U.S. and Brazil AML Audit Comparative Analysis

How a review of AML legislation and practices can give a Board of Directors the confidence to invest – or not

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Introduction

How a review of AML legislation and practices can give a Board of Directors the confidence to invest – or not.

With the enactment of ever-more stringent Anti-Money Laundering (AML) legislations and regulations in the U.S., boards of directors have an increased responsibility to not only ensure that their own institutions are in compliance, but that the organizations they are doing business with in the U.S. and abroad are in compliance as well. This job is made harder by the fact that while many countries have some kind of AML initiative, they differ vastly in their effectiveness and the scope of their review.

In foreign markets, corporations can be exposed to new customers and by creating foreign affiliates, companies become multinational in the process – this is one of the most common courses of an expanding business: going abroad. However, expanding operations beyond the United States in whatever kind of structure (opening of a new branch, establishment of a foreign correspondent banking relationship, joint venture, etc.) requires a certain level of due diligence and understanding of the targeted market. When the matter relates to banking, these aspects become even more critical due to the highly regulated U.S. compliance sector. And as most banking professionals already recognize, Anti-Money Laundering is one of (if not the most) important item on a regulator’s agenda. Therefore, before venturing into a new market, these are some important issues for a Board of Directors to consider. Note that although the main objective of this paper was to compare and contrast Anti-Money Laundering auditing in the United States and in Brazil, topics discussed should be highly positioned within a Director’s due diligence checklist before expanding a banking business anywhere around the world.

In my point of view, auditing is the critical function directors must examine as they review the AML efforts of governments and institutions of other nations. To support this perspective, this paper will examine how the strong AML audit function in the U.S. and the weaker audit practices of Brazil contribute to the overall effectiveness of AML efforts in each country.

The paper discusses how each country stands against the other in terms of enforcement actions, suspicious activity reporting (and equivalent reports), and AML audit standards. One key element to review is audit culture and preparedness of audit professionals in both countries, and the manner by which these aspects influence a regulator’s reliance on work performed and consequently the depth of examination of a financial institution. Examinations are important, as problems can be recognized early and corrective measures taken in order for a bank to return to a healthy condition. But the ideal use of auditing in any organization, in my opinion, is an efficient examination system in which auditors contribute to the organization’s goals by conducting value-added audits and examiners, in turn, rely on an auditor’s performance so as to decrease time and effort spent at a financial institution. In reviewing how close or distant each country is from achieving this ideal state, I hope to provide Boards of Directors with a better sense of how much reliance upon an audit function they may have. Because ultimately, bank leaders could be held liable for Anti-Money Laundering issues that occur at an institution under their command.

Methodology

Since AML regulations are applicable to various sectors of the financial industry, I’ve narrowed this review and centered my research on the banking industry, due to my own professional background
and industry knowledge. As a consultant working for the past 10 years in the United States with Anti-Money Laundering related projects mainly for banks, I’ve gained substantial knowledge of how AML requirements apply to financial institutions and how they are enforced by regulators. Having spent the previous years in Brazil, and having worked on a handful of AML related projects in that country, I could notice that differences were evident, both conceptually (how and why regulations were created) and practically (how the interpretation and applicability transpired in the banking world).

Interviews were conducted with Brazilian compliance executives and a representative of the regulatory system in view of the fact that my work-related experience in that country did not sufficiently allow me to develop an equal amount of comprehension of AML related matters so as to make assumptions and arrive at conclusions. Therefore, besides conducting extensive research, the views of those professionals with whom these topics were discussed were taken into consideration in the preparation of this article. As most professionals were not speaking in the name of the institution for which they worked, I was asked to keep their identities confidential.

**Legislative Impetus Matters**

In order to understand the differences and similarities between overall AML requirements in the United States versus those in Brazil, it is important to review the original legislation in each country, their original intent and historical context.

The evolution of the laws in both countries demonstrates the differences in terms of where they stand nowadays in the combat of money laundering. Several enhancements have been made to American anti-money laundering regulations over the years. Brazil is still in its second version. Amendments such as the ones the U.S. has put in place over the years do not necessarily signify a more robust regulatory environment. In fact, in many instances a more thoughtful and planned process is capable of producing superior quality work that requires less reiterations and changes. Unfortunately, this does not appear to be the case of Brazil’s anti-money laundering laws. As we’ll see when we review the success of Brazil’s AML efforts, the Brazilian government will not only need more coherent legislation in order to address money laundering concerns, but there also must be enhancements that emphasize the importance of the audit as an aid to ensure enforcement.

Analyzing the reasons that governments pass AML legislation can be helpful in evaluating the strength of the AML regulatory environment in a given country. For instance, while in the United States the intention to pass anti-money laundering laws and regulations appears to be “intrinsic” – a self-identified need to deal with actual problems that the population was facing at a certain point in time – in Brazil, the motivation appears to result from outside influence – the result of international pressures and commitments made by Brazil to other countries. This difference in the initiation of AML laws is key to understanding the differences in results the two countries have achieved, as we’ll see in the final section.

**AML Legislation in the U.S.**

The Bank Secrecy Act in the United States comprises several separate legislative acts, ranging from 1970 to the present, including the USA PATRIOT Act of 2001. The legislative framework known as the “Bank Secrecy Act” or “BSA” is in fact named Currency and Foreign Transactions Reporting Act, promulgated back in 1970. It contains two main parts referring to financial
recordkeeping and reports of currency transactions. The motivation to pass this law related to the
government’s belief that some Americans were using secret foreign bank accounts and foreign
financial institutions as part of illegal schemes, fostering organized crime in the United States. In
this context, focus on recordkeeping (lack of evidence may impede criminal prosecutions) and
currency reporting (trail of ‘unmarked’ monetary instrument) made sense, but over the years has
been proven insufficient.

While its original intent evolved around aiding law enforcement investigations into certain criminal
activities, including tax evasion and money laundering, nowadays, BSA-related reports contain
valuable information to help them track other types of illegal activities, such as drug dealing and
terrorist financing. What made this viable were the various subsequent acts and legislations
promulgated afterwards, of which the most relevant are1:

Money Laundering Control Act of 1986
- The motivation behind this law had to do with the inability of Government to prosecute
  money launderers for structuring, as structurers essentially complied with recordkeeping
  and reporting requirements of the BSA.
- Includes the requirement for bank regulatory agencies to issue regulations for financial
  institutions to have compliance procedures in place and that agencies include a review of
  BSA during each examination, issue cease and desist orders to address banks’
  noncompliance with BSA and failure to correct identified deficiencies
- Makes money laundering a criminal offense - § 1352

Annuzio-Wylie Anti-Money Laundering Act of 1992
- Prohibits illegal money transmitting businesses and adds provisions for recordkeeping
  with respect to certain funds transfers
- Adds the suspicious activity reporting requirement and associated safe harbor
- Includes what we currently refer to as the “four pillars”

Money Laundering Suppression Act of 1994
- Geared towards simplifying and streamlining the CTR filing process
- Includes several other measures to improve the efficiency of the overall process (e.g.
  enhance bank examiner’s training to improve their ability to identify money laundering
  schemes)

- Directed the President, acting through the Secretary, to develop a national money
  laundering and related financial crimes strategy
- Authorizes the Secretary of the Treasury, in consultation with the Attorney General, to
  designate certain regions as high risk money laundering areas

Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and
Obstruct Terrorism Act (USA PATRIOT Act)
- Passed shortly after the tragic events of September 11, 2001
- Some experts argue that most sections were already in advanced stages of implementation

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1 American Bankers Association; A New Framework for Partnership - Recommendations for Bank Secrecy Act/Anti-
Money Laundering Reform – Appendix C: History of the Bank Secrecy Act -
http://www.aba.com/Solutions/Compliance/Documents/07cbe87f05f94aa8b84faa573c790ba5AppendixC.pdf
Includes issues pertaining to private banking, correspondent banking, offshore banks, shell banks, concentration accounts, bulk cash smuggling, jurisdictions/institutions of primary money laundering concerns, and others.

**AML Legislation in Brazil**

Many international agreements were signed following the Vienna Convention ("The United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances" of 1988), which aimed at promoting international cooperation amongst several countries worldwide in the matters related to the drug trafficking. In 1991, Brazil issued a Decree (154/1991) pertaining to this agreement. But it wasn’t until 1998 that Brazil promulgated its first regulation (9.613/1998), defining a legal framework to combat this type of activity and creating protection mechanisms for the Brazilian economy, in particular the financial system. Overall, the law made criminal the acts of concealing funds deriving from certain serious crimes, such as drug trafficking, firearms, and extortion through kidnapping, with a sentence of three to ten years in prison. COAF, an intelligence unit within the scope of the Ministry of Finance, was also established under this law. COAF is the equivalent in Brazil to the Financial Crimes Enforcement Network in the United States. For comparison purposes, FinCEN was established eight years earlier in 1990.

Fourteen years after promulgating its first Money Laundering law, Brazil passed a second legislation (Law 12.683/2012) amending the first one. The objective was to make more efficient the prosecution of crimes related to money laundering. One significant change from the previous law was that it expanded the list of activities that could be criminalized as an act of money laundering. In the previous version, only funds related to certain illegal activities were considered money laundering, including arms and narcotics trafficking, terrorism, kidnapping and extortion. The new amendments brought by 12.683 abolish the limited list of predicate offenses, setting that any criminal offense can be a predicate offense for the purpose of money laundering. Controversial opinions exist with regards to this change, some citing that this exaggerated amplitude is not in compliance with international standards, which usually require that money laundering activities be treated as “serious offenses”. It is also argued that, by not setting thresholds for the money laundering predicate, Brazil is incurring chances of having an already overloaded criminal system becoming even more backlogged.

**How each country responds to worldwide initiatives**

Another notable fact regarding the differences between the two countries’ approach to money laundering pertains to their involvement in worldwide initiatives. The Financial Action Task Force ("FATF"), an inter-governmental body that, amongst other initiatives, sets standards and promotes effective implementation of legal, regulatory and operational measures for combating money laundering and terrorist financing around the globe, was created back in 1989. It took Brazil 10 years to join as an observer and the country was accepted as an actual member only in 2000. The United States has been a member since 1990. Created 24 years ago to combat money laundering, terrorist financing and other threats to the integrity of the international financial system, FATF created in 1990 a list of 40 recommendations, which were revised in 1996, that to this day are followed as standards by over 180 countries around the globe. They are regarded as the international principles for anti-money laundering and combat of terrorist financing. FATF does not apply sanctions to non-compliant members like other international bodies do. However, the group ranks the reliability and credibility of each participating country and these evaluations send strong signals to the international
financial markets. Evaluations for both Brazil and the United States are discussed in subsequent chapters.

**Understanding the Banking Regulatory Structure**

Regulatory systems are a reflection of the degree to which countries fight against money laundering.

Just as directors place certain reliance on auditors to assist them with their oversight responsibilities, so do authorities trust on robust regulatory enforcement systems to ensure proper application of laws and rulemakings. This section compares the regulatory enforcement structure in the U.S. and in Brazil in order to illustrate how significantly the fight against money laundering is handled by each.

The U.S. Regulatory System

Several regulatory bodies compose the US financial system, both on federal and state levels. A table has been included providing an overview of the main federal US regulatory agencies involved in banking supervision. The focus of this analysis is set on the examination of Anti-Money Laundering in the banking system. State regulatory supervision will not be discussed.

<table>
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<tr>
<th>Institution</th>
<th>Description</th>
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<tbody>
<tr>
<td>Federal Reserve</td>
<td>Commonly referred to as the Fed, the central bank of the United States. The Fed is responsible for regulating the US monetary system, as well as monitoring the operations of holding companies, including traditional banks and banking groups. Broadly speaking, its mandate is to promote stable prices and economic growth.</td>
</tr>
<tr>
<td>U.S. Department of the Treasury</td>
<td>Originally created specifically to manage government revenues, it has evolved to encompass several different duties. In terms of financial regulation, it functions primarily through the operations of two agencies it oversees, the OCC and OTS, which regulate banks and savings and loans, respectively.</td>
</tr>
<tr>
<td>Office of the Comptroller of the Currency</td>
<td>The OCC is the primary means through which the Treasury regulates U.S. banks. It is headed by the comptroller of the currency. The OCC is responsible for chartering all U.S. banks and, more broadly, for ensuring the stability of the banking system.</td>
</tr>
<tr>
<td>Federal Deposit Insurance Corporation</td>
<td>Created in 1933 following a wave of bank closures, the Federal Deposit Insurance Corporation, or FDIC, was intended as a financial backstop to provide the broader U.S. population a guarantee that individual savings wouldn't evaporate when a bank did.</td>
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National Credit Union Administration

The NCUA, in some ways functions both like the FDIC and the OCC, though it regulates credit unions rather than banks (credit unions are nonprofit savings and loan institutions that pool the money of members in order to provide credit and banking services to one another, theoretically at lower rates than for-profit banks). The NCUA is responsible for chartering and supervising U.S. credit unions.

Consumer Financial Protection Bureau (CFPB)

The CFPB is a federal agency that holds primary responsibility for regulating consumer protection with regard to financial products and services in the U.S. It was founded as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act which passed in response to the late-2000s recession and financial crisis. The bureau began operation on July 21, 2011.

Note: Securities and Exchange Commission (SEC) and Commodities Futures Trading Commission (CFTC) are also part of the US regulatory system. Details are not included as these agencies are not directly related to the banking system, which is the scope for this analysis.

US Regulatory agencies usually take a similar approach when examining financial institutions, especially due to the fact that they all follow the Federal Financial Institutions Examination Council (“FFIEC”) guidelines. The Council is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the various supervisory agencies in order to promote uniformity in the supervision of financial institutions.

Overall, the frequency of a full-scope or specialty examination depends on the size and complexity of the bank. That means that regulatory agencies utilize a risk-based approach in their supervision of financial institutions in order to determine what needs to be examined and with which frequency. Regulators take into account the general risks that the specific financial institution is exposed to, combined with the results from previous examinations and management’s implementation of corrective actions, in order to determine the examination cycle. This may vary from 12 months or less, when an institution is under scrutiny for past failures, to 18-month cycles. Although generally most agencies follow this risk-based approach, certain regulatory bodies are guided by strict regulations. For instance, minimum frequencies and scope of examinations for OCC are determined by 12 USC 1820(d). Similarly, section 337.12 of the FDIC Rules and Regulations requires an annual full-scope on-site examination of every insured institution at least once during each 12-month period. Annual examination intervals may be extended to 18 months under certain conditions, such as when the institution is well capitalized, under $500M in assets, or has an assigned management component rating of 1 or 2.

For most agencies, the full examination cycle focuses on three main areas: safety and soundness, regulatory compliance and specialty areas. The Bank Secrecy Act is one of the specialty areas. As such, there are designated trained regulators assigned to conduct the exam.

In terms of types of enforcement actions, in the United States each agency utilizes its own designation for the different types of actions, such as Matters Requiring Attention, Commitment Letter, Formal Agreements, Memorandum of Understanding, etc. One commonality between all

3 Source: FFIEC’s website - http://www.ffiec.gov/
agencies is the use of Cease and Desist Orders and Civil Money Penalties. When determined to be sufficiently critical, banking organizations may become subject to cease and desist orders, which require them to take actions and follow certain proscriptions or to Civil Money Penalties, which require them to pay fines. In both cases these orders become public.

The Brazilian Regulatory System

Regulation of the financial and capital markets in Brazil is the responsibility of three institutions: the National Monetary Council (CMN or Conselho Monetario Nacional), the Central Bank of Brazil (Banco Central) and the Securities Commission (CVM or Corretora de Valores Mobiliarios). The table below provides a brief explanation of each institution:

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<tr>
<td><strong>National Monetary Council</strong> (Conselho Monetario Nacional - CMN)</td>
<td>Its primary responsibilities include the formulation of monetary and credit policies, seeking stable currency and the economic and social development of the country. The Council also oversees financial institutions establishing rules and guidelines that must be followed both by the Central Bank and the Securities Commission related to audit and control.</td>
</tr>
<tr>
<td><strong>Securities Commission</strong> (Comissao de Valores Mobiliarios - CVM)</td>
<td>Capital markets in Brazil are monitored and regulated by the CVM, a Federal agency that is part of the Ministry of Finance. Among its principal responsibilities are the monitoring of organized over-the-counter markets (assets traded outside the Stock Exchange), publicly traded companies, stock exchange and futures markets, fund and equity administrators, among other functions.</td>
</tr>
<tr>
<td><strong>Central Bank of Brazil</strong> (Banco Central do Brasil - BCB)</td>
<td>The Central Bank of Brazil is responsible for implementing the policies established by the National Monetary Council (CMN). It is the duty of the entity to monitor the behavior of brokers and banks that operate in Brazil, supervise existing financial institutions, and to authorize the admission of new financial companies and monitor their financial transactions, both in the public and the private sector.</td>
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Note that other normative institutions exist for private pension funds and insurance – National Council of Private Insurance (CNSP) and National Council of Complementary Private Pension (CNPC), along with their regulatory entities – Superintendence of Private Insurance (Susep) and National Superintendence of Complementary Private Pension (Previc). These are not discussed in detail as they are not directly related to the banking system, which is the scope of this analysis.

Similar to the U.S. regulatory system, the examination approach in Brazil is risk-based. The Supervision Manual published by the Central Bank indicates that “the emphasis is now on

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evaluation of the risks and controls, substantiating an integrated and continuous process, encompassing activities focusing on the planning of Supervision and on the classification, monitoring and inspection of the supervision institutions”.

Two main types of supervision are carried out by the Central Bank: inspections and monitoring. The first relates to regular exams in order to assess in an objective manner the economic and financial situation of the institution and can be undertaken either at the institution’s own offices or remotely, when physical presence is not necessary. Monitoring is carried out in a continuous way and is complementary to inspections, with the objective of assessing the entity’s soundness, compliance with regulations and operational limits on an ongoing basis.

In Brazil, disciplinary instruments issued in response to irregular practices include Administrative Punitive Process (disciplinary action), Injunction Orders, Commitment Letters, and classification of the institution as “In Evidence”. Administrative Punitive Process can be issued in different forms, including warning, fine, suspension from the exercise of public service, incapacitation of the exercise of managerial positions, special regime of supervision and temporary impediment to practice audit activity (Central Bank has the authority to issue enforcement actions against audit firms as well). Limited information is made publicly available through Central Bank’s website.

Besides the regulatory enforcement system, one key institution in each country deserves to be mentioned when it comes to Money Laundering: FinCEN in the United States and COAF in Brazil. These agencies are both primarily charged with the responsibility to help their countries fight money laundering. FinCEN’s mission, according to its website is “to safeguard the financial system from illicit use and combat money laundering and promote national security through the collection, analysis, and dissemination of financial intelligence and strategic use of financial authorities”. Similarly, COAF, also according to its website, “plays a central role in the Brazilian anti-money laundering and countering the financing of terrorism system not only at the operational level but also at the policy level through its plenary council, which is comprised of representatives from all the responsible bodies and ministries that meet as needed”.

Regulatory systems and their contribution to actual enforcement

Differently from the US regulatory system, banking supervision in Brazil is concentrated within one institution, the Central Bank. A recent report issued in June 2012 by the International Monetary Fund (“IMF”) indicated that Brazil’s financial sector oversight and infrastructure were deemed strong, but with room for improvement. Some of the deficiencies noted included constraints on budgets and human resources. A similar recommendation had been issued in 2002 by IMF – review of the personnel hiring practices across different institutions of the public sector involved with the supervision of the financial system to improve the scope for attracting and retaining highly qualified personnel – which in 2012 was deemed partially implemented.

Although the number of financial institutions in Brazil is far below that of the United States (roughly 1,603 depository institutions in Brazil versus 6,259 insured commercial banks in the U.S. as of December 2011), a single regulatory body presenting deficiencies in human resources and hiring practices may not be fully prepared to handle enforcement demands in an efficient manner. Furthermore, an interview with a Central Bank representative revealed that the group responsible for Anti-Money Laundering enforcement is composed of a handful of examiners.

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7 All insured commercial banks in the United States per FFIEC’s Uniform Bank Performance Report tool - [http://www.ffiec.gov/UBPR.htm](http://www.ffiec.gov/UBPR.htm)
They are in charge of supervising all financial institutions throughout the country with regards to compliance with Anti-Money Laundering provisions. Although it was noted that other regulators may be asked to join their team during onsite inspections, the number of regulators with expertise on the subject of Money Laundering inside the only regulatory institution handling banking supervision in Brazil is deemed extremely low.

Audit Requirements Make a Difference

A review of legislative audit requirements shows how differently two countries can structure a regulatory environment.

Several differences in legislative approaches to audit requirements contribute to the strength of the US system and the weakness of the Brazilian system.

Emphasis on audit / independent testing per legislation

It appears that an independent audit of a financial institution’s Anti-Money-Laundering program seems to be a best practice standard in many parts of the world, but a big issue in the United States. FATF recommends that financial institutions’ anti-money laundering programs include an audit function to test the system (Recommendation 15)\(^8\). Additionally, FATF’s AML/CFT Methodology for Assessing Compliance indicates that financial institutions should be required to maintain an adequately resourced and independent audit function to test compliance\(^9\).

FATF is comprised of 36 members (34 countries and 2 regional organizations), of which both the United States and Brazil are part. It is only expected that both countries equally follow general recommendations. However, this is not what has been observed in practice. For a start, Brazil has only implemented its Anti-Money Laundering requirements in 1998, as opposed to the United States having implemented in the ‘70s. Having had years to mature, the US framework has grown into a program that offers more than just the various regulatory mandates. It offers insight as to what is expected from an examiner’s point of view. The 400- plus pages\(^10\) of the Federal Financial Institutions Examination Council (“FFIEC”) Examination Manual details not only every single area that financial institutions should expect to have examined upon a regulator’s visitation, but it also includes a specific section regarding independent testing, where auditing standards and expectations are set. Therefore, differently from Brazil and maybe some other countries around the world, the United States has placed a huge emphasis on the auditing of Anti-Money Laundering programs at financial institutions that appears to be helping the country combat such crimes. In the United States, auditing is considered one of the four main pillars for a successful AML program and the US AML industry has developed a routine practice of providing independent audits tailored in scope and cost to institutions throughout the spectrum of risk and size.

Regarding Brazil’s late implementation of AML requirements and consequently less detailed rules and instructions, when it comes to the independent testing aspect, the mere mention relates to customer file records (“dados cadastrais de clientes”), which is the equivalent of U.S.’s CIP.

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\(^9\) FATF Methodology for Assessing Compliance with the FATF Recommendations and the Effectiveness of AML/CTF Systems - [http://www.fatf-gafi.org/media/fatf/content/images/FATF%20Methodology%202013%20Feb%202013%20.pdf](http://www.fatf-gafi.org/media/fatf/content/images/FATF%20Methodology%202013%20Feb%202013%20.pdf)

\(^10\) Including appendices
requirements. The requirement is that verification tests be performed on customer file records on at least an annual basis.

To illustrate the lack of emphasis in audit per regulatory requirements, the following statement was extracted from Brazil’s Central Bank website. Note the absence of the referral to the audit function. Central Bank is responsible for enforcing AML laws in the Brazilian banking system.

“As one of the administrative authorities in charge of applying the Law 9.613/1998, the Central Bank of Brazil published a series of norms establishing that all financial institutions under its regulation must: keep their customers’ records updated; keep internal controls in order to verify either the appropriate customer's identification, the compatibility between the corresponding resources movements, the economic activity and financial capacity from the users of the national financial system; keep operations' records; inform operations or suspicious situations to the Central Bank of Brazil; promote training to their employees and; implement internal procedures to detect suspicious operations”.

AML audits, although a substantial part of the overall audit cycle for Brazilian financial institutions, do not appear to be as comprehensive and to produce results that are as useful as audits in the United States. This is mainly due to the fact that, as per regulatory requirement, only a single section of the program needs to be addressed. Why would a financial institution spend scarce resources on an internal or external audit when it is not required by regulators? So in practice, it appears that there are far more periodic independent audits in the U.S. than in Brazil.

U.S. examiners often ask for independent audit reports in order to assess the institution’s overall compliance program by examining deficiencies revealed, recommendations raised, as well as management’s follow-up actions in response to such. At the end of the day, the real matter is that, if there are compliance problems, the BSA Compliance Officer is unlikely to be the source of identifying and addressing them. So if not raised by auditors or independent parties who have performed tests, who else would help regulators identify such?

**Practical reliance by regulators**

It has been observed that there is a recent increase in US regulator’s expectation towards the work produced by auditors, and a tendency to utilize the work produced by them in their own examination of financial institutions. The idea is to decrease redundancy and repetition given that auditors and examiners should practically be following the same standards and working towards the same objective of ensuring that the organization’s compliance program is comprehensive and effective to prevent it from being used as a vehicle for money laundering, terrorism financing and related crimes.

Regulators are also interested in ensuring that institutions have effective audit programs in place from a governance perspective. Often times, the main source of information provided to senior management regarding the adequacy of compliance are audit reports. As they are not involved in day-to-day operations and in view of the fact that compliance programs can deteriorate rather quickly if controls are not well-designed and implemented, being attuned to the institution’s performance and adherence to the designed program is crucial. It also helps management emphasize the ‘tone at the top’ culture throughout the organization, since the more involved they

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are in understanding and quickly acting towards solving problems, the better the image they’ll send as a role model for the remainder of the organization. Effective oversight of the AML program by senior management is another fundamental component emphasized by regulators.

Examiners’ use of audit reports is directly proportionate to the extent to which they agree with the auditor’s overall work quality. In first instance, regulators will assess the thoroughness and findings of the internal audit as well as how effectively it tracks management’s corrective actions. This determines whether or not examiners will rely upon the audit group’s results. In case it was found thorough and appropriate by an examiner, the audit report will be used to focus on specific areas or lines of business according to audit results. If reports are not thorough, regulators will expand their scope of review and “re-do” the work themselves. Based on interviews conducted in Brazil with compliance professionals and regulators, this concept is similar in that country. The difference is that, since there are already flaws in legislature in terms of scope requirements, it is almost impossible for examiners at this point in time to rely on work done by auditors.

Having worked alongside examiners in the United States for the past ten years as a consultant providing specialized AML internal audit services for banks, I can affirm with a certain level of confidence that a successful audit in line with regulatory expectations has to address the following elements:

- Comprehensive assessment identifying risks and controls pertaining to AML requirements
- Adequately scoped and documented audit plan
- Determination of the adequacy of a program’s written policies and procedures
- Detailed risk-based testing of AML controls, including sample sizes, techniques and rationale
- Thorough work paper documentation
- Proper written and oral reporting of audit results to management and the board of directors
- Effective tracking and testing of management’s corrective actions
- Assigning auditors with appropriate skills, knowledge and experience

Of these, workpaper documentation is probably the most important of all, as it will “tell the story” about what was done, when, how, by whom and in which way. Workpapers will include all other elements and therefore the completeness of this item is a way to evidence the high standard of the audit process. A well-documented set of workpapers can save an institution from going through extensive regulatory scrutiny. Of course, this will only happen if the institution itself has undergone extensive analysis by its independent testing function. In other words, in no way will an institution escape from a complete examination. The question is – is it better to have it done by the independent audit function or by regulators?

It appears that Brazilian financial institutions are not yet at the point where they can make a choice for themselves. Brazilian regulators simply do not rely on the work done by auditors due to their lack of preparedness. In the United States, in contrast, it appears that auditors are not only becoming empowered and respected within their organizations, but also amongst regulatory bodies of the financial system. The reason, in my point of view, is the maturing of the internal audit profession and culture, which will be discussed in the following section.
Audit Culture Matters

Attitudes toward auditing translate to success or failure.

Just as there are significant differences in audit requirements between the U.S. and Brazil, differences in audit culture also have contributed to AML outcomes in these countries.

Corrective versus preventive approach and its impact on irregularities

Overall, auditors are not the most welcomed group of professionals in any organization. Even with their recent efforts towards improving and contributing to the achievement of company goals instead of acting as ‘police’, they are still feared and disliked.

There has been enormous changes in the practice and philosophy of internal auditing (further discussion about professional standards to follow), most of it falling under the principle of “value-added auditing”. However, at the end of the day, auditors are still looking at somebody’s work and judging it. Even when the focus is on performance or analysis of the system of controls, they are still looking for deficiencies, issues, and potential opportunities for improvement. That’s their job, their responsibility and their goal. The difference is that, in the old days that meant pointing out that something was wrong, or that they found a defect within the program. Nowadays, this means stating that the structure in place could look better. Is this such a bad thing?

So why not welcome the opportunity for improvement? Compliance professionals should work alongside audit teams to identify better and more efficient ways to address key issues. One way to do it is by employing their knowledge. Auditors are everywhere, in every single department of the company – and have certainly seen several different ways to accomplish things. Their exposure to the various different processes and understanding of how people tackle the solution of simple problems could well help compliance professionals solve their own. In my point of view, this is a win-win situation. Auditor jobs in line with a value-driven approach can only contribute to making compliance programs more useful as opposed to simply compliant.

In the past, auditors used to take a “gotcha” approach, which would in turn instigate corrective as opposed to preventive actions from management. Also, by acting as law enforcement, auditors who found little wrongdoing in the company’s operations usually decided to dig a little deeper to try to identify any signs of trouble, even if insignificant or immaterial. This ended up being an ineffective, lengthy and costly process for all parties involved. A “gotcha” approach may satisfy a narrow interpretation of accountability and wrongdoing – it helps ensure that what went wrong was uncovered. However, it does little in terms of value-added contribution that performance audits can provide to the enhancement of the overall program. Nobody particularly likes it when an auditor comes knocking, however, the idea of a more cooperative, collaborative approach to audits could make everyone happy at the end of the day.

When acting as police, auditors’ work results in corrective actions by management. Corrective actions, by definition, are reactive measures taken in response to issues. Uncovering problems after the fact and acting solely on fixing past mistakes is not what the audit profession of today’s world advocates for. Conversely, preventive actions, as the name already suggests, identifies in advance the actions that need to be taken to prevent that irregularities occur. This should be the true goal of an auditor and that’s when their contribution comes into play. Irregularities that may be uncovered by examiners, which could potentially result in fines or other types of enforcement actions, should be prevented and one way to identify such instances is by applying the value-added audit process
As mentioned above, it would focus on enhancements to the overall program. In simple words, corrective actions are reactions taken to a voice external to the process. Preventive actions are the proactive response to the quality guidelines set internally, hopefully with the input from your auditor.

There are plenty of those in the profession who still believe that an auditor's job is solely the cursory or “checklist” type. Others, especially newer professionals who are maturing in a different audit culture, realize that without adding value to the ‘customer’ (yes, auditees are in fact auditor’s customers), the work is harder. Today, the focus is ensuring that the system of internal controls is operating efficiently and effectively. This means testing the controls, not only the transactions. This perspective changed the whole scenario and is finally helping the audit profession gain its space within the business sphere.

Ultimately, how the audit process unfolds will be impacted by a.) the internal auditor’s mentality: “gotcha” versus supportive collaborator, and b.) compliance professional’s receptiveness to the auditor, since, by definition, collaboration requires equal involvement of both parties.

It appears that the more advanced the profession is in a certain country, the more likely the country is to be following best practice standards. The upcoming section discusses this topic.

**Preparedness of audit professionals: audit standards and continuing education**

Similar to many disciplines, internal auditors are guided by a professional organization. The IIA, Institute of Internal Auditors, is an association established in 1941 that advocates its value by promoting best practices, promulgating standards, providing education, and issuing professional certifications mainly to the internal audit and risk management communities. As an international organization, its outreach encompasses both the United States and Brazil. The Brazilian Chapter of the IIA was founded in 1960 and today it is considered the tenth biggest affiliate outside of the United States. For the purposes of this analysis, IIA’s standards are considered to be of equal value in both countries.

The IIA has issued Standards for the Professional Practice of Internal Auditing delineating basic principles for the profession and providing an auditing framework. The structure of the Standards is divided between Attribute and Performance Standards. *Attribute Standards* address the attributes of organizations and individuals performing internal auditing. *Performance Standards* describe the nature of internal auditing and provide quality criteria as basis for performance measurement. There are many important sections within the Standards and many are well aligned with regulatory requirements for the independent testing function described within FFIEC’s BSA Examination Manual. In particular, two Standards caught my attention as they tie back to the examination manual linked to another crucial pillar of the BSA/AML structure: training.

One of the key standards relate to the continuing professional development (*Standard 1230*). Internal auditors, per IIA Standards, need to undergo regular training. Training does not necessarily need to be specific to the subject matter that the professional focus on (e.g. IT or compliance); rather, it should be geared towards enhancing the auditor’s knowledge, skills, and other competencies. With regards to proficiency and due professional care (*Standard 1200*) the IIA indicates that in order to properly carry out their professional responsibilities, internal auditors should obtain appropriate professional certifications and qualifications.

In a certain way these two standards combined can be compared to the fourth pillar of the BSA compliance system: training. This requirement should not only be applicable to the personnel
involved with the program, but also to those auditing to make sure that it is well designed and operating effectively. Because in order to test, one needs to understand how it should work. Per FFIEC’s BSA Examination Manual: “Banks must ensure that appropriate personnel are trained in applicable aspects of the BSA. (...) At a minimum, the bank’s training program must provide training for all personnel whose duties require knowledge of the BSA. The training should be tailored to the person’s specific responsibilities”.

It is expected that a company’s policy with respect to competency should be to utilize experienced professionals with appropriate professional designations (e.g. CAMS for BSA/AML audits) to either perform internal audit work or to, at a minimum, provide adequate professional supervision and review practices to ensure the quality of internal audit services. Furthermore, internal audit professionals should be required to participate annually in an appropriate number of hours of specific training.

In the United States this ruling is enforced by examiners. Within the banking industry, examiners are accustomed to obtaining both resumes and/or bios describing the qualification of the audit professionals performing BSA audits, as well as proof of continuous training.

In researching the Brazilian regulations, it was noted that a Central Bank circular\(^{12}\) pertaining to the procedures to be adopted with regards to AML mentions training. Banks are expected to define the criteria and procedures for training of its employees. However, this guidance is very subtle and certainly far from being considered one of the basic pillars in the overall AML program.

The present study was not able to uncover whether or not the training rule is followed in Brazil. However, with regards to IIA’s standard relating to having a subject matter expert within the audit team, I can affirm, from a vantage point given my involvement in launching the Brazilian Chapter for ACAMS, that subject matter experts in BSA/AML in that country are scarce.

Once again, it appears that there is a gap between the United States and Brazil in terms of preparedness of audit professionals – at least in what pertains to overall requirements and enforcement.

**Measuring the Results**

**A by-the-numbers review of the success of each countries AML compliance efforts**

The differences in the way the U.S. and Brazil approach audit legislation and practice have yielded significant differences in the results these two countries have been able to achieve.

While acting as the central repository for suspicious activity reports and other relevant AML-related data, FinCEN and COAF make available certain information filed by financial institutions, as does other regulatory agencies. In order to better understand the differences and similarities between AML matters between Brazil and the United States, a number of comparative tables are included below, along with brief descriptions explaining the data provided. Further discussion and qualitative analysis is part of the conclusion section of this article.

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\(^{12}\) Circular is a norm produced in all levels of public administration in Brazil, through which the standardization of rules and procedures are defined and communicated to the interested parties. Brazil’s Central Bank issues Circulars providing its interpretation of rulemakings – almost the equivalent of a ‘Supervisory Guidance’ in the United States.
Table A: Suspicious Activity Reporting

The following table illustrates the difference in the number of suspicious activity reports (referred to in Brazil as “atypical operations”). Data has been obtained from FinCEN’s and COAF’s website for American and Brazilian numbers, respectively.

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>COAF</td>
<td>5,405</td>
<td>7,086</td>
<td>12,593</td>
<td>10,942</td>
<td>15,842</td>
<td>17,389</td>
<td>22,042</td>
<td>31,283</td>
<td>37,237</td>
<td>38,417</td>
</tr>
<tr>
<td>FinCEN</td>
<td>288,343</td>
<td>381,671</td>
<td>522,655</td>
<td>567,080</td>
<td>649,176</td>
<td>732,563</td>
<td>720,309</td>
<td>697,367</td>
<td>798,688</td>
<td>860,858</td>
</tr>
<tr>
<td>Difference</td>
<td>282,938</td>
<td>374,585</td>
<td>510,062</td>
<td>556,138</td>
<td>633,334</td>
<td>715,174</td>
<td>698,267</td>
<td>666,084</td>
<td>761,451</td>
<td>822,441</td>
</tr>
</tbody>
</table>

Note that in Brazil, financial institutions are required to communicate COAF when atypical situations are detected (equivalent to the Suspicious Activity Report). Additionally, the obligation also extends to certain operations, not necessarily atypical, defined by supervisors as mandatory reporting (automatic). One example is any cash transaction over R$100,000. The table above includes numbers related to atypical situations only, excluding cash transactions.

Table B: Administrative Processes in Brazil related to non-compliance with AML provisions.

The following is non-public data obtained confidentially from a Central Bank representative. Information relates specifically to AML.

<table>
<thead>
<tr>
<th>Administrative Punitive Process Year</th>
<th>Banks</th>
<th>Other Institutions</th>
<th>Total # of Administrative Punitive Processes</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>2002</td>
<td>0</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>2003</td>
<td>2</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>2004</td>
<td>0</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>2005</td>
<td>2</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>2006</td>
<td>6</td>
<td>1</td>
<td>7</td>
</tr>
<tr>
<td>2007</td>
<td>4</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>2008</td>
<td>2</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>2009</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>2010</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2011</td>
<td>1</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>2012</td>
<td>0</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>19</td>
<td>17</td>
<td>36</td>
</tr>
</tbody>
</table>

Table C: Civil Money Penalties and Cease & Desist Orders in the United States

The following table was compiled based on information provided by Banker’s Online website (http://www.bankersonline.com/security/bsapenaltylist.html#bsa2010) and includes information on monetary penalties assessed and C&D Orders imposed by FinCEN or federal and state financial institution regulators for deficiencies in BSA/AML programs.
<table>
<thead>
<tr>
<th>Year</th>
<th>Banks</th>
<th>Other Institutions</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>2002</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>2003</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>2004</td>
<td>2</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>2005</td>
<td>5</td>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>2006</td>
<td>6</td>
<td>5</td>
<td>11</td>
</tr>
<tr>
<td>2007</td>
<td>28</td>
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<td>2</td>
<td>11</td>
</tr>
<tr>
<td>2010</td>
<td>10</td>
<td>2</td>
<td>12</td>
</tr>
<tr>
<td>2011</td>
<td>4</td>
<td>3</td>
<td>7</td>
</tr>
<tr>
<td>2012</td>
<td>2</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>91</td>
<td>21</td>
<td>112</td>
</tr>
</tbody>
</table>

**Conclusion**

As previously mentioned, Brazil’s and U.S.’s anti-money laundering regulations emerged in very different timeframes and institutional setups. Consequently, such divergences ended up affecting the configuration, implementation and outcomes of these policies. Despite similarities such as customer information requirements and reporting obligations of financial institutions, the Brazilian legislation proves very incipient when compared to U.S. laws in the fight against money laundering.

Numbers clearly show a big difference in each country’s end result. In terms of suspicious activity reporting, one of the most important tools aiding investigations and prosecution of money laundering-related crimes in the United States, a notable difference is apparent – hundreds of thousands more SARs are produced in the U.S. than in Brazil (see Table A). Not only the number of suspicious activity reports is noticeably higher, but also the utilization of such data, which is expressively evident given the history of convictions resulting from money laundering in each country. The most recent FATF mutual evaluation of Brazil (in 2010) indicated that the overall number of final sentences and convictions pertaining to money laundering offenses was low given the size of the country and sophistication of its financial system.

AML regulatory enforcement in banks is also far stronger in the United States. The number of publicly available data pertaining to cease and desist orders and civil money penalties in the United States (Table C) is much higher when compared to instances of administrative punitive processes in Brazil (Table B). Administrative punitive processes are those applied by the Central Bank upon verification of infringement to legal or regulatory norms and can be in the form of warning, fine, suspension, etc. Data shown in Table B is non-public information and includes all AML-related problems in banks raised by the Central Bank over the years. When the total number of cease and desist and civil money penalty instances from 2004 through 2012 in the U.S. is calculated as a percentage of the number of institutions supervised (112 orders for 6,259 institutions) compared to Brazil’s administrative punitive processes totals over institutions supervised (28 for 1,603), the difference is minimal – 1.79% for the U.S. versus 1.75% for Brazil. This less significant difference may be explained by the fact that the publicly available U.S. data utilized in this study does not
encompass lesser severe cases. i.e. formal agreements, commitment letters, or memorandum of understandings between the institution and the regulatory agency.

FATF has also raised a number of concerns during their most recent mutual evaluation of Brazil in 2010. Similar issues were raised and had already been addressed by U.S. policies and practices back in 2006 when the United States’ mutual evaluation was conducted. Nowadays, after seven years have passed, it is safe to assume that current practices in the United States are even more forceful.

The strategies for the control of money laundering in the U.S and in Brazil are certainly qualitatively different. As previously mentioned, the lack of preparedness of audit professionals and specialization on AML matters in Brazil is probably reflective of an immature system. As with anything, time is needed for one to gain expertise, and being that the subject matter barely existed 14 years ago in Brazil, it is no surprise that professionals are still in the early stages of specialization. Discussions with a regulatory authority from the Central Bank, however, revealed a high level of expertise and proficiency on AML matters on the supervisory side. Brazilian regulators’ know-how is comparable to individuals considered highly skilled U.S. compliance experts. Capability levels on the regulatory side were also discussed with compliance professionals interviewed in Brazil and for the most part, their view of the work quality and expertise of examiners was positive. Generally speaking, it appears that Brazil’s AML enforcement system is equipped with qualitative supervisors, but limited workforce.

Interviews also revealed that a gap exists on the work performed by auditors, particularly ‘in-house’ auditors (as opposed to external auditors which are more likely to have specialization and higher level of expertise). Therefore, audits currently do not properly assist regulators in their mission of ensuring proper compliance across the banking industry. The concept of examiners relying on work done by competent auditors in order to more efficiently monitor the overall system is not yet a reality in Brazil.

Conversely, in recent years the audit has become increasingly scrutinized by regulators in the United States, meaning that there is a potential for reliance upon an institution’s independent testing by examiners. This would streamline the entire process and release examiners to oversee a broader range of institutions. As previously mentioned, although in Brazil auditing is required, it is not emphasized. Auditors lack knowledge and expertise, a fact that is recognized by both compliance professionals and regulatory authorities. In the end, it appears a lot needs to happen before Brazil reaches this ideal state, whereas in the United States, the phenomenon appears to already be taking place.

As a final note, I wanted to bring up a recent IMF review of Brazil’s financial system, published in June 2012. IMF concluded that a comprehensive legal framework and supervisory process was in place for Anti-Money Laundering. The analysis indicated that the Central Bank closely monitors compliance through a mix of offsite and onsite activities, including horizontal reviews by its specialized AML staff. I would argue that the first part of this conclusion is speculative. The supervisory process may be competent (although not as resourceful as it should be); however, I would not judge that the legal framework is comprehensive. To my point of view, there is no comparison on the treatment given to the crime of money laundering in the United States and Brazil. Although Brazil managed to create a national system of AML controls from scratch, such structure is deficient especially when it comes to what we in the United States call the main “four pillars” of an effective program. Because U.S. regulations consider auditing as one of the main pillars and oblige financial institutions to undergo periodic independent testing of their compliance programs, efforts to ensure compliance nationwide are strengthened.
To a bank considering doing business in Brazil, this may serve as an alert. While Directors tend to rest assured that an audit process is in place at the institution they are overseeing in the United States, even though not all issues may be uncovered as its effectiveness depend upon a number of factors, when venturing outside of this country such reliance may be weakened. The lack of prominence of AML audits in Brazil hinders the supervision process, not only from a regulatory point of view, but from a governance perspective as well. Auditors assist the Board in its responsibility for overseeing the quality and integrity of operations and its importance cannot be overlooked. At the end, all thoughts and differences considered, auditing is, in my point of view, the pillar that sets us apart.