

## THE ROLES OF FORENSIC ACCOUNTANTS IN PREVENTION AND DETECTION OF MONEY LAUNDERING IN PHOENIX ACTIVITIES

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### Abstract

*The process of company liquidation is always full of money laundering allegations and vulnerable to fraud. This fraudulent scheme is referred to as phoenix activity. The main purpose of phoenix activity is to avoid liability and expenses, which detracts the stakeholders. This research explains the importance of the role of forensic accountants prior, during, and after bankruptcy. The methodology used in this research is literature review examining the problems through various researches and frameworks. The literature review discusses three aspects related to fraudulent bankruptcy scheme i.e. motivation, the scheme processes and litigation processes. The research concludes that the presence of forensic accountants is important in the insolvency prevention and detection, in their roles as (1) independent and hired experts; (2) professional legal assistance providers of Anti-Money Laundering (AML) and asset manager; (3) business valuation experts; (4) private investigators; and (5) surveillance body for anti-money laundering purposes.*

### Abstrak

Proses likuidasi perusahaan selalu dipenuhi dengan dugaan pencucian uang dan rentan terhadap kecurangan. Skema penipuan ini disebut sebagai “*phoenix activity*”. Tujuan utama *phoenix activity* adalah menghindari pertanggungjawaban dan biaya yang merugikan para pemangku kepentingan. Penelitian ini menjelaskan pentingnya peran akuntan forensik sebelum, selama, dan setelah proses likuidasi. Metodologi yang digunakan dalam penelitian ini adalah kajian literatur yang menguji permasalahan melalui berbagai penelitian dan kerangka teori. Tinjauan literatur membahas tiga aspek yang terkait dengan skema penipuan terkait kebangkrutan, yaitu motivasi, skema proses likuidasi dan proses litigasi. Penelitian ini menyimpulkan bahwa kehadiran akuntan forensik penting untuk mencegah dan mendeteksi insolvensi, dalam peran mereka sebagai (1) tenaga ahli yang direkrut secara independen; (2) penyedia bantuan hukum dan pengelola aset; (3) pakar penilaian bisnis; (4) penyelidik swasta; dan (5) pihak pengawas anti-pencucian uang.

**Keywords:** *Phoenix Activity, Insolvency, Bankruptcy, Money Laundering, Asset Recovery Forensic Accounting*

## **RESEARCH BACKGROUND**

A company ends its partnership through the liquidation process. It involves selling non-cash assets and recognizing the gains or losses on realization, allocating the gains or losses to the partners based on their ratio, paying the company's liabilities in cash. If there is remaining fund, it would be shared to the partners based on their ownership ratio. The most important thing on the liquidation processes is when the partnership decides to terminate the business which requires them to pay tax and liabilities before sharing the remaining funds to the owners. However, there are possibilities in which the owners of the company have self-interests in making liquidation decision (Beasley, Carcello, & Hermanson, 1999).

In regards to liquidation process, a "Phoenix Company" may be involved. Phoenix refers to an illegal activity of transferring cash from a near-insolvency company to new enterprises as a way of avoiding the tax and liabilities through brand new business activities. This activity ranges from laundering the money by acquiring property to getting involved in complicated derivatives transaction. The phoenix activity contravenes law and statutes that require businesses to fulfil all liabilities. The infringements also harm the stakeholders i.e. creditors, investors, and governments. The effect gets worse when unpaid employees become the victims of such fraudulent activities. This fraudulent activity also injure insurance companies, financial institutions, assurance services providers, board of professional

associations, and policy makers (Pande & Ansari, 2014).

Given the extent of risks arising from a phoenix activity, a liquidation process in general involves forensic accounting investigators with anti-money laundering (AML) specification to prevent and detect possible illegal activities as they have assisted many litigations and law enforcements as well as policy makers in the subject of bankruptcy statutes and procedures. However, there are instances of lack of comprehensive roles of forensic accountants to oversee and supervise the investigative processes from the development early-preventive AML, early-detective AML, and post-bankruptcy litigation system (Cassella, 2013; He, 2010). In the context of AML, what are the roles of forensic accountants to prevent and detect money laundering activities prior, during, and after bankruptcy processes? Therefore, the objective of this research is to provide a comprehensive explanation regarding to the role of forensic accountants during the pre- and post-bankruptcy to prevent money laundering activities.

To answer the research question and achieve the research objective, this research applies a literature review. A literature review is an evaluative report of information found in the literature related to your selected area of study. It is more than the search for information and goes beyond being a descriptive annotated bibliography. All philosophical methods included in the review must be read, evaluated and analysed (Cooper, 1999). The review describes and summarizes the

concepts and evaluates the issue of interest to provide further

## **LITERATURE REVIEW**

### **Motives behind Fraudulent Liquidation**

Liquidation is an event that usually occurs when a company cannot pay its liabilities when they are due. However, liquidation is not merely triggered by insolvency. There are three types of fraudulent motive that trigger a company liquidation: (1) concealment of illicit assets resulted from phoenix activity to prevent asset seizure (Schneider & Windischbauer, 2008); (2) multiplication of illicit cash before liquidating new enterprises (Beasley et al., 1999); and (3) early liquidation to avoid liabilities fulfilment (He, 2010). In other words, liquidation is treated as a law contravention when the process does not reconsider the deprivation and disadvantages of other stakeholders.

Weygandt, Kimmel, and Kieso (2012), there are four steps of liquidation processes that must be done in sequence i.e. (1) selling non-cash assets for cash and recognizing gain or loss on realization, (2) allocating gain and or loss on realization to the partners based on their income ratios, (3) paying partnership liabilities in cash, and (4) distributing remaining cash to partners on the basis of their capital balances (Weygandt, Kimmel, &

clarification on this literature.

Kieso, 2012). Based on these sequences, there potentially four types of scheme: (1) fraudulent concealment of cash received from the third parties done by either company's agents, directors, or one of the ownership members; (2) financial report deception to either the investors and partners regarding to amount of cash received from the sale of non-cash assets or amount of cash dividends, or the result of non-cash assets sales that is actually the opposite with the fact (meaning that deceptively stating loss on realization to withdraw the partners' cash); (3) unfair burden of partnerships liabilities, infringement of company's liquidation policies and procedures, or use of assets to offset certain liabilities without any disclosure of transparency with other partners; (4) unfair cash distribution and treatment to minor partners, fraudulent partnerships equity statement that strikes down the amount of minor partners, or conspiracy between partners in bankrupting other partners (Kranacher, 2006).

The aftermath of fraudulent liquidation practices is severe. In an economic discussion, liquidation has caused many banks to write-off all their potential receivables and lose their potential interest revenue. Banks' Capital Adequacy Ratio (CAR) is affected by the availability of cash for customers' withdrawal in

which the amount lost during the liquidation is one of the signs of phoenix activity (Bryan, Janes, & Tiras, 2014; Nkama & Onoh, 2016). Similar to banks, vendors are also disadvantaged with the uncollectible receivables. In the accounting perspective, this is systematically explained through the recording of bad debt expenses as all possible receivables become impossible to be collected (Schneider & Windischbauer, 2008).

Furthermore, in USA, many cases show that the state government, to some extent is also disadvantaged because one of the state's taxable objects is currently untaxable. On the other hand, the state must provide the litigation services, which means that all costs related to the proceeding processes are the state's responsibilities. This event will have longer impact for the government due to various claims made to court compelling the government to hold many proceedings and trials for the sake of law enforcement processes. The effects of liquidation create unnecessary cost for any related stakeholders (Black, 2001).

Meanwhile, the company is also liable to investors, employees, and customers. Specificity is the idea of the distinction between the financial institution and government, and these three first-layer of stakeholders. These stakeholders are

directly affected by company's decision to liquidate the business and may face heavy losses and disadvantages as: (1) most equity and debt investors lose their ownership rights such as dividends and return rights as well as principal and interest payment; (2) most employees lose their potential income and contingencies, for example, pension funds, periodic remuneration, and irresponsible dismissal; (3) most customers lose their rights to be guaranteed and served meanwhile, wholesale customers must find another supplier (FATF, 2012). These three stakeholders are most disadvantaged because they are connected directly to the company's system. Furthermore, as the most of independent stakeholders, are not backed-up by high-volume of financial reserves, the company's bankruptcy may detriment the direct stakeholders (Brennan & Mcgrath, 2007).

However, the main stakeholder who determines the balance between the ownership interests, management interests, and minor stakeholders' interests. Initially, one of the role of board of directors is to separate the ownership with the daily company's operational activities (Black, 2001; Brennan & Solomon, 2008; Kiel, 2005). This directors' role is one of the key point in good governance practices, which is highlighted on

the contemporary agency theory. Agency theory is preferable to view this matter as it can capture the conflicts between the owners, directors, employees, and other employees (Donaldson & Davis, 1991; Glinkowska & Kaczmarek, 2015; Yang & Tan, 2012).

Plessis, Hargovan, & Bagaric (2012) argues that directors, as an agent of company, are responsible to merely serve the owners' interest through well-managed leadership towards the managers' decisions and policy implementation. On the other hand, the directors are also legally handed a role to limit the commissaries' intervention, the uncertainty due to various information asymmetries does exist. This results to owners' dissatisfaction due to owners' restrained interest to the enterprises' strategic in which, the directors' duties that accentuate to the company's interest usually pend the owners' personal target (Fauziah, Yusoff, & Alhaji, 2012).

The problem is located on the directors' specific knowledge and expertise, which would benefit them and company in a long-term, not the owners; hence a monitoring mechanism is designed to protect the whole company's stakeholders from owners' interest (Fauziah et al., 2012). This contradictory terminology has jeopardized the company as the absence of owners'

confidence would trigger the instability of company's governance. Directors role is strained between the owners' vision and the reality of business in the company, this circumstance also put the directorship in unnecessary allegations (Black, 2001). Therefore, one of the solutions in facing these agency problems is to appoint one-independent board to oversee an enterprise from a bigger perspective, who is liable for ownership interest, directors' duties, employees' rights, internal audit, and other stakeholders' affairs protection. The classic idea of the auditors as a watchdog is now being abandoned due to numerous failure of auditors to prevent accounting scandals and macro-economic losses (Kassem & Higson, 2012; Sankaran, 2004). This trend is not a solution for problems occur in agency theory since, the emergence of independent supervision from accounting perspective is highly-needed when the internal auditors are powerless (Godfrey, Hodgson, Tarca, Hamilton, & Holmes, 2010). Hence, the presence of accounting investigators is the solution not only to handle agency problems, but also for the stakeholders' interest protection (Houck et al., 2006).

This solution is supported through many lessons related to the American and European financial crisis from late 90s' to early 2000s.

Most of the cases depict a modus operandi which is utilizing all facilities and amenities financial institutions to defraud investors, owners, and the debtors itself (Kranacher, 2006). One of the most famous motivation of perpetrators at that time was the bonus and compensation from the persuasive financial reports. Historically, most of the perpetrators were the board of

directors, CEOs, CFOs, and managing directors. Many legal prosecutions have made and more facts were uncovered regarding to the causes of financial crisis i.e. inability of the assurance service providers, the unrealistic goals set by owners and stockholders, and the unethical board (Murphy & Dacin, 2011).

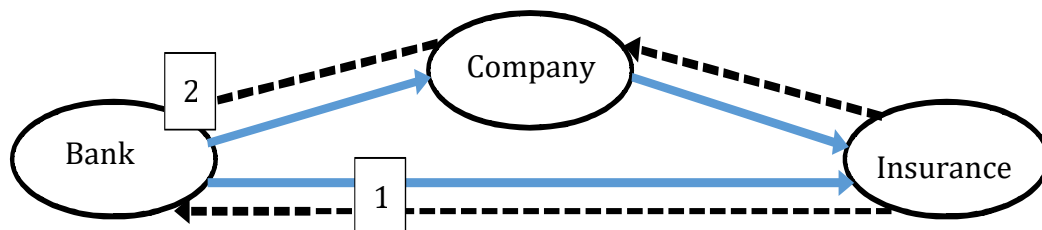


Figure 1. The Background of Fraudulent Financial Statement

Figure 1 shows that most companies uses financial institutions to gain trust in the form of cash and contingencies and to create a viable-look upon the financial statements. In the period of financial world crash, financial statement fraud scheme involves three groups of enterprises i.e. bank, public company, and insurance company (Fafatas, 2010). The processes were started since the company submit the prospectus containing fraudulent financial and non-financial information while, other prospectus was diffused to financial institutions regarding to mounted assets, projected sales, and prospected development (Brennan & Mcgrath,

2007). On the other hand, most investors were shown the data of return on equity and future project to ensure them on the company's ability to make a return. The bank then authorized the prospectus by lending clients' funds along with the expectation of the interest due to the company's asset availability based on the survey done by the bank (Beasley et al., 1999). Using that funds, most of the directors of the companies fraudulently constructed fraudulent financial reporting for the investors such as by: (1) confirming that cash possessed by the company were gained through the sales (Yang & Tan, 2012), (2) instructing the employee to make bogus invoices

including shell companies and multiple entries (Sahiti & Bektashi, 2015), and (3) concealing the long-term loans through fraudulent accounts receivable entries and deferred interest expenses (Financial Accounting Standard Boards, 2012).

At this stage, the directors understand the assistance from insurance company would likely be both source of funds and safety facilities. The directors also conceals the loans from the investors through the insurance premium. Therefore, any financial downfalls and deficiencies threatening the company would be covered and protected by insurance policies. At this stage, the banks who provides funds for the company were also insured by the insurance (Pedneault, Silverstone, Rudewicz, & Sheetz, 2012). The second stage on the figure shows that two risks occurs when insurance companies are liable to ensure both banks and companies regarding to: (1) the bankruptcy of the company would force insurance company to make reimbursement (Fafatas, 2010) and (2) the uncollectible receivable by the bank would also impel the insurance to do the same due to banks' capital inadequacy for customers' withdrawals (Kranacher, 2006). Finally, most of insurance companies are near-bankruptcy stage, due to the absence of insurance premium from the clients,

banks, and companies. Therefore, both financial institutions started to accuse the companies' reporting that varied across stakeholders.

Auditors are typically blamed due to their incompetency in the stakeholders' protection matters through the unreliable audit opinion. However, the auditors were working in accordance to the scope following the code of ethics of the auditors and examining financial data based on audit sampling was regarded sufficient to assess the risk of fraud and misstatement (American Institute of Certified Public Accountants, 2002; Louwers, Henry, Reed, & Gordon, 2008). In this context, the independent assurance service providers also sought charges to the independency of companies' internal audit and competency of both banks' credit assessors and insurance companies' surveyors. From these systematic accusing-one-each-other phenomenon, both internal and external assurance service providers along with insurance surveyors were unreliable to maintain transparency. Thus, Sarbanes-Oxley 2002 was structured as a set of regulations intervening the investor protection (Sarbanes-Oaxley 2002, 2003).

The introduction of Sarbanes-Oxley 2002 (SOx) act by Public Company Accounting Oversight Board (PCAOB) was a solution towards the challenges in global

economic disaster during the period caused by fraudulent professional behaviour (directors and auditors). There are three main topics regulated by SOx, namely auditors' ethic, supervision of corporations, and law enforcement.

hand-back all responsibilities to the professionals in terms of transparency and accountability when all investors were relentlessly criticising professionals' ethics that led to the birth of SOx Act (Jain, Pankaj & Rezaee, 2006).

However, according to the figure 1, PCAOB is formed to

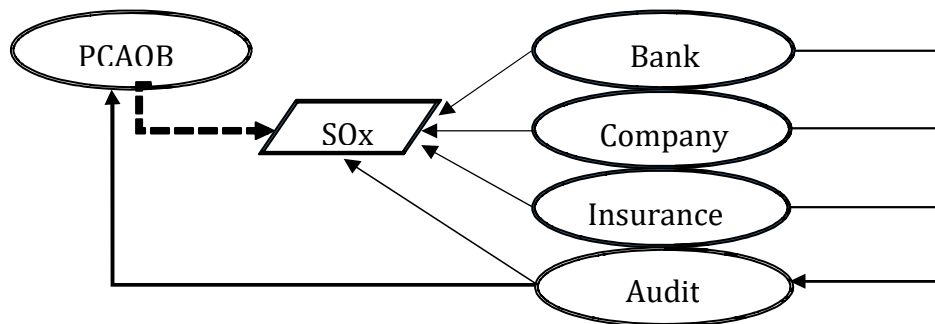


Figure 2. The Flow of Accountability between Parties

PCAOB is formed to oversee the performance of assurance services providers with the scope of regulation, investigation, and prosecution. These three fields are divided into two categories namely law enforcement and formal examination in which, as an independent body, its function must be separated from law enforcement (conducted by the court) and formal examination (conducted by professional bodies) (Groenendijk, 1997; Peterson, 2016). The other problem that is likely to occur is the reliance of public to PCAOB creates a loophole for conspiracy between

PCAOB's assessors and assurance service providers. Given the situation, there is a necessity to protect the investors' interests through a formation of independent body especially to conduct the/an? (what investigation) investigation (Dowling, 2006; Simunic, 1984).

The term "phoenix" in Greek etymology is a bird that arises from the ashes of its predecessor. According to some sources, the phoenix dies in a show of flames and combustion, although there are other sources that claim that the legendary bird dies and simply decomposes



before being born again. In bankruptcy context, the term “phoenix activity” refers to an activity associated with directors who transfer the assets of an indebted company into a new company of which they are also the directors. In criminology perspective, Phoenix activity is the deliberate and systematic liquidation of a corporate trading entity which occurs with the illegal or fraudulent intention to avoid tax and liabilities i.e. employee entitlements and continue the operation and profit taking of the business through another trading entity (Bryan et al., 2014).

### **Money Laundering in Phoenix Activity**

Recent researches uncovered several symptoms of the company’s likelihood to indulge in phoenix activities i.e. (1) the company fails to lodge tax returns and/or Business Activity Statements; (2) the business records and/or taxation records significantly understate or overstate the operations of the business, including debts owed (3) withheld payments such as PAYGW, superannuation and child support payments are kept by the business; (4) workers are pressured to take leave; (5) workers have their employment status changed from permanent to casual; (6) workers are underpaid; and (7) equipment, machinery and uniforms are not

replaced as needed (FATF, 2012). These symptoms are referred to common operational practices of the company. However, stakeholders’ awareness towards phoenix activities can also be obtained from typical corporation rumours i.e. (1) the directors of the new entity are family members of the director of the former company or are close associates, such as managers, of the former business; (2) the directors of the new entity are family members of the director of the former company or are close associates, managers of former business; (3) a similar trading name of new entity; and (4) the same business premises and telephone number (particularly mobile number) are used by new entity (Brun, Gray, Scott, & Stephenson, 2011).

Due to its nature, phoenix activities are fraudulently used to either omit company’s obligation or conceal other criminal motives (FATF, 2012; Houck et al., 2006). The last one mentioned is done due to perpetrators’ motivation to conceal the money obtained illegally since the beginning of the company’s establishment. In a more sophisticated scheme, the phoenix company usually launder the money through wire transfers prior the bankruptcy date even years prior the announcement of insolvency, called as money laundering (Schneider & Windischbauer, 2008). In a legal

term, money laundering is defined as a process to disguise illicit assets as legitimate assets either tangible or intangible that they have a right to possess and spend for the proceed of illegal activity e.g. drug and human

trafficking, corruption, and other misappropriations (Agha, 2007). In other words, money laundering schemes is done to make “dirty-money” look clean.



Figure 3. Three Stages of Money Laundering

### **Placement**

During this initial phase, the money launderer introduces the illegal proceeds into the financial system. Often, this is accomplished by placing the funds into circulation through financial institutions, casinos, shops and other businesses domestically to blur the investigation while waiting for the moment to run the money one by one through wire transfer (layering). There are at least three methods of placement. First, the transportation of cash across borders to deposit in foreign financial institutions; second, the purchase of high-value goods e.g. artwork, antiques, and precious metals and stones that can then be resold for payment by check or bank transfer; and third, the breaking up of large amounts of cash into smaller sums and deposit them directly into a bank account (Veng Mei Leong & Leong, 2007).

The latter method can be done through numerous bank accounts and investments in an amount slightly less than the threshold that will require disclosure (Alldrige, 2008).

### **Layering**

This stage represents the most difficult area of detection. This is so because there is lack of juridical cooperation between countries in which the money has been deposited into numerous instruments in various financial institutions. Layering emphasizes mainly on wire transfers not only for a bank deposit but also other potential economic destinations e.g. traveller’s checks, resale of high-value goods and prepaid products, real-estate business, stocks, bonds, life insurance, and other legitimate enterprises. All these efforts are done for the money legitimation (integration) (FATF, 2012; Weibing, 2011).

### ***Integration***

In this phase, perpetrators usually involve numerous steps, more than the processes involved in both placement and layering activities, to increase the complexity of tracing the funds, paper trail, and length of examination (Albrecht, Albrecht, Albrecht, & Mark F. Zimbelman, 2012). Generally, perpetrators have four options regarding to cash integration: (1) derivatives investment e.g. stock transactions, foreign exchange trading, and debt investments; (2) non-profit organization e.g. foundation; (3) personal luxury assets e.g. super cars, mansions, and other properties; (4) cheques and money orders. Amongst all options, cheques and money orders is the most favourable option due to two reasons: (1) those are easy-to-carry instrument between borders and (2) those are easy-to-use and liquid assets (Weibing, 2011).

### **Litigation Processes of Money Laundering**

Money laundering activities that includes three phases (placement, layering, and integration) would reflect the way that the assets are recovered through juridical system. Money laundering litigation processes encompasses wide range of issues regarding to the differences between law systems

i.e. civil and criminal law systems (Brun et al., 2011; FATF, 2012; Schneider & Windischbauer, 2008). However, as a criminal law contravention, the case of money laundering which is proven using beyond-reasonable-doubt as a standard of proof, forces the anti-money laundering (AML) experts and specialists to provide evidences admissibly including maintenances of chain of custody of assets identification between countries and legalsystems (Pedneault et al., 2012). The explanation of the process of litigation is addressed to return the assets to the victims of money laundering including the parties who have rights upon the percentages of assets comprising both domestic and international parties (Veng Mei Leong & Leong, 2007).

Generally, litigation process for money laundering has been started since the accusation is sought by the victims to the attorneys. Given that situation, an AML experts are appointed to assist the attorney in terms of investigation plans and programs including all legal notifications to certain institutions in terms of interview and audit. To protect the assets, litigation process must force related institutions' assets to be seized until the end of litigation processes. At this stage, the assets are to be proven in the court of law

through legal procedures which results in court's indictment for a party to return the assets to the victims and to both states. The litigation processes are started at the beginning of investigation called tracing.

### ***Asset Tracing***

Asset tracing involves some legal manoeuvres to understand (1) where the money goes, (2) what link, and (3) relationship sender and receiver of money have. In the investigation perspectives, when tracing assets through the financial sector, it is important to remember that proceeds of corruption may be commingled with other assets not linked to the offense, may change form, and may flow through various channels. Past experiences showed that corrupt official does not hold assets or bank accounts in his or her own name. Instead, assets are held by other individuals or companies to disguise the official's role as the natural person who ultimately owns or controls the assets or the bank accounts (Schneider & Windischbauer, 2008). Hence, investigators must consider some potential parties involved i.e. (1) relatives and business associates, (2) intermediaries (someone who is willing to shield the corrupt official by holding an asset or managing an account), and (3) corporations, trusts, limited liability partnerships, and foundations (Weibing, 2011).

In regard to the aforementioned issues, as an early stage of assets recovery, the data collection and maintenance are done due to the principle of chain of custody and admissibility of evidence. There are some basic information related to the asset tracing i.e. (1) date and place of birth or related person, (2) date and place of birth of related family and relatives, (3) telephone number of related person, (4) recent photographs of all targets, (5) fingerprint card/s, (6) criminal record from police officers, (7) results from recent searches regarding to target (through numerous search engines), and (8) information from other government agencies (fixed assets and its income declaration; business, court, immigration, real estate and tax record; customs declaration; and salary statement). A trash run or a search of a business or residence may reveal documents that link the targets to bank accounts; and these facts can be used to support a subsequent order to obtain bank account documentation because they demonstrate a nexus between the targets and the bank accounts (Houck et al., 2006).

Based on documents extracted from numerous sources, physical surveillance is conducted at this stage to reveal a potential gatekeeper to be investigated; and

documents obtained through a production order on a bank may reveal the names of bank officials or individuals involved in a transaction who may be able to provide additional leads if interviewed. The existence of invigilators in physical surveillance is important for the integrity of the evidence and its originality for the court purposes (Brun et al., 2011). In the perspective of fraudulent bankruptcy, the early evidence gathered from phoenix activity must be monitored rigorously due to its complexity. Furthermore, the identification of supporting document must be formalized in the form of forensic reports according to the statutes to be presented admissibly in the court of law (Chong & Lopez-De-Silanes, 2015).

### ***Asset Protection***

At this stage, the identification of assets laundered or resulted from fraudulent activity has been confirmed and both governmental states have been informed regarding to the findings. This stage is the most time-consuming due to law enforcement processes that differ from one country to the other. Asset protection phases encompasses all legal processes from the process of custody to verdict which consists of (1) securing the assets; (2)

processing the legal matters; and (3) enforcing orders (Brun et al., 2011).

**Securing Assets.**To secure illicit assets, Brun et al (2011) states that both civil and common law requirements embrace two processes of security i.e. seizure and restrain. Seizure involves taking physical possession of the targeted asset. On the other hand, Restraint orders are a form of mandatory injunction issued by a judge or a court that restrains any person from dealing with or disposing of the assets named in the order, pending the determination of confiscation proceedings. Unlike seizure orders, restraint orders do not result in the physical possession of the asset. In the legal perspective, some courts can restrain the alleged defendants to deal with secured property and fixed assets, this is called “Mareva Injunction” to prevent the defendant to conceal the money (Wright, 2001).

Furthermore, the court can also freeze the illicit assets without any courtesy due to the heavy impact to the respected states. The court may require the “Anton Piller Order” to search premises and seize evidence without warning. This order is specified for more sophisticated form of asset i.e. intangible assets, derivative investment, and social capital. There are at least three criteria for the use of Anton Piller order i.e. (1) strong *prima facie* against

respondent; (2) serious damage (either potential or actual) for applicant; and (3) clear confirmation from the respondents regarding to the assets possession which is vulnerable to be destructed by them. However, any assets freezing orders are impossible without any legal assistance bridging both systems of law. Asset protection by law enforcement officials and prosecutors may take months or years because the principle of sovereignty restricts domestic authorities' ability to take investigative, legal, and enforcement actions in foreign jurisdictions (Brun et al., 2011).

Therefore, mutualcooperation must be initiated in the light of fraud eradication. According to its nature, there are two types of legal assistance i.e. informal and mutual legal assistance (MLA). MLA is a term by which jurisdictions seek and aid in gathering information, intelligence, and evidence for investigations; in implementing provisional measures; and in enforcing foreign orders and judgments. An MLA request is typically submitted in writing which complies to specified procedures and specifications setting out in multilateral or bilateral agreements or domestic legislation. In the investigation stages, MLA reports are required to present evidence, rational

measurement, or detail of investigative techniques. An MLA request is generally required for the enforcement of confiscation orders (Brun et al., 2011; Simser, 2010). In contrast to an MLA request, the information gathered through informal assistance may not be admissible in court; rather, it is more like intelligence or background information that can be used to develop the investigation and may lead to an MLA request (Association of Certified Fraud Examiners, 2014; FATF, 2012; Veng Mei Leong & Leong, 2007).

**Processing Legal Matters.** In the process of legal matters, once assets have been secured through provisional measures, authorities will need to ensure the safety and value of the assets until they are eventually confiscated potentially. For preserving the asset for the court purposes, the court usually demands the assets to be managed and supervised by professionals. The reasons behind this appointment is to maintain the independency of the judge and to avoid early dispute of the attorneys outside the trial (Beasley et al., 1999). The quality of professional assets manager for court purposes is vital for the decision-making process therefore, the court grant them legal authorities: (1) preserve the security and value of assets pending confiscation (including the

sale of rapidly depreciating assets); (2) hire contractors with specialized skills to accomplish management tasks; (3) liquidate assets for a fair price after confiscation; and (4) distribute the proceeds in accordance with applicable legislation following payment of all necessary expenses (Brun et al., 2011).

In the perspective of phoenix activity, many researches show that this fraudulent act involves the unethical behaviour of the board of directors according to their intention to conceal the result of their negligence and company mistreatment (financial predatory crime). Other researches emphasize on the misuse of trust to gain personal benefit (corruption) (Mietzner, 2007). Another research explains that fraudulent phoenix activity is purposed mainly to save millions of cash from the government and unnecessary individual expenses (Weibing, 2011). Based on these statements, confiscation as one of the main legal processes for asset recovery has two rational purposes: (1) to compensate the victims with any recoverable funds; and (2) to deter the possibility of enjoying illegal gains (Simsler, 2010).

For the purpose of indictment, the evidence of confiscation must be presented in

the court to explain to the judge about the case. Evidence establishing the link between the asset and the offense or the value of benefits can be complex and difficult for the judge (or jury) to follow. Such evidence is often best presented using flow charts and spreadsheets that present the financial material in a more easily comprehensible way. Care must be taken to ensure that presentation aids are accurate and precisely reflect the evidence in source documents: a factual or methodological error may impeach the credibility of the evidence, leaving a big hole in the prosecution's case (APESB, 2013; Brun et al., 2011; Kranacher, 2006).

**Enforcing Court Orders.** The case of money laundering can be addressed through two different approaches. First, money laundering's results that threatens the existence of a country such as a threat for generations of human existence, economic development, and changes in ideology; these typical effects are usually emerged from drugs and human trafficking and terrorism financing. This type of crime must be sought through criminal proceedings. However, minor losses of any parties, either financially or non-financially, resulted from humans' negligence or intentional concealment of

others' assets possession causing disputes between parties, this type of crime are decided though civil proceedings (FATF, 2012).

Narrowing the court orders as the final decision, there are at least four types of verdict issued by the court: (1) proprietary

claims, (2) actions in tort, (3) actions based on invalidity or breach of contract, and (4) actions based on illicit enrichment. Each of these claims consist of the cause of action and remedies for the victim. Below is the Table listing both aspects including the cited cases (Brun, et al., 2011).

Table 1. The Typical Cause of Actions and Remedies for Phoenix Activities

No	Cause of Action	Court Remedies	Cases
1. Proprietary Claims	<ul style="list-style-type: none"> <li>• Asset misappropriation</li> <li>• Executive bribery</li> </ul>	<ul style="list-style-type: none"> <li>• If the proceeds of corruption were invested, the claimant may also be entitled over the interest or profits earned by the defendant.</li> <li>• if the proceeds cannot be traced to the corruption offense (it has been laundered around the world), court will not recognize bribes received by government officials or profits derived from fraudulent contracts as property of the state or government.</li> </ul>	<ul style="list-style-type: none"> <li>• Federal Republic of Nigeria v. Santolina InvestmentCorp., Solomon&amp;Peters, andDiepreye Alamiyeseigha (2007)</li> <li>• Kartika Ratna Thahir v. Pertamina (1992–1994)</li> <li>• Attorney General of Hong Kong, SAR, China v. Reid (1994)</li> </ul>
2. Action in Tort	<ul style="list-style-type: none"> <li>• Loss or harm directly caused by a breach of duty,</li> <li>• Criminal wrongdoing</li> <li>• Immoral conduct</li> <li>• Precontractual fault.</li> </ul>	<p>a) In Civil law system:</p> <ul style="list-style-type: none"> <li>• A reasonable loss expected but not gained because of corruption and non-pecuniary damages that cannot be immediately calculated.</li> <li>• The briber is held for the losses due to fraudulent transactions of the contract with an assumption that the briber is both benefited and suffered from the increased and decrease in transactional amount which must be measured.</li> </ul>	<ul style="list-style-type: none"> <li>• Attorney General of Zambia v. Meer Care &amp; Desai &amp; Others (2007)</li> </ul>



		<p>b) In Common law system:</p> <ul style="list-style-type: none"> <li>• An exact amount is ordered by the court based on the damages calculation.</li> <li>• The briber is held liable for the loss sustained by the victim in entering a contract with unfavourable terms.</li> </ul>	
3. Actions Based on Invalidity or Breach of Contract	<ul style="list-style-type: none"> <li>• Contract extortion by fraud</li> <li>• Consent vitiation by corruption</li> </ul>	<ul style="list-style-type: none"> <li>• Compensatory damages (the court will order the defendant to pay the current and probable amount of economic value injured by the plaintiff.)</li> <li>• Punitive damages (the court will order the defendant to pay the exact losses and injury occurred to the plaintiff, and might be sought to criminal proceedings.)</li> <li>• Incidental damages (the court will order the defendant to pay a seller's commercially expenses incurred in cancellation in delivery or transporting goods after a buyer's breach of contract.)</li> </ul>	<ul style="list-style-type: none"> <li>• Fyffes v. Templeman (2000)</li> <li>• World Duty Free Company Limited v. The Republic of Kenya (2006)</li> </ul>
4. Actions Based on Illicit Enrichment	<ul style="list-style-type: none"> <li>• Benefits restitution obtained by illegal acts</li> </ul>	<ul style="list-style-type: none"> <li>• The defendants are ordered to pay back any illegal profits obtained even if the victims do not suffer any loss.</li> <li>• The defendants must recover for the loss in excess of bribe.</li> </ul>	<ul style="list-style-type: none"> <li>• U.S. District Court for the Southern District of New York v. Livent Inc. (1998)</li> </ul>

Source: Brun, et al. (2011)

## **Asset Recovery**

At the end of the stages, the court shall return all illicit assets including its profits during the layering and integration processes. There are at least three tribunal ways according to Brun et al., (2011) return the assets: (1) requesting criminal proceedings; (2) direct recovery through foreign tribunal; and (3) procedural recovery in accordance to agreement and statutory authorities.

**Criminal Proceedings.** Recovering assets through criminal proceedings usually conducted at the early stage of investigation prior the assets' identification. The advantage of this method is that the assets will be returned as soon as possible however, the plaintiffs' claims regarding to the legal and professional expenses are impossible recovered until the alleged perpetrators are captured. In most cases, the court usually pends the recovery when the experts' reports are not sufficiently explainable. At this point, high-cost tribunal argumentation is usually made by plaintiff.

**Direct Recovery from Foreign Tribunal.** Plaintiffs are also welcome to lodge claims to foreign tribunal. The court usually requires plaintiffs to arrange international agreement between local investigators and hired consultants. This arrangement shall

provide the court a basis for asset confiscation. However, this method does not guarantee the direct asset recovery. Therefore, there are at least recover their assets: (1) raising up civil remedies to criminal proceeding; (2) accepting the compensation in accordance with criminal plea agreement; and (3) receiving directly the sole amount of civil remedies without any further compensation.

**Procedural Recovery According to Agreements.** The most favourable method for asset recovery is by giving up all matters to MLA for the law enforcement assurance. The professional MLA is usually an expert in inter-juridical agreement and statutory authorities in which the evidence reports are usually admissible for court purposes. Furthermore, the absence of agreement would be replaced with the authority given to the government to make a discretion in asset recovery.

As it has been discussed earlier regarding to asset recovery procedures, the next part of the research explains the role of forensic accountants in litigation processes.

## **The Role of Forensic Accountants in Phoenix Activity Litigation**

In accordance with the research purpose, this section is structured to

explain the role of forensic accountant at: (1) prior to bankruptcy, (2) during bankruptcy, and (3) after bankruptcy.

### **Prior to Bankruptcy**

Many cases show that the absence of independent body to supervise the operational transparency. In Livent Inc.'s bankruptcy case, the bankruptcy was initially caused by the conflict of interest between Gottlieb (Livent Inc.'s director) to one of the third-party company in which he did not disclose his ownership to the related party transaction. In this case, the internal auditor was unable to warn the effect of the director's acts (Đorđević & Tadija, 2015; Vanasco, 1998). This situation is compounded by the internal auditors' lack of independency in which, the auditors assisted the directors to delete expenses and apply the fraudulent expenses capitalization. This organization fraudulent behaviour was not anticipated by the external auditors. At the end of the saga, Deloitte and Touché was ordered to pay \$8.5 million for their negligence in fraud risk assessment in accordance to the Statement Auditing Standard (SAS) No.99 which requires the professional auditors to consider the fraud risk with high-degree of care during the audit planning (American

Institute of Certified Public Accountants, 2002). Another famous fraud cases like ZZZZ Best Co. also represents the auditor (Sam Antar) who satisfied the owner's (Barry Minkow) greed through the assistance of fraudulent misrepresentation of financial reporting (document forgery and invoices alteration) (Kranacher, 2006). Another case related to the bankruptcy is in Indonesia. One of the micro-banks (named: Bank Century) created an economic tragedy in Indonesia when, the millions of dollars' bail-out was given to bankrupted micro-bank which was equal to the normal banks' bail-out ratio with an excuse that this bankruptcy case would likely to affect the macroeconomics system. The result of investigation processes show that the bank contravened the Indonesian's applicable interest policy including allegations of utilization for political campaigns (BBC, 2014).

These illustrations show that in a corrupted situation either at the micro or macro-economic scale, the existence of independent body who concentrates its scope in insolvency prevention is inevitable. In the level of internal audit, there must be a of fraud risk assessment according to SAS No.99, including the audit policy to conduct focused audit periodically (Louwers et al., 2008). Focused audit

is a centred independent examination to certain department with the purposes of fraud findings. Therefore, the broadened examination area of internal audit is recommended with forensic accountants who initiate the focused audit grounded on the law and applicable security procedure (Bastin & Townsend, 1996; Girodo, 2008).

The security of investors leans on the hand of external auditors' professionalisms even if, it now become pertinent that forensic accounting be introduced and practices since the external auditors do not or may not have the required training to be able to tackle modern white-collar crimes which is a complex area requiring investigative techniques (Popoola, Ahmad, & Samsudin, 2014). Hence, there must be an independent commission bridging the PCAOB's statutory with the surveillance of external audit performances (Coffee, 2001). The appearance of corruption eradication bodies in all country nowadays is not enough to govern the fraudulent economical practices. However, since the external auditors are liable for the PCAOB's specification along with others, there must be a superintended body placed by international financial regulator to protect its examiners from both local governments', auditors, and business conflicts (APESB, 2010).

The problem related to the investor protection is also applied by appointing independent business valuation experts. The difference of the business valuation experts is their uniqueness of accountability. When internal audit activity purposed for internal business transparency, and external auditors are liable to PCAOB; independent business assessors are liable to investors and exercising their duty in accordance with the statutory based on the Accounting Professional and Ethical Standards (APES) 225 (valuation services) (APESB, 2012). The focus of their service is to present the viability of the company based on (1) financial performance; (2) market, fraud, and misstatement risk assessment; and (3) statement of board evaluation.

### **During Bankruptcy**

As it has been stated in the literature review that bankruptcy is vulnerable to be used to launder the assets (phoenix activity), there must be an escort for liquidation processes. The main objective of placing a forensic accountant is to oversee the liquidation processes with the accordance to the corporation acts. Accounting Professional and Ethical Standards Boards (APESB) provides two sets of statutory managing the role of forensic accountant or

investigative auditors i.e. APES 220 (taxation services) and APES 330 (insolvency services). All these statutory do not exempt forensic accountants from their ethical and professional responsibility (to exercise their duty in integrity, objectivity, professional competence and due care, and confidentiality) as it is regulated on the APES 110.

The difference in both services provided by forensic accountants is that, taxation service is precedence rather than insolvency service (APESB, 2015). The necessity of insolvency service emerges when meeting at least one of these two criteria i.e. (1) the allegation of fraudulent practices in bankruptcy that needs to be proven financially; and (2) the external stakeholders agree to appoint business assessors as liquidation supervisors (Albrecht et al., 2012; Onofe, Izevbigie, & Usifo, 2015). Taxation liability of insolvent company is the most common motive for a company to be insolvent intentionally. Therefore, forensic accountants' investigation scopes at this order embraces these following examinations according to APES 220 i.e. (1) preparation and lodgment of returns to revenue authorities; (2) tax scheme, planning, and arrangement; and (3) liabilities estimation. All these examination is included a

consideration of the existence of false and misleading information (Dechow, Hall, Larson, & Sloan, 2009; Pedneault et al., 2012).

On the other hand, APES 330 setting up the forensic accountants' role to assess a business circumstance is focused to the legal matters regarding to insolvency. When the external stakeholders demand the insolvency service engagement, it is usually based on the existence of false and misleading information (APESB, 2014). When forensic accountants are engaged based on APES 330, there are at least two obligations for the forensic accountant i.e. (1) property and asset valuation; and (2) expert testimony for legal purposes (Pedneault et al., 2012). The importance of assets valuation is grounded on the cash-conversion process of assets by the company which is easily to get laundered. Furthermore, the investigation conducted must result in forensic report and provide the objectivity to be presented in the court. When engaging with an expert witness duty, their role is regulated on APES 215.

### **After Bankruptcy**

The role of forensic accountants after bankruptcy is situational. The engagement of forensic accountant may end with the liquidation

processes even though some of them might be hired to oversee the assets distribution. However, many bankruptcy cases contain money laundering allegations that need to be proven legally. When the phoenix activities are occurred, forensic accountants are usually hired in joint task force for asset recovery. Based on the whole concepts of money laundering and international procedure of assets recovery, forensic accountants may be engaged to conduct professional services i.e. (1) independent fraud examiner and money tracer; (2) mutual legal assistance (MLA); (3) asset manager for legal purposes; (4) accounting expert assistance; and (5) accounting expert witness.

First, as a fraud examiner, forensic accountants are usually hired for domestic investigative program (Brun et al., 2011; Veng Mei Leong & Leong, 2007). As the placement stages of money laundering involving domestic financial institutions, many information must be extracted from related financial institutions as it has been stated in the literature review section (Alldridge, 2008; Weibing, 2011). The investigative report must be able to identify the perpetrators' destination of money laundering and provide a persuasive evidence for the judge to issue a formal confiscation

orders (Wright, 2001). At this stage, the rapidity and accuracy of a forensic accountant deter how fast the case will be uncovered (Vanasco, 1998).

Second, when asset confiscation orders are issued by domestic court to foreign jurisdiction, the international agreement must be formed for the legal power of investigation continuity. The importance of MLA is differed by its scope. A person with law background is usually appointed to exercise this duty. However, there are several characteristics of forensic accountants matching the MLA's job descriptions i.e. (1) conducting coercive investigation program in the light of judicial assistance; (2) analyzing link between assets and offenses in the form of persuasive expert evidence; (3) obtaining and capturing evidence for the needs of chain of custody maintenance (Brun et al., 2011; Popoola et al., 2014). Furthermore, international court also demands the admissibility of evidence to be managed under the international evidence act. Therefore, forensic accountants are usually to be appointed as asset manager due to the inability of human resources with legal background to manage the assets (Brun et al., 2011). In the context of fraudulent money laundering, asset managers are given legal authorities i.e. (1) pay all expenses connected to

the assets restrained; (2) sell all seized assets to be distributed as remedies; (3) insure assets under control; (4) operate the business (terminate the employment, hire managers, or other decisions); (5) exercise the stockholders' rights; and (6) getting involved in asset management (FATF, 2012).

Third, forensic accountants' role as expert witness and assistance are usually separate function. According to APES 215, a forensic accountant who has been involved in investigation, executive report organization, and in this context, becoming an asset manager has acquired special knowledge regarding to the object and case in which he/she is considered to be competent to present the case to the court to the extent that he/she maintains all professional aspects stated on APES 110. Meanwhile, attorneys usually need an expert to explain the case in legal aspects. The attorneys' necessity is usually triggered by the complexity of the monies' flow in which an accountant's knowledge encompassing that subject (DeFond & Zhang, 2014; Fafatas, 2010). Moreover, at both direct and cross-examination stages, there must be a person who can guide the lawyers to examine in the points that assist the judge to decide the case. Both expert witness and

assistance's existences in court are mainly objected to assist the court and recovery the stolen assets (Brun et al., 2011).

## **CONCLUSSION**

In conclusion, this literature review answers the research question on accountant's involvement in money laundering prevention and detection in a sequential manner. According to the theoretical research, it is shown that forensic accountants may be assigned to prevent and detect money laundering that may be occurred from fraudulent company liquidation.

First, forensic accountants might be working as internal investigator, surveillance agents, and independent experts in business valuation. Second, forensic accountants also assist stakeholders and government regarding to the tax evasion issues emerged from phoenix activity. Lastly, forensic accountants play their biggest role in the legal aspect of asset recovery as investigators, MLA, assets managers, and both experts assistance and witness. All these roles are grounded on international accounting standards of forensic accounting services (APES) issued by APESB along with the corporate ethics carried out by SoX 2002.

This literature review is expected to be a framework for researches that discuss to the money laundering and phoenix activity discussion in a way that this research provides sequential explanation regarding to the accountant involvement in money laundering investigation. However, a limitation of this research such as the sample of phoenix activity cases that were not discussed in detail.

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