Laundering/documents/money_laundering_neg_effects.pdf> p. 23

[5] For detailed analysis of effects of money laundering, see Bartlett, B. L. The negative effects of money laundering on economic development. Economic research report for the Asian development bank. May 2002

[6] Many criminals count with the imprisonment as a price they have to pay for the money they have illegally gained. This changes if the possibility of confiscation of the money is very probable.

[7] One example speaking for all is imprisonment of Al Capone.

International organizations feel the need to combat this phenomenon. Thus, several anti money laundering conventions have been adopted. **Council of Europe** adopted the Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (Strasbourg Convention). **United Nations Organization** adopted two conventions: UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substance 1988 (Vienna Convention) and UN Convention against Transnational Organized Crime 2000 (Palermo Convention). Aim of the conventions is to unify national rules on criminalization of money laundering and thus make the fight against this phenomenon more effective.

Banking sector also became active in fight against money laundering. **Basel Committee on Banking Supervision** focused on money laundering in several recent texts. The committee elaborated rules for customer due diligence (October 2001) and consolidated know your customer (KYC) management (October 2004)[8].

Wolfsberg Group[9] drafted Wolfsberg AML Principles. The principles were agreed by major international private banks. The Principles set general guidelines for client acceptance. Categories of information that are essential to collect in order to comply with due diligence rules are named. The Principles also define situations that require additional diligence, give definition of unusual or suspicious activities, their identification and reporting. Banks are required to monitor account activities, establish regular management reporting on money laundering issues, establish a training programme on the identification and prevention of money laundering for employees who have client contact and keep records of anti-money laundering related documents. They shall establish department responsible for the prevention of money laundering.

There are also international organizations that focus expressively on AML rules. **Financial Action Task Force**[10] (further in text FATF) is a body created by states of G7 to combat money laundering. Main aim of the body is to *generate the necessary political will to bring about legislative and regulatory reforms in these areas*[11]. FATF examines the international

[8] See http://www.bis.org/bcbs/publ_13.htm

[9] Wolfsberg Group is an association of twelve global banks, which aims to develop financial services industry standards, and related products, for Know Your Customer, Anti-Money Laundering and Counter Terrorist Financing policies.

[10] For more information see official web sites on www.fatf-gafi.org

[11] Access from: <http://www.fatf-gafi.org/pages/0,2987,en_32250379_32235720_1_1_1_1_1,00.html> Accessed: <14. 10. 2005>

methods and trends of money laundering. The body also publishes a list of non-cooperative countries and territories[12].

FATF created 40 recommendations to combat money laundering. Recommendations are divided into four parts: legal systems, measures to be taken by financial institutions and non-financial businesses and professions to prevent money laundering and terrorist financing, institutional and other measures necessary in systems for combating money laundering and terrorist financing, international cooperation. Recently, the recommendations have been amended by 9 special recommendations against terrorist financing.

First part of the recommendations defines minimal legal scope of money laundering offence. Then the recommendations focus on due diligence, record keeping and reporting suspicious transactions. Recommendations also define competent authorities that shall prevent money laundering. Countries shall establish financial intelligence units (centers for receiving, analysis and dissemination of suspicious transactions).

Egmont Group is an informal body that stimulates cooperation among financial intelligence units (FIU). FIUs, at a minimum, receive, analyze, and disclose information by financial institutions to competent authorities of suspicious or unusual financial transactions[13]. Nowadays, 94 countries are members, including the Czech Republic.

International organizations pay sufficient attention to AML phenomenon. Regional integrations must follow basic principles set by the most important AML conventions (UN conventions, Council of Europe convention, FATF rules) in order to combat money laundering effectively. Mainly FATF list of non-cooperative countries and territories creates an international environment in which it is not politically possible for a country to avoid international standards.

3. EU fight against money laundering

To take action in some field of activity, European Union must have competence conferred by primary legislation. Fight against money laundering has two dimensions – economic measures and criminal prosecution. Economic dimension of money laundering falls in the scope of the first (supranational) pillar whilst criminal law belongs to the third pillar – cooperation in the field of justice and home affairs.

[12] The list of the non-cooperative countries and territories as well as report on observance of FATF recommendations is published also by IMF

[13] According to: http://www.egmontgroup.org/about_egmont.pdf <7. 10. 2005>

At the beginning, the aim of the Communities was to combat drug abuse. Several resolutions of European Parliament dealt with that topic. European Union participated in the United Nations conference on Drug Abuse and Illicit Trafficking and became party to the Vienna Convention. Lately, EC has adopted the first anti – money laundering directive[14].

Important political step in cooperation of European countries in AML fight was Tampere summit (1999). Aim of the summit was to create an area of freedom, security and justice. In Tampere, EU member states (MS) agreed on action against money laundering. MS shall implement Strasbourg Convention and FATF 40 recommendations. AML directive shall be revised. Further, summit conclusions focus on cooperation of FIU. MS agreed upon approximation of criminal law on money laundering (mainly on the scope of criminal activities, which constitute predicate offences for money laundering)[15].

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[14] **List of relevant legal texts on money laundering:**

1. Council Directive 91/308/EEC, of 10 June 1991, on prevention of the use of the financial system for the purpose of money laundering. (OJEU L 166 of 28.6.1991 p. 77)
2. Joint Action 98/699/JHA, of 3 December 1998, adopted by the Council on the basis of Article K.3 of the Treaty on European Union, on money laundering, the identification, tracing, freezing, seizing and confiscation of instrumentalities and the proceeds from crime. (OJEU L 333 of 9.12.1998 p. 1)
3. Council Decision of 17 October 2000, concerning arrangements for cooperation between financial intelligence units of the Member States in respect of exchanging information. (OJEU L 271 of 24.10.2000 p. 4)
4. Council Framework Decision 2001/500/JHA, of 26 June 2001, on money laundering, the identification, tracing, freezing, seizing and confiscation of instrumentalities and the proceeds of crime. (OJEU L 182 of 5.7.2001 p. 1)
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Access from <http://www.europarl.eu.int/comparl/libe/elsj/zoom_in/26_en.htm>

[15] X. Special action against money laundering

51. Money laundering is at the very heart of organised crime. It should be rooted out wherever it occurs. The European Council is determined to ensure that concrete steps are taken to trace, freeze, seize and confiscate the proceeds of crime.

52. Member States are urged to implement fully the provisions of the Money Laundering Directive, the 1990 Strasbourg Convention and the Financial Action Task Force recommendations also in all their dependent territories.

The fight against money laundering is carried out by the Commission, mainly DG Justice and Home Affaires and DG Internal Market. The cooperation in the field of criminal justice is realized through Financial Crime Group of Europol.

3.1 Why does EU have to harmonize AML rules?

Fight against money laundering is important for proper functioning of the single market. Council expressed the peril that launderers could try to take advantage of the freedom of capital movement and freedom to supply services and stated that money laundering has evident influence on the rise of organized crime in general and drug trafficking in particular. Money laundering can constitute an existential threat to European integration[16].

EU cannot combat the phenomenon isolated. Therefore, when drafting any anti money laundering measures, EU must take into account international AML rules listed above. European Union expressed this in the preamble of

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53. The European Council calls for the Council and the European Parliament to adopt as soon as possible the draft revised directive on money laundering recently proposed by the Commission.
54. With due regard to data protection, the transparency of financial transactions and ownership of corporate entities should be improved and the exchange of information between the existing financial intelligence units (FIU) regarding suspicious transactions expedited. Regardless of secrecy provisions applicable to banking and other commercial activity, judicial authorities as well as FIUs must be entitled, subject to judicial control, to receive information when such information is necessary to investigate money laundering. The European Council calls on the Council to adopt the necessary provisions to this end.
55. The European Council calls for the approximation of criminal law and procedures on money laundering (e.g. tracing, freezing and confiscating funds). The scope of criminal activities which constitute predicate offences for money laundering should be uniform and sufficiently broad in all Member States.
56. The European Council invites the Council to extend the competence of Europol to money laundering in general, regardless of the type of offence from which the laundered proceeds originate.
57. Common standards should be developed in order to prevent the use of corporations and entities registered outside the jurisdiction of the Union in the hiding of criminal proceeds and in money laundering. The Union and Member States should make arrangements with third country offshore-centres to ensure efficient and transparent co-operation in mutual legal assistance following the recommendations made in this area by the Financial Action Task Force.
58. The Commission is invited to draw up a report identifying provisions in national banking, financial and corporate legislation which obstruct international co-operation. The Council is invited to draw necessary conclusions on the basis of this report.

[16] Mitsilegas, V. Money Laundering Counter-Measures in the European Union. A New Paradigm of Security Governance versus Fundamental Legal Principles. Kluwer Law International, 2003. ISBN 90-411-2131-5

new AML directive, stating that ... *money laundering is frequently carried out in an international context. Measures at Community level… have very limited effects*. And vice versa, ignoring the problem would lead to pressure of international organizations on EU states to take appropriate steps.

3.2 Anti money laundering directive

First directive against money laundering was adopted in 1991 (directive 91/208 EEC on the prevention of the use of financial system for the purpose of money laundering). The directive defines money laundering in accordance with international conventions. Money laundering shall be prohibited. Then it sets rules for credit and financial institutions. Basic principle of the directive is thus "**know your customer**". Credit and financial institutions shall require identification of transactions involving a sum amounting 15.000 ECU and more, keep evidence on the transactions and inform competent authorities of suspicious transactions.

The directive was amended by the directive 2001/97. Main change is the extension of the scope of persons covered by the directive on auditors, external accountants, tax advisors, real estate agents, notaries, independent legal professionals, dealers with high value goods and casinos.

New, **third text of the directive** was being prepared mainly as a consequence of terrorist attacks in September 2001[17]. The text of the directive focuses expressly also on terrorist financing. New text of the directive is considerably longer and more detailed than previous directive. Main principles of the directive stay the same[18], though described in more details. Main aims of the directive declared by EU are as follows:

- including the funding of terrorism in the definition of money laundering
- extending application of the system to trusts and insurance intermediaries
- introducing a simplified due diligence system
- banning anonymous accounts[19].

Important part of the directive is Chapter II – **Customer due diligence**. Due diligence is adopted according to risk-based approach.

[17] Commission proposed the directive on 30 June 2004.
[18] The directive extended the list of obliged persons on trust or company service providers
[19] see European Parliament. Money laundering. Access from :
<www.europarl.eu.int/comparl/libe/elsj/zoom_in/26_en.htm>

According to the directive, due diligence has three forms: simplified, enhanced and general.

Due diligence comprises identifying the customer and verifying his identity, identifying the beneficial owner[20], obtaining information on the purpose and intended nature of the business relationship, conducting ongoing monitoring of the business relationship. Persons covered by the directive may however determine the extent of the measures on a risk sensitive basis[21].

Simplified procedure appears when customer is a credit or financial institution covered by the directive, listed company whose securities are admitted to trading on a regulated market, beneficial owner of pooled account held by notaries or independent legal professionals and domestic public authorities, e.g. subjects with a very low risk. In case of credit and financial institutions, these are automatically not subject to due diligence. In case of other institutions mentioned, member state may allow by the way of national legislation not to apply customer due diligence.

Enhanced customer due diligence appears in case when risk of money laundering activity is very high, mainly in situations when the customer is not physically present for identification purposes, cross frontier correspondent banking relationships with respondent banks from third countries and transactions with politically exposed persons[22] residing in other state. Directive lists additional measures to prove that the transaction is not a case of money laundering. Transactions with shell banks[23] are prohibited.

Directive prohibits credit and financial institutions from keeping anonymous accounts or anonymous passbooks. These may be an important tool for money launderers because their owners are hard to identify.

The directive sets reporting obligations. For this purpose, each state shall establish financial intelligence unit (FIU) at national level. Persons covered by the directive shall inform the FIU on suspicious transaction and furnish FIU with all necessary information.

The duty of record keeping by persons covered by the directive remains the same. The directive deals also with supervision and requires that

[20] new feature of the directive
[21] A. 7 of the draft directive
[22] natural persons who are or have been entrusted with prominent public functions and immediate family members or persons known to be close associates of such persons
[23] The directive defines shell bank as "a credit institution, or an institution engaged in equivalent activities, incorporated in a jurisdiction in which it has no physical presence, involving meaningful mind and management, and which is unaffiliated with a regulated financial group."

currency exchange offices, trust and company service providers must be licensed or registered and casinos licensed.

Member states are required to review the effectiveness of adopted measures by means of keeping comprehensive statistics. The statistics shall at minimum cover the number of suspicious transactions made by the FIU, the follow-up given to these reports and initiate on an annual basis the numbers of cases investigated, the number of persons prosecuted, the number of persons convicted for money laundering and amount of property frozen, seized or confiscated (A. 29).

As to enforcement, the directive urges member states to require that persons covered by the directive establish adequate policies of due diligence, record keeping and other measures necessary for prevention of money laundering. The persons shall also train their staff to recognize money laundering and be able to take necessary steps. Persons covered by the directive shall get access to up-to date information on the practices of money launderers and on indications leading to recognition of suspicious transactions.

3.3 Critical approach to the (third) directive

The directive however includes also some controversial issues. Majority of problematic parts remains from previous directive[24]. Main concerns are about disclosure requirements, fundamental right to legal advice and concept of due diligence. This part of the paper discusses selected problematic provisions of the directive.

- **Data protection and bank secrecy**

Institutions have to keep records on transactions for at least five years. This is not relevant only for credit and financial institutions but also for other professions who may not have precisely developed data protection system. To combat money laundering, states have to remove bank secrecy provisions in circumstances related to informing on money laundering. This fact could undermine the credibility of credit institutions. Already the first directive was characterized as "death of bank secrecy"[25]. The opinion of the Communities was that money laundering facilitates drug trafficking and therefore undermines human dignity and physical and moral integrity of its victims.

[24] The Council of the Bars and Law Societies of Europe (CCBE) considers the second directive as threat for the independence of lawyers and thus illegal. See Euractiv. Money Laundering. Access from: <www.euractive.com>

[25] see Mitsilegas, V. Money Laundering Counter-Measures in the European Union. A New Paradigm of Security Governance versus Fundamental Legal Principles. Kluwer Law International, 2003. ISBN 90-411-2131-5 p. 132

Fight against money laundering was put forward as a moral imperative everybody has to follow[26].

- **Scope of responsible persons**

Second directive has broadened the scope of persons covered by the directive. The third directive further extended the scope on trust or company service providers. The remaining question is whether the notification duty doesn't mainly in case of legal professionals, accountants and tax advisers undermine the customer – client relationship. Further, the second directive threatens the independence of legal professionals and therefore the fundamental right to legal advice[27].

Notification duty may be in conflict with the right on fair trial. However, member states are not obliged to apply the directive on legal professionals, auditors, external accountants and tax advisor *with regard to information they receive form their clients in the course of ascertaining the legal position of their client or performing their task of defending or representing their client in or concerning judicial proceedings* (A.20 of the directive).

- **Due diligence**

A risk based approach to due diligence seems to be welcome by the banks. However, European Banking Federation had several remarks to the original draft of the directive. The enhanced due diligence is problematic in case of politically exposed persons. The definition of such persons appears to be very broad and may cause difficulties for banks. Banks are also concerned with the obligation of identifying beneficial owners because they often don't have access to relevant information. As a result of remarks of European Banking Federation, threshold was raised up to 25% so that the banks would be able to comply with the provision[28].

- **Effectiveness**

Measures taken by responsible institutions are quite costly. Every state established FIU, which traces suspicious transactions. However, there is no report on the effectiveness of measures taken by first and second AML directive. Detailed report on the effectiveness of such measures should have been a starting point before drafting the third directive. The directive

[26] Ibid.
[27] See Euractiv. Money Laundering. Access from: <www.euractiv.com>
[28] See Brouver de, F. *Toward Third Anti-Money Laundering Directive*. Better Management. Access from: <www.bettermanagement.com/library.aspx?libraryid=11366>

however provides for keeping essential statistics on the effectiveness of AML measures by MS.

- **Costs**

Measures taken by financial institutions to prevent money laundering appear to be very costly. The question of costs goes hand in hand with the question of effectiveness. The directive obliges credit and financial institutions as well as other persons covered by the directive not only to inform on suspicious transactions and keep record of relevant data, but also establish AML system of informing and training of employees so that they are aware of AML rules and are able to recognize suspicious transactions and take appropriate steps. All these measures constitute additional costs.

- **Enforcement measures**

The directive suggests better enforcement of AML through providing access to up-to date information on the practices of money launderers. This is very important because knowledge of the recent techniques of criminals helps to better detection and prosecution. But we shall consider this measure from other point of view. The information shall be provided to persons covered by the directive – i.e. also to notaries, independent legal professionals and tax advisers. This is a scope of persons that are logically the first to be capable to give advice to launderers. The directive therefore ensures that advisers to criminals get recent and up-to –date information on money laundering techniques and helps them indirectly develop their activities. From this point of view, the measure seems to be contra - productive.

- **Security**

Practical question that arises when talking about anti money laundering measures is the security of institutions that have duty to inform about suspicious transactions. Not only notaries and legal professionals but also employees of financial institutions can fear of revenge from launderers. Effectiveness of the AML measures can be from this point of view very lowered. Protection of such persons shall be also considered when drafting amendments to AML rules.

- **Corruption**[29]

No matter how effectively the system is thought out, human factor may also play its role. A corrupted employee of a financial institution can allow money laundering. A corrupted employee may therefore ruin the whole system of AML prevention.

- **Adoption by member states**

The question is whether it is appropriate and wise to adopt a new anti-money laundering directive in the situation when about half of member states haven't transposed the directive into their national legislation. The second directive should have been transposed until 15 June 2003. The new text was therefore created in a situation when it was premature to evaluate effects of measures taken by the second directive.

3.4 Future of the Directive

The directive is not yet finally approved. Regardless of many remarks of bar associations, banking federations and other persons covered by the directive, there are still some points that shall be considered. The text of the directive was regarded as controversial[30]. Quick preparation of the directive in the situation when the second directive wasn't implemented by all member states could make the EU stop and consider the effectiveness of AML measures. Elaborating appropriate AML measures statistics shall be essential for EU before taking any other steps. Though the amount of laundered money can be only estimated, sufficient could be however the statistics demanded by the directive: the number of cases investigated, the number of persons prosecuted, the number of persons convicted for money laundering and amount of property frozen, seized or confiscated.

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[29] "*Money laundering is the handmaiden of international corruption . . . Those who take bribes must find safe international financial channels through which they can bank their ill-gotten gains. Those who provide the bribes may well assist the bribe takers to establish safe financial channels and launder the cash."*
Frank Vogl, Transparency International. Access from:
<http://www.globalpolicy.org/nations/corrupt/corner.htm>

[30] Euractiv. Money Laundering. Access from: <www.euractiv.com>

4. Conclusion

The European Union, mainly after September 11, 2001, tries to combat money laundering and terrorist financing. The fight is important in international context and EU AML rules are in conformity with international AML standards. When adopting the third directive, we shall however consider the effectiveness of AML rules. The remaining questions are measuring of the effectiveness of such measures, costs, scope of responsible persons and possible conflict with human rights.

The question shouldn't be whether we should fight against money laundering or not. The fight is internationally very important – it shows criminals that crime doesn't pay. The question is whether we have internationally found the right balance between effective AML fight and protection of human rights, bank secrecy and economic and professional interests of persons covered by AML rules.

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THE PROTECTION OF FINANCIAL INTERESTS OF THE COMMUNITY IN STOPPING AND CONTROLLING OF FRAUD AND THE UNLAWFULNESS

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Abstract

The control of legality and regularity in the use and administration of nonrefundable funds coming from the EU financial assistance programs, accorded to Romania, has as aim:

- the identification of irregularities, of the imperfect financial administration

and of frauds

- the establishment of eventual prejudices

- the establishment of the persons guilty of producing the prejudices.

The control begins when are clues or remarks from the part of the internal or external audit's structure, or from other institutions named by the law, or also from the part of citizens or mass-media, concerning the imperfect or illegal financial administration of public founds. The recuperation activity consists in executing the administrative function that leads to the disappearance of the debts resulted from fraud and irregularities.

Keywords*: budget debts, financial administration, co-financial founds, fraud, control procedure*

1. Fighting fraud and embezzlement

Fraud against the community financial interests is any deliberate act that consists in using and handling false documents or statements that result in the fraudulent appropriation or incorrect possession of funds and the illegal diminution of the resources of the general community budget. In the actions directed at abolishing fraud against the community financial interests, the Union pays attention to the public property fraud. The principle at the basis of this orientation consists in the fact that while the losses of the victims are relatively limited in cases of fraud in private wealth, the damage caused to the public wealth affects all the tax-payers by diminishing the public funds. Designed to remove the deficiencies and irregularities between the provisions of the criminal law of the member states, the Convention for the protection of the community financial interests (the PIF Convention adopted by the Committee Act of July 26th 1995, 95/C 316/03) requires that the member states should make sure that the action defined as fraud against the community financial interests is a crime. In order to include the different types of fraud, two complementary concepts cover the financial process within the Union: income and expenses.

From the perspective of the expenses, by fraud, one understands any deliberate act or omission connected to the use or presentation of false, incorrect or incomplete documents, the concealment of information by breaching a specific obligation that result in the fraudulent appropriation or incorrect possession of funds from the general community budget, or the fraudulent investment of these funds with purposes other than their original destination. From the expenses viewpoint, the effect of the fraudulent appropriation or retention is not necessarily present in the fraudulent investment of funds.

As for the income, by fraud one understands any deliberate action or omission of using or presenting false documents or statements, incorrect or incomplete the concealment of information by breaching a specific obligation and the fraudulent investment of legally obtained benefits that result in the illegal diminution of the resources of the general community budget or its management by or for the European Union.

The adequate protection of the community financial interests must be ensured not only against fraud but also against embezzlement, not necessarily fraudulent.

By irregularity one understands any breach of a community law provision that results in an action or omission of an economic agent, with the purpose of harming the general community budget, by the diminution as well

as the moss of income gained from the resources collected directly or on behalf of the Union, or by unjustified expenses.

One of the instruments of fighting fraud is the internal audit. This procedure is concerned with the protection of the public funds against the losses that may occur due to errors and/or fraud.

The internal audit is conducted by a special division, organised within every public institution and consists of one or more people hired for this purpose or contracted for audit, people who are never involved in the activities they audit.

The internal audit is applied according to the norms issued by the Ministry of Public Finance and is based on the principles of independence and ethics.

Another prophylactic measure against fraud is that of the financial control carried out by the Ministry of Public Finance, in those situations that show evidence of fraud or any other breach of the financial regulations of public institutions. From the perspective of the income, fraud offends the national financial interests by tax evasion.

The influx of financial funds from the budget is monitored by the tax inspection, concerned with the implementation framework, the legality and the concordance of the financial operations, the correctness and the exactness of the obligations of the citizens, the observation of the provisions of the fiscal and bookkeeping regulations as well as their accessories.

The tax inspection is directly and freely enacted by the National Agency of Fiscal Administration (in Romania), on all the citizens, regardless of their organisation, citizens who are compelled to establish, retain and pay the taxes.

Tax evasion leads to the illegal diminution of the budget resources, thus being classified as fraud. For this reason, the legal provisions (Law no 87/1994, reissued in 2003), concerning the control of tax evasion, can be interpreted as support is controlling fraud.

The legal provisions concerning the control of tax evasion establish a series of events that can be classified as crimes: The refuse to hand in to the control authorities the justifying documents and bookkeeping papers, as well as the material goods undergoing taxation and contributions to the public funds, to determine the budget duties;

The incomplete or inadequate drawing up of the primary documents or accepting such documents with the purpose of obstructing the financial-

bookkeeping control, if the deed had as consequence the diminution of the income or taxable sources;

The illegal issue in any manner, or the possession in view of illegally circulating financial and fiscal documents. The circumvention from paying the legal taxes by not registering certain activities that must be legally registered or by conducting unauthorised activities with the purpose of obtaining profit;

The complete or partial circumvention from the fiscal obligations with the purpose of gaining profit, by not declaring the taxable income, hiding the taxable object or source or by the diminution of the income as a result of fictitious operations;

The omission, total or partial, of the bookkeeping or any other legal documents of the developed commercial activities or of the profits made or the recording of unreal operations or expenses with the purpose of not paying or diminishing the tax or contribution;

The organisation and management of double bookkeeping, the change or destruction of bookkeeping documents, memories of the electronic taxation or identification machines or other data recording means with the purpose of diminishing the profits or the taxable sources; The issue, distribution, purchase, filling in or accepting false fiscal documents.

The measures against fraud are also provided in the Customs Code that stipulates as a crime the use of false documents and/or the transportation or presentation of commercial documents with the purpose of reducing the taxes while the customs declarations are carried out.

Similarly, an additional measure for fighting/controlling fraud at the customs is the existence of the anti-fraud service as part of the Customs Surveillance Division.

Moreover, the Bookkeeping Law stipulates that the deliberate registering of inaccurate data as well as the deliberate omission of the bookkeeping records, having as consequence the alteration of income, expenses, financial results as well as the assets and liabilities provided in the balance are defined as intellectual false.

Eventually, beyond the income-expenses approach of the funds, the Criminal Code defines the different kind of activities that can generate fraud. These include especially:

The fraudulent administration, as a deliberate act of causing prejudice to one person by managing and keeping the goods that belong to that particular person;

Deceit, i.e. the use of a mistaken interpretation of reality, the presentation as correct of false information or papers or vice-versa, the presentation of real facts and truths as untrue, to the deliberate end of gaining for oneself or someone else undeserved material benefits. The presentation of false information at the time of the conclusion or implementation of a contract, information whose presence would have prevented the victim from signing or implementing the contract, is also considered fraud;

The abuse against the public interests, as a deliberate act of a civil clerk, during his mandate, that willingly causes or alters the good functioning or causes prejudice to the state, department or institution goods.

Embezzlement, as change of destination of the money or material resources, by violating the legal provisions in the field, causing the bankruptcy of the economic and financial activity or causes prejudice to the state or the institution respectively.

2. The European Anti-Fraud Office (OLAF)

OLAF was founded in 1999 as a subsidiary of the European Committee, as a consequence of the fact that the units and departments for the prevention of fraud proved to be inefficient control authorities.

The OLAF activities concentrate on the discovery and monitoring of customs fraud, the fraudulent appropriation of subsidies and tax evasion, if the community budget is affected, as well as on the fight against corruption and other illegal activities that damage the community financial interests.

The OLAF activities especially involve:

The development of administrative investigations (internal and external) for the fight against fraud, corruption and other illegal activities;

Commission counselling in cooperation with the member states, in the field of prevention of fraud;

The development of other operational activities of the Committee, related to the fight against fraud.

The investigations, administrative inspections and other measures taken by the PLAF employees according to their duties may be:

External, developed in the member states and, according to the cooperation agreements, in third countries;

Internal, developed in the community institutions, departments, offices and agencies.

OLAF has the right to:

Immediate and unannounced access to any information of the institution, department , offices and agencies and their subsidiaries;

Make, get copies and acquire extracts of any document or contents that include additional data;

Require information from the members of the institutions, departments, offices and agencies, in written or verbally;

The OLAF executive can conduct the internal or external investigations, at his own initiative or as a consequence of a request of a member state or a community institution, a department, office or agency.

The OLAF independence is ensured by:

the rules that establish the executive's appointment, activities and the disciplinary sanctions

For the appointment of the executive, following a public advertisement for applicants and a favourable opinion of the Surveillance Committee, the Committee draws up a list of the applicants qualified for this position. When the Surveillance Committee has issued an opinion on the candidateship of the executive and after consulting the European Parliament and the Council, the Committee can appoint the executive.

The executive does not seek or follow any instructions from any government or institution, department office or institution on the initiation and development of investigations or editing of reports. If the executive feels that a decision made by the Committee threatens his independence, he has the right to take action against this institution in the Court of Justice.

The executive regularly reports to the European Parliament, to the European Council and Court of Auditors, on the findings resulted from the investigations he has conducted;

the powers granted to the Surveillance Committee

The Surveillance Committee is made up of five independent individuals (from outside), with the right expertise, and its main role is to support the OLAF independence by regular surveillance of the implementation of its investigative power. It expresses its own opinions or at the request of the OLAF executive, on the OLAF activities, without disturbing the developing investigations.

The PLAF executive regularly informs the Surveillance Committee on:

the OLAF activities, investigations, their results and the measures that have been taken;

the cases when a community institution, office, department or agency did not act according to the OLAF recommendation;

the cases when the information must be transmitted to the judiciary authorities of a member state.

3. The single OLAF contact in Romania

The single contact with OLAF in Romania is the Romanian institution that ensures the cooperation between OLAF and the corresponding authorities in Romania until Romania becomes a member of the European Union.

The coordination of the anti-fraud fight and effective and balanced protection of the financial interests of the European Union in Romania is ensured by the Government Control Body, as unique contact with OLAF.

In this direction the Government Control Body:

coordinates the anti-fraud fight and protects the financial interests of the European Union in Romania, acting with complete functional and decisional autonomy, independent from other public institutions, according to the obligations assumed by Romania;

receives for control, from OLAF or any other interested institution or individual, notes on embezzlement or possible frauds in gaining, developing or using the funds from the assistance programs of the European Union and makes a control note with the result of the investigations. The note is sent to the Prime Minister and to OLAF.

In order to investigate the notes on embezzlement or possible fraud in gaining, developing or using the money from the assistance programs of the European Union, the Government Control Body requires the necessary data from the public authorities and institutions, as well as the public or private companies involved. These institutions and companies are compelled to answer in a complete and adequate manner within 30 days.

In order to ensure the anti-fraud fight and the effective and equivalent protection of the financial interests of the European Union in Romania, all the central and local, public and private institutions appoint one or more contact persons. Those individuals benefit from specific expertise and technical means to adequately answer to the requirement of the Government Control Body.

At the request of OLAF, its representatives may be directly involved in the control developed by the Government Control Body which reacts to the

notifications of OLAF. The OLAF representatives may have legal access to the data and information that lead to the drawing up of the control note.

If there is evidence of criminal elements in the granting or use of the community funds, the control note is transmitted to the competent criminal prevention authority that must take legal action to release the funds, recover the damages, as well as to bring action against the people responsible.

The Government Control Body can benefit from technical assistance and facilities from the European Union, as well as from specific training programs for its personnel.

The control and recovering of the community funds and the additional co finance funds, used inadequately.

4. The object of control and recovery of the budget debts caused by embezzlement and fraud

The control of the observance of laws and regulations in using and managing the funds resulted from the irredeemable financial assistance provided by the European Committee to Romania, as well as the afferent co-financing funds, is directed at:

identifying the embezzlement, the faulty financial management and fraud;

establishing the possible prejudices;

identifying the people responsible for the prejudices.

Another object of control and recovery of the budget debentures are the unjustified sums paid from the community funds and/or the afferent co-financing, as a result of the embezzlement and/or of fraud, their accessories, i.e. interest, delay penalties and other penalties, as the case may be, as well as the bank expenses.

Co-financing is the financing of a program, project, sub-project, objective and other such steps, partially by budget credits and partially by external source financing.

The budget debts resulted from embezzlement and/or frauds caused by the inadequate use of the community funds and the afferent co-financing funds, are sums to be recovered for the European Committee budget as well as for the budgets that have released those funds, co-financed as follows:

the state budget;

the state social insurance budget;

the special funds budget;

the state treasury budget;

the budget of the public autonomous institutions;

the budget of the public institutions, fully or partially financed from the state budget, the state social insurance budget and the special funds budget, as the case may be;

the budget of the funds that came from contracted external funds or guaranteed by the state and whose reimbursement, interest and other costs come from public funds;

the budget of the irredeemable external funds;

the local budgets of the villages, cities, municipalities, sectors of the capital Bucharest, the counties and Bucharest;

the budget of the public institutions, fully or partially financed from local budgets, as the case may be;

the budget of internal and external loans for which the reimbursement, the pay of interests, commissions, expenses and other costs is ensured by the local budgets consisting of: contracted external loans and further loaned to the authorities of the local public administration and/or the economic agents and public services subordinated to them; external loans contracted by the authorities of the local public administration and guaranteed by the state. External and/or internal loans contracted or guaranteed by the authorities of the local public administration.

Irregularity means any deviation from legality, regularity and conformity, as well as any disrespect of the provisions of the financing memorandums, of the agreement memorandums, of the financing agreements on the financial and irredeemable assistance provided to Romania by the European Community – as well as of the provisions of the contracts signed under the terms of these memorandums or agreements, resulting in an action or omission of the economic operator who, by unelectable expenses, prejudices the general budget of the European Community and/or of the internal budgets that have provided or co-financed the funds about to be recovered.

Fraud is any intended action or omission, deeds that result in the allocation or acquiring, or inadequate or incorrect use of the community budget of the European Communities or the budgets administered by them or on their behalf and/or of the afferent co-financing sums.

Fraud is:

the use or presentation of false, inaccurate or incomplete documents or statements, resulting in the unlawful gaining of funds or the illegal diminution of the community resources;

the omission of willingly communicating the data required according to the law, failing to communicate information by breaching a specific obligation respectively, if the deed results in the unlawful gaining of funds or the illegal diminution of the community resources;

the change, without abiding by the legal provisions, of the destination of the funds, the embezzlement of the funds from their initial purposes, respectively;

the change, without abiding by the legal provisions, of the destination of a legally gained use, if the deed results in the illegal diminution of the community resources.

The procedure of recovery of the budget debts resulted from embezzlement and fraud comprises two stages:

the finding – the control activity that establishes and singularizes the obligation of payment in the form of a debenture;

the so-called recovery of the budget debt through the voluntary payment, the deduction from the subsequent expense statements, by forced execution or by other means provided by the law.

The debenture is the document or paper that establishes and singularizes the obligation of payment of the budget debts resulted from embezzlement or fraud, drawn up by the inspection officials or other lawful authorised control structures, as follows:

the document or paper that establishes the obligations of payment of the budget debts resulted from unlawful payments made from the community funds and/or from afferent co-financing funds, as a result of embezzlement and/or fraud, as well as their accessories and the bank costs, issued by the inspection officials or other specialty structures of the Ministry of Public Finance or other institution qualified by the law ;

the final or unalterable court order that establishes the obligation of payment of the budget debts resulted from embezzlement and/or fraud;

other documents issued by appointed officials, documents which assess and singularize, according to the law, the budget debts resulted from embezzlement and/or fraud.

These documents establish the sums unlawfully paid from community funds and/or from afferent co-financing as a result of embezzlement and/or

fraud, their accessories, i.e. interest, delay penalties and other penalties, as the case may be, as well as the banking costs, the breached law as well as the individuals compelled to pay them.

5. The competent officials should carry out the control of the recovery of the budget debts resulted from embezzlement or fraud (in Romania)

Qualified to carry out the control and to manage the recovery of the budget debts resulted from embezzlement and/or fraud, the officials of the central or local public administration and their subsidiaries, as the case may be, as well as other public institutions qualified by the law.

The competence of carrying out the control is granted to:

the inspection and/or control officials or other specialty structures from the Ministry of Public Finance , according to their specific legal framework;

the specialized structures of the local or central public administration authorities, including their territorial subsidiaries, structures that manage the funds from external financial assistance and have ensured national co-financing by specialty departments. The responsibility of establishing the necessary organisational framework for the above-mentioned specialty structures is granted to the manager of that specific entity;

the institutions qualified by the law, like the Government Control Body and the criminal investigation officials, according to their specific legal framework.

The Ministry of Public Finance and the other budget creditors who manage the budget debts of the co-financing budgets are qualified by the law to carry out control, to enforce and to carry out the insuring measures and to apply the forced execution procedure under the circumstances established by law.

6. The control procedure. The control report.

Control is imposed when there are clues or notices from the internal or external audit structures, from other lawful institutions as well as from the citizens or the mass-media, on the faulty or fraudulent financial management of the public funds, including the external irredeemable financial assistance.

The manager of the control structures establishes:

the nominal constitution of the control team;

the length of the control which cannot overcome 30 days;

the warrant on the control of the confirmation of the notice.

The control team announces the institution undergoing the examination on the starting date of the action, at least five days in advance. The announcement establishes the purpose and length of the control. The control caused by a notice is not announced

The control is carried out totally or by survey with reference to:

the complexity of the activities and operations undergoing control;

the value and nature of the goods;

the frequency of the previous infringements.

The control by survey covers a large number of the operations that will allow the issue of solid conclusions. In the case of finding prejudices, control by census can extend over the entire period during which, according to the law, recovery and indictment measures can be enforced on the guilty parties, by correctly extending the control period, but not more than 90 days.

In order to accomplish the control objectives, the controllers have access to all the data and documents, as well as to all the storing and production locations of the assets during the control of the structure and of the beneficiaries of the public funds financial assistance. The staff of the controlled structure, including the beneficiaries of the public financial assistance, is compelled to bring forward, at the settled time, all the required data and documents and provide all the necessary support for a proper development of the control activity.

For concordance, the control officials can require data, information, as well as copies of the certified documents from the legal or natural persons related to the structure undergoing control, including from the beneficiaries of the public funds financial assistance, and they are compelled to provide this information at the specified date.

The control officials may require the development of specialty expertise from authorised individuals, for the goods, services and executed works, resulted from financial activities and operations undergoing control and only in a case of utter necessity to ground their findings.

The quantum of the prejudice is established from the specific time it was inflicted, and if this time cannot be established, from the time it was found.

The budget debt includes, aside from prejudice, the interest and delay penalties owed at the time when the prejudice was inflicted or found, calculated according to the legal provisions related to collecting budget debts.

When the control has been carried out,, a control report is drawn up with the following information:

the identification data of the control officials and of the responsible individuals of the bookkeeping structure, its headquarters and the locations where control has been developed;

the description of the context in which embezzlement or fraud have appeared, the breached normative acts, the budget debt, separating it for the affected budgets, including European funds as well as the people responsible;

the bank accounts where the budget debts are to be collected;

the full evidence that lead the findings is registered in annexes.

The control report is sent:

to the controlled structure for announcing, signing and completing further observations. The control paper is a debenture;

to the manager of the institution initiating the control, who, if prejudice is found, will require the bookkeeping recording of the budget debt and will enforce the measures of recovery.

The Obligation of payment of the budget debt resulted from embezzlement or fraud can be disputed in a court of law.

7. Methods of extinction of the budget debts resulted from embezzlement and/or fraud.

Obligation and responsibility of payment

The payer of the budget obligation, i.e. the funds received unlawfully from community funds and/or from afferent co-financing, as a result of embezzlement and/or fraud, as well as their accessories (interest, penalties, bank costs) will be the economic operator as debtor or the individual who, according to the law, represents the operator or who, on behalf of the debtor operator unlawfully profited by the money that came from community funds and/or afferent co-financing funds as a result of embezzlement and/or fraud.

If the budget obligation resulted from embezzlement and/or fraud is not paid by the economic operator, the person who represents him or who profited by the money from the community funds and/or afferent co-financing, as the case may be, under lawful provisions, compelled to pay is:

The institution or the person who assumes the obligation of payment of the debtor by a payment commitment or by any other authentically signed paper, with the insurance of a real warranty at the level of the payment obligation;

Other institutions or individuals under lawful provisions.

The recovery of the budget debts resulted from embezzlement and/or fraud

The recovery action consists in executing the administrative function that leads to the extinction of the debts resulted from embezzlement and/or fraud.

The extinction of the budget debts resulted from embezzlement or fraud is developed in the following ways:

The voluntary payment by the individuals responsible for it;

The deduction from the future expense statements;

Forced execution;

Other means provided by the law.

The payment of the budget debts resulted from embezzlement or fraud, found and established by the inspection officials or any other qualified structure, is made by the debtors in the accounts indicated by the budget creditors, at the dates established by the present legislation concerning the collection of the budget debts.

The debtor's obligations of payment, as well as their accessories due for untimely payment and the bank costs are calculated and paid in Romanian currency at the exchange rate established by the National Bank of Romania the day the payment is made.

The manager of the entity that has initiated control has the payment notification sent to the debtor who is compelled to record the owed sum in the ledgers and, within 15 days from the notification, he should pay the debts or prove the extinguishment of the debt. Otherwise, when the time has expired, the debenture becomes writ of execution and is send to the competent execution officials.

If the debtor does not willingly pay his obligations on the budget debts resulted from embezzlement or fraud, the qualified officials decide and carry out the insuring measures and develop the forced execution procedure.

Authorised to carry out the ensuring measures and to develop the forced execution procedure are the officials or specialty departments of the

central public authorities or their territorial subsidiaries, of the local administration authorities or other public institutions qualified to manage the budgets that provided the co-financing.

The qualified control officials authorised to find and to establish the debts may impose by a motivated decision in an administrative procedure, the insuring interdiction on the income and/or the insuring distrait of the debtor's goods, measures carried out by the qualified execution officials.

The insuring measures in the form of insuring interdiction and the insuring distrait imposed on the movable or immovable goods owned by the debtor, as well as on his income, are enforced when there is a possibility that he may steal them, hide or spend his patrimony, thus endangering or considerably slowing down the recovery of the debts resulted from embezzlement or fraud.

These measures can also be enforced when the budget debt has not yet been singularized and fallen due.

The enforced insuring measures remain valid during the period of forced execution, without carrying out other formalities. Once the debt has been singularized and fallen due, in case of delay in payment, the insuring measures become execution measures.

A copy of the report of insuring distrait on immovable goods is announced for recording to the cadastral register and the recording prevents the distrait to all those who subsequently gain any rights on the building. The enforcing papers subsequent to the recording become void.

If the value of the debtor's assets does not fully cover the budget debt, the insuring measures can be called in on the goods owned by the debtor together with third parties, for the share he holds.

The enforced insuring measures are removed by a motivated decision, when the reasons for insurance no longer exist or when a guarantee for the debts had been settled.

The forced execution of the budget debts resulted from embezzlement or fraud is developed only on the grounds of a writ execution, according to the law.

A writ execution is:

the paper or document drawn up by the inspection officials or any other lawful control structures, for the budget debts resulted from embezzlement or fraud;

the court decision, for the budget debts resulted from embezzlement or fraud settled in a court of law;

Any type of expenses caused by the carrying out of the insuring measures and the development of the forced execution procedure are deducted from the budgets of the central public administration authorities, the local public administration authorities and other institutions qualified to manage the co-financing budgets that have started the forced execution procedure.

The recovery procedure for the unlawful sums paid from the community funds and/or from the afferent co-financing budgets, as well as their accessories and of the bank costs does not influence in any way the development of the criminal procedure when the embezzlement or fraud is classified as criminal offence.

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