



Finanšu izlūkošanas dienests  
*Financial Intelligence Unit of Latvia*

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**MONEY LAUNDERING AND TERRORISM  
FINANCING RISK ASSESSMENT REPORT OF  
PROFESSIONAL SERVICE PROVIDERS  
2017-2018**

RIGA

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# 1. Introduction

## THE NECESSITY FOR RISK ASSESSMENT

- 1.1. On 23<sup>rd</sup> of August, 2018 Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (Moneyval) published its Fifth Round Mutual Evaluation Report on Latvia, which includes an analysis of the effective regulatory framework and performance results during the Moneyval's expert visit on 8<sup>th</sup> of November, 2017<sup>1</sup>.
- 1.2. Consequently, following the Moneyval report, "Plan of Anti-Money Laundering and CounterTerrorism Financing Measures for the Period of Time till 31 December 2019" was approved on 11<sup>th</sup> of October, 2018 with the Cabinet of Ministers (hereinafter — the CoM) Order No 512 (hereinafter – the Action Plan)<sup>2</sup>. The objective of the Plan is to strengthen the capacities of Latvia to combat money laundering (hereinafter – ML), terrorism financing (hereinafter – TF) and proliferation and its financing, to mitigate the overall ML and TF risks, by ensuring conformity with the international commitments and standards in the field of anti-money laundering (hereinafter – AML) and countering the terrorism financing (hereinafter - CTF) and promoting the public safety, competitiveness of economic environment and confidence in jurisdiction of the Republic of Latvia. The measures contained in the Action Plan have been developed to reach the above mentioned objectives.
- 1.3. Taking into consideration the Second National Risk Assessment for 2013-2016 which recognised independent legal service providers, tax advisors and accounting service providers as high ML/TF risk srector, the Action Plan stipulates to draw up a report on the ML/TF risk assessment for the respective sector (hereinafter — the Report). The purpose of the Report is to promote the awareness of Latvian ML/TF policy makers, the Financial Intelligence Unit of Latvia (FIU Latvia), law enforcement authorities, the obliged entities under the Law on the Prevention of Money Laundering and Terrorism Financing (hereinafter — the AML/CTF Law), as well as any other interested persons regarding the risks of ML/TF associated with tax advisors, outsourced accountants, sworn auditors, the commercial companies of sworn auditors, sworn notaries, sworn advocates, other independent legal service providers (hereinafter — Professional Service Providers) and their operations in Latvia.

## RISK ASSESSMENT METHODOLOGY

- 1.4. Report was prepared for the period of 2017-2018 (hereinafter — Reporting Period).
- 1.5. FIU Latvia is the responsible authority for the preparation of this Report. The quantitative and qualitative information included in this Report was summarized and analyzed by the FIU Latvia, in collaboration with the State Revenue Service, the Latvian Association of Certified Auditors, the Latvian Council of Sworn Notaries, the Register of Enterprises and policy makers who are responsible for the monitoring of the respective sector — the Ministry of Finance and the Ministry of Justice; at the same time in the process of drawing up the Report discussions have been conducted with the Latvian Council of Sworn Advocates.
- 1.6. The Report is prepared using laws and regulations of the Republic of Latvia, reports and opinions, as well as international laws and regulations, guidelines and reports.
- 1.7. ML and TF threats, vulnerability and risk level of the obliged entities under the AML/CTF Law reviewed in the Report are arranged using a six-point assessment comparison system — "low", "medium low", "medium", "medium high", "medium high/high", "high". The higher the evaluation the higher the probability to be subjected to ML and TF. If the evaluation is "medium high/high", the overall risk level in the sector is high but at the same time, significant differences between the risk levels of different subjects of the sector, of which individual representatives have a medium or even low risk level, have been identified.

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<sup>1</sup> Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (Moneyval) Fifth Round Report on Latvia. Available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/Moneyval-Mutual-Evaluation-Report-Latvia-2018.pdf>

<sup>2</sup> Cabinet Order of 11 October 2018 No. 512 Regarding Planned Actions for Prevention of Money Laundering and Terrorism Financing until 31 December 2019. *Latvijas Vēstnesis*, 203 (6289), 15.10.2018 Available at: <https://m.likumi.lv/doc.php?id=302218>

## 2. Executive summary

- 2.1. Professional Service Providers whose activity is related to providing legal, financial or tax advice are among the major players in the commercial and financial world who facilitate transactions of economic significance. Thus, it is important that their services are not used for illegal purposes. Professional Service Providers also have to act with integrity and comply with requirements of laws and regulations and they should not be involved in criminal activities.
- 2.2. ML and TF are serious threats to public safety and well-being.
- 2.3. Considering that financial institutions have introduced relatively high-level ML/TF prevention measures, the risk for detecting potential criminal activities (especially, ML and TF) in financial institutions has increased. Sequentially, persons with intentions of ML/TF search for an expert — Professional Service Provider — to consult or provide services to them.<sup>3</sup>
- 2.4. The use of Professional Service Providers in ML is an internationally recognised ML method.<sup>4</sup> This is also evidenced by the observation of the FIU Latvia, that increasingly sophisticated business schemes, including sophisticated business structures and fictitious documentation prepared by professionals, are being used for the purposes of the ML.
- 2.5. Representatives of the professions concerned are referred to as gatekeepers because persons who wish to abuse legitimate financial systems and corporate entities for ML or TF purposes can use these specialists as an access point to the financial system. In this context, Professional Service Providers may, intentionally or unintentionally, provide advice and/or services which may facilitate ML or TF.<sup>5</sup>
- 2.6. The recommendations of the Financial Action Task Force<sup>6</sup> (supplemented in 2003) clearly state that legal professionals, tax advisors, as well as other obliged entities under the AML/CTF Law or Professional Service Providers covered in the Report have the obligation to conduct customer due diligence activities and provide suspicious activity reports. The competent authorities have the obligation to ensure that the respective persons are monitored for the purpose of ML and TF prevention.<sup>7</sup>
- 2.7. The Report provides informative summary and analysis of threats, vulnerabilities and the resulting risks in the sector of Professional Service Providers assessing them as follows:

Assessment of ML threats, vulnerabilities and risks and TF risks of Professional Service Providers				
Obliged entity	Level of threats	Level of vulnerability	ML risk	TF risk
Tax advisors	MH	MH/H*	MH/H*	L
Outsourced accountants	MH	MH/H*	MH/H*	L
Independent legal service providers	MH	MH/H*	MH/H*	ML
Sworn advocates	MH	MH/H*	MH/H*	L
Sworn notaries	MH	M	MH	ML
Sworn auditors	M	MH	MH	L

- 2.8. The Report concludes that the assessed obliged entities under the AML/CTF Law (Professional Service Providers) can be involved (or may be unintentionally involved) in ML/TF schemes due to the specific and extensive knowledge of the respective persons. These persons may be used to hide the origins of criminal proceeds and/or legitimise assets in a variety of ways, such as

<sup>3</sup> FATF Report: "Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals" June 2013. Available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20vulnerabilities%20legal%20professionals.pdf>

<sup>4</sup> Same as previous

<sup>5</sup> AUSTRAC. Strategic analysis brief: "Money laundering through legal practitioners". Available at: <http://www.austrac.gov.au/sites/default/files/sa-brief-legal-practitioners.pdf>

<sup>6</sup> An international inter-governmental Financial Action Task Force. Internationally recognised global FATF standards provide a framework of comprehensive and consequent measures which the states have to implement in order to combat money laundering and TF, as well as financing of proliferation of mass destruction weapons. FATF Recommendations set out an international standard that countries must implement by taking measures to ensure that the target is achieved in the specific circumstances.

<sup>7</sup> See FATF 40 Recommendations. Available at: <http://www.fatf-gafi.org/media/fatf/documents/FATF%20Standards%20-%2040%20Recommendations%20rc.pdf>

\* The overall risk level in the sector is high but some individual representatives have a medium or even low risk level

setting up companies and offshore company structures, producing fictitious contracts and other transaction documents professionally, preparing or auditing companies' annual reports, acquiring properties (including real estate), certifying economically irrational and unjustified contracts or establishing fictitious legal proceedings, etc. There is a possibility that Professional Service Providers may be unintentionally involved in ML/TF schemes due to a lack of knowledge in the field of ML/TF prevention and the ability of the relevant obliged entities under the AML/CTF Law to identify unusual and suspicious transactions can also be limited.

- 2.9. In addition, during the drawing up of the Report shortcomings in the regulatory framework of the sector were identified. Regarding the risks of fictitious legal proceedings, the need to supplement the regulatory framework with a reference was identified, providing that the exemption for reporting is not applicable to cases where the obliged entities under the AML/CTF Law suspects the veracity of proceedings (there is a suspicion that the process in question should be considered to be a fraudulent or fictitious). The need to clarify regulatory framework regarding the termination of business relations stipulated in Section 28 of the AML/CTF Law was also identified.
- 2.10. Also, the Report indicates the need to bring the issue of the AML/CTF Law's "subjectivity" regarding sworn notaries, sworn advocates and other independent legal service providers for further discussion, namely, whether it is justifiable to limit the performance of the duties of the respective obliged entities under the AML/CTF Law only to professional activities listed in Section 3, Paragraph one, Clause 4 of the AML/CTF Law.
- 2.11. At the same time, the Report concludes that the model of supervision of sworn auditors and the commercial companies of sworn auditors is ineffective, as the supervision of sworn auditors and the commercial companies of sworn auditors is implemented by both SRS and LACA. Namely, the professional services provided by sworn auditors and the commercial companies of sworn auditors are supervised by LACA, while consultations on taxes and outsourced accounting services — by SRS. Similar issues were identified within the supervision model of sworn advocates and independent legal service providers. Whereas the inspections carried out by supervisory and control authorities of Professional Service Providers, incl. the types and levels of penalties applied do not reach their preventive function. Also, the independence of LCSA and LACA and their capacity to carry out supervisory activities is debatable. However, it is stressed that the supervisory and control authorities of the Professional Service Providers have increased their capacity and awareness regarding ML and TF risks.

## 3. Legal framework

- 3.1. According to Article 3 of the AML/CTF Law, obliged entities under the AML/CTF Law, *inter alia*, are persons performing an economic or professional activity — tax advisors, outsourced accountants, sworn auditors and commercial companies of sworn auditors, sworn notaries, sworn advocates, other independent legal service providers.
- 3.2. It must be stressed that in accordance with the applicable regulatory framework sworn notaries, sworn advocates, and other independent legal service providers are considered as the obliged entities under the AML/CTF Law only when they, acting on behalf of their client, assist in the planning or execution of transactions, participate therein or carry out other professional activities related to the transactions for their client concerning the following:
  - 3.2.1. purchasing and selling of real estate, shares of a commercial company capital,
  - 3.2.2. managing of the clients's money, financial instruments and other funds,
  - 3.2.3. opening or managing of all kinds of accounts in credit institutions or financial institutions,
  - 3.2.4. establishment, management or provision of operation of legal persons or legal arrangements, as well as in relation to the making of contributions necessary for the establishment, operation or management of a legal person or a legal arrangement.<sup>8</sup>
- 3.3. This regulatory framework is in line with FATF 40 Recommendations.<sup>9</sup>

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<sup>8</sup> Law on the Prevention of Money Laundering and Terrorism Financing. Latvijas Vēstnesis, 116 (3900), 30.07.2008; Latvijas Republikas Saeimas un Ministru Kabineta Ziņotājs, 16, 28.08.2008 — Section 3, Paragraph one, Clause 4

<sup>9</sup> See FATF 40 Recommendations (Recommendations 22 and 23). Available at: <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf>

- 3.4. At the same time, it should be noted that, in accordance with the FATF Recommendations, the requirements for the prevention of ML/TF regarding Professional Service Providers, are applicable only to employees in the companies of the Professional Service Providers. Namely, the requirements do not apply to professionals who are employed in companies or state institutions as internal service providers.<sup>10</sup> Respective FATF Recommendation is also implemented in the regulatory framework of the Republic of Latvia. Section 3 of the AML/CTF Law specifies the prerequisites that the person shall be deemed as the obliged entity under the AML/CTF Law if the person is performing an economic or professional activity in the specific field.
- 3.5. However, shortcomings in the regulatory framework can be identified in Section 30 of the AML/CTF Law, where an exception to the reporting obligation is declared, providing that the reporting obligation stipulated in the AML/CTF Law<sup>11</sup> does not apply to Professional Service Providers when they defend or represent their customers in pre-trial criminal proceedings or court proceedings, or provide an advice on the initiation or avoidance of court proceedings, except in the field of prevention of ML and TF.
- 3.6. Section 30 of the AML/CTF Law does not contain a reference to a list of professional activities which would limit the reporting obligation as it was in Section 3 of the AML/CTF Law. Taking into consideration the aforementioned, it is possible to draw a conclusion that the reporting obligation of sworn notaries, sworn advocates and other independent legal service providers is not limited to the professional activities listed in Section 3, Paragraph one, Clause 4 of the AML/CTF Law.
- 3.7. This regulatory framework, in theory, is consistent with the FATF 40 Recommendations<sup>12</sup>, since FATF Recommendation 23 provides that the reporting obligation for suspicious transactions is limited to professional activities, but in particular the activities listed in Section 3, Paragraph one, Clause 4 of the AML/CTF Law. However, the AML/CTF Law provides for a reporting obligation to be extended to a wider range of activities, the only exception being where the relevant obliged entities under the AML/CTF Law defend or represent clients in pre-trial criminal proceedings or court proceedings or advise on the initiation or avoidance of court proceedings, except in the field of money laundering and terrorism financing.
- 3.8. It should be noted that, in theory, such regulatory framework is in line with the FATF Recommendations, namely that Professional Service Providers should report suspicious transactions where the relevant information is obtained in circumstances where the persons concerned are subject to the requirements of client secrecy or professional secrecy<sup>13</sup>. However, there is no clear justification why this exemption is extended to representatives of non-regulated professions, i.e. tax advisors, outsourced accountants and other independent legal service providers.
- 3.9. It must be noted that it is not clear, whether it is justifiable to limit the "subjectivity" of the AML/CTF Law of sworn notaries, sworn advocates and other independent legal service providers only to the professional activities listed in Section 3, Paragraph one, Clause 4 of the AML/CTF Law. As a result of requirements in the respective regulatory framework, dishonest obliged entities under the AML/CTF Law may be given the opportunity to simply avoid the performance of their obligations under the AML/CTF Law by hiding the true type of services provided. Accordingly, the relevance of the requirements of the AML/CTF Law to sworn notaries, sworn advocates and other independent legal service providers should be put up for further discussions.
- 3.10. It should also be noted that, in theory, the "subjectivity" preconditions stipulated in the AML/CTF Law result in a situation where the obliged entities of the AML/CTF Law listed in Section 3, Paragraph one, Clause 4 of the AML/CTF Law do not need an internal control system if one of the professional activities listed in Section 3, Paragraph one, Clause 4 of the AML/CTF Law is not provided, since Section 6 of the AML/CTF Law provides for an obligation to carry out risk assessment and establish an internal control system only for the obliged entities under the AML/CTF Law. However, such interpretation of the regulatory framework would be seen as debatable from the point of view of supervisory and control authorities.

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<sup>10</sup> <https://www.fatf-gafi.org/glossary/d-i/>

<sup>11</sup> Law on the Prevention of Money Laundering and Terrorism Financing. Latvijas Vēstnesis, 116 (3900), 30.07.2008; Latvijas Republikas Saeimas un Ministru Kabineta Ziņotājs, 16, 28.08.2008 — Section 30, Paragraph one

<sup>12</sup> See FATF 40 Recommendations (Recommendation 23). Available at: <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf>

<sup>13</sup> FATF Report: "Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals", June 2013. Available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20vulnerabilities%20legal%20professionals.pdf>

- 3.11. At the same time, confusion in the context of the regulatory framework, but in particular the professional activity stipulated in Section 3, Paragraph one, Clause 4 of the AML/CTF Law, is also caused by the Cabinet Regulation No. 674 Regarding the List of Unusual Transaction Indications and the Procedures for Submitting Reports on Unusual or Suspicious Transactions. Paragraph 5.6.1 of the mentioned regulation stipulates that sworn notaries must submit a report on an unusual transactions which correspond to the following characteristic: in the case of inheritance, the heir, when submitting a list of the property to be inherited with an assessment of the property, has indicated a non-registerable movable property (including cash) in the composition of the mass of the inheritance which is equivalent to EUR 15,000 or more. This characteristic imposes an obligation to sworn notaries to submit reports to FIU Latvia in inheritance cases, however, inheritance cases are not included in the list of Section 3, Paragraph one, Clause 4 of the AML/CTF Law.
- 3.12. The FATF emphasises that the proceedings are not a process covered by the FATF Recommendations and the courts thus far have recognised that the exclusion of the relevant processes from the reporting obligation is important in order to protect the fundamental rights of people to access the court. However, the Court of Appeal of England stated that although the proceedings should be exempted from the reporting requirements, such an exception should not apply to fraudulent or fictitious proceedings in order to avoid abuse of judicial proceedings with the purpose of avoiding the reporting obligation.<sup>14</sup>
- 3.13. The proceedings could be considered to be fraudulent or fictitious if the subject of the dispute is established fictitiously, for example, if there is no actual debt and the funds transferred are simply the transfer of criminal proceeds from one person to another.<sup>15</sup> Such a ML scheme was identified globally in the "Russian Laundromat"<sup>16</sup> case (see Annex 1 for more detail).
- 3.14. The regulatory framework should be supplemented by providing that the reporting exemption does not apply to cases where the obliged entities under the AML/CTF Law defends or represents client in pre-trial criminal proceedings or court proceedings, or advises on the initiation or avoidance of court proceedings, and the obliged entities under the AML/CTF Law suspects the veracity of proceedings (that is, there is a reasonable suspicion that the proceedings in question should be considered to be a fraudulent or fictitious process and used for ML or TF purposes). The purpose of such proceedings is to transfer the criminal proceeds from one person to the other as quickly as possible, while acquiring a legitimate basis for the transfer of funds, namely a court judgement. It should be noted that the use of fraudulent proceedings in money laundering is a worldwide ML typology.<sup>17</sup>
- 3.15. FIU Latvia in its practice has also identified a case which is possible associated with the aforementioned ML scheme.

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#### Case analysis No. 1

In 2018, FIU Latvia received a report on a law firm of sworn advocates named "X" in relation to possible fraud scheme and ML. The non-cash funds of the law firms "X" client — person A — were deposited at Latvian credit institution which had seized the respective funds for an indefinite period of time (during in-depth investigation period). Aware of the potentially negative results of the due diligence conducted by the credit institution, person A referred to the law firm "X" for assistance.

The report received by the FIU Latvia stated the following:

1. law firm "X" drew up essentially fictitious invoices for services provided to person A;
2. acts on the recovery of funds from person A in favour of the law firm "X" have been issued on the basis of the documents in question (possibly, legal proceedings);
3. the acts have been submitted to the Latvian credit institution with the purpose to ensure the transfer of funds as a result of fraudulent activities.

At the same time, public records were found that identify similar fraudulent cases that have occurred in Moldova and Russian where fraudulent collection of debt through the court for ML purposes took place (to find legal grounds for further transferring of funds of dubious origin). Criminal proceedings have been initiated for this case and currently it is heard in the court.

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<sup>14</sup> See FATF 40 Recommendations (explanatory note of Recommendation 23). Available at: <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf>

<sup>15</sup> FATF Report: "Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals", June 2013. Page 69. Available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20vulnerabilities%20legal%20professionals.pdf>

<sup>16</sup> More information available, for example, here: <https://www.rise.md/english/the-russian-laundromat/>

<sup>17</sup> Legal Sector Affinity Group "Anti-money laundering: Guidance for the Legal Sector", March 2018. Available: [www.sra.org.uk/documents/solicitors/freedom.../money-laundering.pdf](http://www.sra.org.uk/documents/solicitors/freedom.../money-laundering.pdf)

- 3.16. In the context of regulatory framework, attention should also be paid to customer due diligence obligations stipulated in the AML/CTF Law. Section 11 of the AML/CTF Law stipulates the obligation to conduct customer due diligence. Paragraph seven of Section 11 stipulates that in case the obliged entity under the AML/CTF Law is unable to apply the customer due diligence measures specified in this Law, it is prohibited for the obliged entity under the AML/CTF Law to establish or continue the business relationship (business relationship it is a subject to termination) and to execute an individual transaction with the relevant person or legal arrangement. Meanwhile, Paragraph eight of the same Section stipulates that the aforementioned provisions shall not apply to Professional Service Providers in cases when they defend or represent a customer in pre-trial criminal proceedings or court proceedings, or provide advice on the commencement of the court proceedings or avoidance thereof.
- 3.17. It must be noted that such regulatory framework is not in line with FATF Recommendations. This is also mentioned in Moneyval Fifth Round Mutual Evaluation Report identifying that: "The obligation to terminate business relationship does not apply to sworn advocates, sworn notaries, other independent legal service providers and accountants (tax advisors) if they are not able to acquire the customer due diligence information and documents stipulated in the AML/CTF Law in cases when they defend or represent a client in pre-trial criminal proceedings or court proceedings, or provide advice on the commencement of the court proceedings or avoidance thereof, thus clearly derogating from the exception defined by the FATF, which would only apply to suspicious transaction reports."<sup>18</sup>
- 3.18. The above mentioned exceptions stipulated in the AML/CTF Law indicate that these exceptions should be referred to all of the Professional Service Providers described in the Report, however, there is no regulatory grounds for extending such exceptions to all listed obliged entities under the AML/CTF Law. Namely, the regulatory framework that provides for a possibility to apply the aforementioned exceptions to such obliged entities under the AML/CTF Law as independent legal service providers or tax advisors, should be assessed critically, since, unlike sworn advocates or sworn auditors, the prohibition of information disclosure stipulated in the AML/CTF Law and regulations does not apply to them.

## 4. Assessment of ML threats

- 4.1. ML/TF vulnerability, threats and risks of Professional Service Providers in the Updated Latvian National ML/TF Risk Assessment Report of 22<sup>nd</sup> of June, 2018, are assessed as follows:<sup>19</sup>

Assessment of ML and TF threats, vulnerabilities and risks of Professional Service Providers			
Obliged entity	Level of vulnerability	Level of threats	ML/TF risk
Tax advisers	MH	ML	M
Outsourced accountants	MH	ML	M
Independent legal service providers	MH	ML	M
Sworn advocates	M	ML	M
Sworn notaries	ML	ML	ML
Sworn auditors	ML	ML	ML

- 4.2. When assessing the shortcomings identified in the Moneyval report in the sector concerned and going through the sectoral risk assessments prepared by the supervisory and control authorities of Professional Service Providers, the need to carry out a reassessment of the vulnerabilities, threats and ML and TF risk levels of Professional Service Providers was identified.
- 4.3. As mentioned before, the use of Professional Service Providers in ML is an internationally recognised ML method.<sup>20</sup> This is also demonstrated by the findings of FIU Latvia revealing that

<sup>18</sup> Fifth Round Report on Latvia of 23 August 2018 of the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (Moneyval) of the Council of Europe. Available at: [http://kd.gov.lv/images/Downloads/useful/MONEYVAL2018\\_5th-Round\\_MER-Latvia.pdf](http://kd.gov.lv/images/Downloads/useful/MONEYVAL2018_5th-Round_MER-Latvia.pdf)

<sup>19</sup> Explanation of units: M — medium; MH — medium high; ML — medium low.

<sup>20</sup> FATF Report: "Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals" June 2013. Available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20vulnerabilities%20legal%20professionals.pdf>

more complex transaction schemes are being used for the purposes of ML, including, more complex business structures, professionally-drafted fictitious transaction documents, as well as other comparable features.

- 4.4. Consequently, a part of services provided by the obliged entities under the AML/CTF Law that are reviewed in the Report is attractive to persons with ML purposes, thus Professional Service Providers may be unintentionally involved in the committing of criminal offences.
- 4.5. The FATF also stated in its 2018 report "Professional Money Laundering" that criminals use third-party ML services, including advocates and accountants. The Report states that criminals generally use Professional Service Providers to establish corporate structures and that the services provided to criminals by accountants are particularly necessary because of the wide range of skills that accounting service providers possess.<sup>21</sup> It should be added that professional ML service providers are involved in ML schemes on a large scale.<sup>22</sup>
- 4.6. The use of Professional Service Providers for ML purposes is also mentioned in the United States national risk assessment.<sup>23</sup>
- 4.7. It is important to stress that Professional Service Providers have the opportunity to identify ML attempts prior any other obliged entity under the AML/CTF Law because the services they offer are used before carrying out any other criminal actions (for example, establishing of a company, consultations on taxes, etc.).
- 4.8. As to the sector's impact on the financial system of the Republic of Latvia, it must be noted that it is not important to specify the type or the amount of the fee paid for services that are carried out between Professional Service Providers and their clients. Financial impact of respective sectors on the scope of ML and financial system in general should be assessed based on the total amount of the transactions within the ML scheme and which services of the respective specialists are being used. For example, sworn advocate draws up documents for the formation of several legal entities and the respective entities are used for ML. In this case, instead of the amount of the advocate's remuneration (fee), the amount of legalised criminal proceeds should be assessed in relation to which the legal entities registered by the help of sworn advocate are involved. However, measuring the scope of such transactions is almost impossible. By analysing and studying ML and TF methods that can involve legal professionals, FATF also points out one specific issue — many services that criminals choose to use in facilitating ML are services that are used for legal purposes on daily basis.<sup>24</sup>
- 4.9. According to the Updated Latvian National ML/TF Risk Assessment Report of 22<sup>nd</sup> of June, 2018, the factors that present the most significant non-financial sector threats are:
  - 4.9.1. criminal offences that are carried out on a large scale and/or in an organised group;
  - 4.9.2. tax offences and fraud.<sup>25</sup>
- 4.10. During the Reporting Period, the most significant ML threat to the non-financial sector is partly in line with those identified during the previous period, but at the same time, attention should also be paid to the effect of the following factors:
  - 4.10.1. dishonest professionals in the sector who can potentially facilitate ML, e.g. criminals can use the services of sworn advocates and other legal professionals to obstruct and/or interfere with law enforcement investigations;<sup>26</sup>
  - 4.10.2. criminals may use representatives of the sector in order to conceal the origins of criminal proceeds and/or to legitimise assets in different ways, e.g. by establishing companies and offshore company structures, by drawing up fictitious contracts and other transaction documents, preparing or auditing companies' annual reports;

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<sup>21</sup> FATF Report: "Professional Money Laundering", July 2018. Available at: <http://www.fatf-gafi.org/media/fatf/documents/Professional-Money-Laundering.pdf>

<sup>22</sup> FATF Report: "Professional Money Laundering", July 2018. Available at: <http://www.fatf-gafi.org/media/fatf/documents/Professional-Money-Laundering.pdf>

<sup>23</sup> U.S. Treasury. NATIONAL MONEY LAUNDERING RISK ASSESSMENT 2018. Available at: [https://home.treasury.gov/system/files/136/2018NMLRA\\_12-18.pdf](https://home.treasury.gov/system/files/136/2018NMLRA_12-18.pdf)

<sup>24</sup> FATF Report: "Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals", June 2013. Available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20vulnerabilities%20legal%20professionals.pdf>

<sup>25</sup> The Updated Latvian National ML/TF Risk Assessment Report of 22 June 2018. Available at: [http://kd.gov.lv/images/Downloads/useful/NRA\\_LV\\_FINAL.pdf](http://kd.gov.lv/images/Downloads/useful/NRA_LV_FINAL.pdf) Section 1.4.39, Page 15.

<sup>26</sup> See also: AUSTRAC. Strategic analysis brief: "Money laundering through legal practitioners". Available at: <http://www.austrac.gov.au/sites/default/files/sa-brief-legal-practitioners.pdf>

- 4.10.3. criminals can use sworn advocates, sworn notaries and other legal professionals to use criminal proceeds and purchase properties (including real estate);<sup>27</sup>
  - 4.10.4. criminals can use sworn notaries to certify economically irrational and unjustified contracts (for example, transactions closed at a price which clearly does not correspond to market value) which later can be used for criminal proceeds integration;
  - 4.10.5. criminals can use sworn advocates and other Independent legal service providers to establish fictitious legal proceedings;<sup>28</sup>
  - 4.10.6. representatives of the sector can be used for their status, thus making fictitious transaction seem more legitimate.
- 4.11. In turn, criminal offence methods used to carry out ML in non-financial sector are the following:
- 4.11.1. transfers to shell companies and transactions that are not actually occurring;
  - 4.11.2. investments in real estate and movable property;
  - 4.11.3. intentional/unintentional involvement of respective professions for the drawing up of documents with the purpose to legalise criminal proceeds, for example, drawing up and/or certifying transaction documents;
  - 4.11.4. provision of professional consultations which intentionally or unintentionally facilitates ML.<sup>29</sup>
- 4.12. Pursuant to the Report, the threat level of Professional Service Providers reviewed in the Report should be assessed as follows:

Obligated entity	Level of threats
Tax advisors	MH
Outsourced accountants	MH
Independent legal service providers	MH
Sworn notaries	MH
Sworn advocates	MH
Sworn auditors	M

## 5. Assessment of ML vulnerabilities

- 5.1. On the basis of the circumstances described and analysed in the Report and the following considerations, the vulnerability of Professional Service Providers is assessed as follows:

Obligated entity	Level of vulnerability
Tax advisors	MH/H*
Outsourced accountants	MH/H*
Independent legal service providers	MH/H*
Sworn advocates	MH/H*
Sworn auditors	MH
Sworn notaries	M

- 5.2. When assessing the vulnerability of Professional Service Providers, attention must be paid to the following factors:
- 5.2.1. insufficient knowledge of obliged entities under the AML/CTF Law on ML and TF;
  - 5.2.2. inability to identify suspicious or unusual transactions (and submit reports);
  - 5.2.3. services that can be provided remotely pose a risk of anonymity;
  - 5.2.4. insufficient customer due diligence and transaction monitoring (including inability to conduct complete customer due diligence);
  - 5.2.5. respective professionals may be unintentionally (due to lack of knowledge) involved in ML and TF schemes, thus facilitating ML and TF;

<sup>27</sup> See, for example. The Updated Latvian National ML/TF Risk Assessment Report of 22 June 2018. Available at: [http://kd.gov.lv/images/Downloads/useful/NRA\\_LV\\_FINAL.pdf](http://kd.gov.lv/images/Downloads/useful/NRA_LV_FINAL.pdf) 4.5.229 – Page 59

<sup>28</sup> FATF Report: "Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals" June 2013. Available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20vulnerabilities%20legal%20professionals.pdf>

<sup>29</sup> FATF Report: "Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals" June 2013. Available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20vulnerabilities%20legal%20professionals.pdf>

\* The overall risk level in the sector is high but some individual representatives have a medium or even low risk level

- 5.2.6. weak or non-existent supervision of Professional Service Providers;
- 5.2.7. as regards to the obliged entities under the AML/CTF Law under supervision of the State Revenue Service (hereinafter — SRS) — weak or non-existent control of the commencement of activity<sup>30</sup>, including inability to identify the existing obliged entities under the AML/CTF Law.
- 5.3. The Supranational Risk Assessment Report on ML and TF of the European Commission states that tax advisors, providers of outsourced accounting and legal services mainly get involved in ML activities that are related to consulting on the purchase of real estate, establishing of shell companies or other legal entities by helping in specific legal proceedings. In addition, it mentions that legal service providers are involved in ML schemes.<sup>31</sup>
- 5.4. Regarding the obliged entities under the AML/CTF Law covered by the Report, it should be noted that, by simplifying the requirements of the AML/CTF Law, they have two basic obligations in the field of prevention of ML and TF, namely 1) to conduct customer due diligence<sup>32</sup>, and 2) to report unusual and suspicious transactions<sup>33</sup> (the procedures for carrying out the relevant duties should be laid down in the internal control system). Accordingly, in order to analyse the quality of customer due diligence, the Report assesses the checks performed by the supervisory and control authorities of the obliged entities under the AML/CTF Law, while the reporting obligation, including the ability to identify suspicious and unusual transactions, is assessed by the number of reports received by FIU Latvia.
- 5.5. In a view of the fact that the threat, vulnerability and risk factors of Professional Service Providers covered by the Report are largely the same, the Report assesses the threats, vulnerabilities and risks of Professional Service Providers all together, however the following chapter of the Report sets out vulnerability factors that are different for the listed obliged entities under the AML/CTF Law, including but not limited to the control of the commencement of activity, the aforementioned inspections and reporting results of the respective supervisory and control authorities.
- 5.6. As regards to the ability of Professional Service Providers to conduct complete customer due diligence, it must be noted that the representatives of non-financial sector struggle to identify customers — politically exposed persons. This is due to the fact that there is not a single and reliable database or register available. Whereas paid databases used by representatives of financial sector are not available for representatives of non-financial sector (due to high costs). Thus, currently the identification of politically exposed persons is based solely on the knowledge of each individual obliged entity under the AML/CTF Law or the validity of the information provided by the client.
- 5.7. At the same time, it should be noted that the representatives of non-financial sector struggle with identifying the beneficial owners of the clients which can be done only in publicly available paid databases, as well as by using other public information.<sup>34</sup>
- 5.8. Attention should also be paid to the fact that significant risks in the activities of tax advisors (except for sworn auditors), outsourced accountants and independent legal service providers are caused by the possibility of providing services to anonymous clients, without having to specify the circumstances of the case.
- 5.9. It is equally important to emphasise that the control of the initial commencement of activity of obliged entities under the AML/CTF Law supervised by SRS (except for sworn auditors) is insufficient. Currently, there are universal control mechanisms for commencement of activity of obliged entities under the AML/CTF Law supervised by SRS, which are equally applicable to all legal entities and clearly cannot be assessed as sufficient. This is also mentioned in the Moneyval Fifth Round Report on Latvia.<sup>35</sup> There is also a risk of the inability to identify obliged entities under the AML/CTF Law that should be supervised by SRS. This is due to the fact that the identification of the respective obliged entities under the AML/CTF Law is possible only by NACE2 classification code specified by the performers of economic activity<sup>36</sup>.

<sup>30</sup> The factor does not apply to sworn advocates, sworn notaries, sworn auditors

<sup>31</sup> Supranational Risk Assessment Report on Money Laundering and Terrorism Financing of the European Commission. Available at: [https://ec.europa.eu/newsroom/just/item-detail.cfm?item\\_id=81272](https://ec.europa.eu/newsroom/just/item-detail.cfm?item_id=81272)

<sup>32</sup> Law on the Prevention of Money Laundering and Terrorism Financing. Latvijas Vēstnesis, 116 (3900), 30.07.2008; Latvijas Republikas Saeimas un Ministru Kabineta Ziņotājs, 16, 28.08.2008 — Section 11. Obligation to conduct customer due diligence

<sup>33</sup> Law on the Prevention of Money Laundering and Terrorism Financing. Latvijas Vēstnesis, 116 (3900), 30.07.2008; Latvijas Republikas Saeimas un Ministru Kabineta Ziņotājs, 16, 28.08.2008 — Section 30 Reporting obligation

<sup>34</sup> For example, Lursoft, Firmas.lv, Crediweb, Companies House.

<sup>35</sup> Fifth Round Report on Latvia of 23 August 2018 of the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (Moneyval) of the Council of Europe. Available at: [http://kd.gov.lv/images/Downloads/useful/MONEYVAL2018\\_5th-Round\\_MER-Latvia.pdf](http://kd.gov.lv/images/Downloads/useful/MONEYVAL2018_5th-Round_MER-Latvia.pdf)

<sup>36</sup> See <https://www.vid.gov.lv/lv/saimnieciskas-darbibas-pamatdarbibas-veidu-janorada-atbilstosi-nace-kodam>

## STATE REVENUE SERVICE

- 5.10. On 31<sup>st</sup> of December, 2018, there were 2571 tax advisors, 7282 outsourced accountants, 3039 independent legal service providers under the supervision of SRS.<sup>37</sup> However, it must be noted that there are several thousands of other obliged entities under the AML/CTF Law that are supervised by the SRS, for example, persons engaged in the trade of precious metals, precious stones and articles thereof.<sup>38</sup>
- 5.11. The supervision of the obliged entities under the AML/CTF Law is carried out by the Anti-Money Laundering Board (hereinafter — AMLB) at the SRS which is under the authority of the Director-General of SRS. AMLB has 23 employees (Transaction Monitoring Division — 15 employees, Methodological Support and Risk Analysis Division — 8 employees). SRS AMLB is a structural unit that is created to monitor the compliance with the requirements of the AML/CTF Law and its employees have extensive knowledge on the prevention of ML/TF. It must be stressed that during the Reporting Period SRS has considerably increased its capacity, knowledge and supervisory measures in the field of ML/TF prevention.

## Tax advisors

- 5.12. Tax consultations often are provided in a general form, without specifying actual circumstances, involved companies, the scope of services/products. Which, in turn, makes it difficult to identify, whether the respective consultations are being used for tax evasion purposes.<sup>39</sup> Considering the in-depth knowledge of professionals in these sectors on laws and regulations and economics, there is a risk that they may be used, including intentionally, for ML purposes.<sup>40</sup>
- 5.13. Criminals may use tax advisors in order to conceal the origins of criminal proceeds and/or to legitimise assets in different ways, e.g. by establishing companies and offshore company structures, by providing fictitious contracts and other transaction documents, preparing or auditing companies' annual reports. Accordingly, considering the in-depth knowledge of tax advisors on laws and regulations and economics, there is a risk that the consultations may be used for ML and tax evasion purposes.
- 5.14. Regards the aforementioned lack of control for commencement of activity, it must be noted that currently anyone can become a tax advisor (by registering economic activity). A person who has violated provisions stipulated in laws and regulations, including the AML/CTF Law or any other regulations providing for ML/TF prevention. Thus, the regulatory framework should be supplemented with, for example, provisions prohibiting persons who have violated the AML/CTF Law to provide tax consulting services (or other services stipulated in the AML/CTF Law).
- 5.15. The Latvian Tax Consultant Association has adopted the Code of Conduct<sup>41</sup>, which is binding only to the members of the mentioned association, however the participation in the Latvian Tax Consultant Association is voluntary. By introducing control mechanisms for the commencement of activity for tax advisors (for example, mandatory licensing process), it would provide for uniform compliance with the ethical standards of professionals in the respective sector, as well as with the requirements of ML and TF.
- 5.16. Supervisory and control authority of tax advisors — SRS — also points out that tax advisors have insufficient requirements for starting their activity and that the introduction of licensing requirements is necessary. Currently, the aforementioned services can be provided by any performer of economic activity who has been registered at the Register of Enterprises of the Republic of Latvia. The requirements for the commencement of activity stipulated in the AML/CTF Laws and regulations are insufficient and do not provide for inspections on the compliance of the subjects with the requirements of the AML/CTF Law.<sup>42</sup>
- 5.17. Regarding the ability of tax advisors to identify suspicious or unusual transactions, it must be noted that FIU Latvia received 1 report from respective sector in 2017, and no reports in 2018. This clearly indicates a critical failure to identify suspicious or unusual transactions and submit reports on suspicious activities. SRS has also reached the same conclusion.<sup>43</sup>

<sup>37</sup> Taking into consideration that one taxpayer may pursue several types of economic activity, the distribution of taxpayers by subject groups is informative.

<sup>38</sup> Risk assessment of money laundering of the obliged entities under the AML/CTF Law on the Prevention of Money Laundering and Terrorism Financing under the supervision of the State Revenue Service.

<sup>39</sup> The Updated Latvian National ML/TF Risk Assessment Report of 22 June 2018. Available at: [http://kd.gov.lv/images/Downloads/useful/NRA\\_LV\\_FINAL.pdf](http://kd.gov.lv/images/Downloads/useful/NRA_LV_FINAL.pdf), 4.5.245.punkts, 60.lpp.

<sup>40</sup> The Updated Latvian National ML/TF Risk Assessment Report of 22 June 2018. Available at: [http://kd.gov.lv/images/Downloads/useful/NRA\\_LV\\_FINAL.pdf](http://kd.gov.lv/images/Downloads/useful/NRA_LV_FINAL.pdf) 4.5.244. Page 60.

<sup>41</sup> Available at: <http://www.lnka.lv/index.php?menu=9&lang=1>

<sup>42</sup> Risk assessment of money laundering of the obliged entities under the AML/CTF Law on the Prevention of Money Laundering and Terrorism Financing under the supervision of the State Revenue Service.

<sup>43</sup> Same as previous

5.18. In 2018, SRS carried out 125 supervisory measures of the tax advisors:

Number of supervisory measures for tax advisors under SRS supervision			
2017		2018	
On-site inspections	Off-site inspections	On-site inspections	Off-site inspections
0	0	72	53

- 5.19. As a result of supervisory measures carried out, SRS stated that the most common violations identified were the following:
- 5.19.1. the lack of a ML and TF risk assessment also leaves impact on the adequacy and effectiveness of the establishment and application of the internal control system. It was identified that the internal control system has been purchased and is actually not applied;
  - 5.19.2. shortcomings for assessing client's ML and TF risks. Insufficient understanding about client's activity, structure of owners, transaction monitoring;
  - 5.19.3. shortcomings in customer due diligence, failure to identify the beneficial owners. A formal completion of customer questionnaires is often identified where the information is not documented;
  - 5.19.4. identified suspicious transactions that were to be reported by the obliged entities under the AML/CTF Law but they failed to do so.<sup>44</sup>
- 5.20. Penalties for the identified violations in the field of ML and TF SRS started to introduce on 1<sup>st</sup> of July, 2018. In the first half of 2018, however, when violations were identified, obliged entities under the AML/CTF Law were given consultations and information required to comply with the requirements of the AML/CTF Law based on SRS's "consult first" principle, as well as a period of time to eliminate the identified non-compliance with the purpose to raise awareness and knowledge of the requirements of the AML/CTF Law. Since 1<sup>st</sup> of July, 2018, SRS has imposed the following penalties<sup>45</sup>:

Imposed penalties by SRS to tax advisors for the violation of ML/TF requirements in 2018				
Warning	Warning and a fine (number of cases)	A fine (number of cases)	A fine (amount in EUR)	Decision on termination of activity
1	7	6	1660	1

- 5.21. When assessing the scope of penalties imposed by SRS, it must be noted that the penalties are not severe enough to serve as a preventive measure that would deter from further infringements. SRS is the only institution allowed to impose penalties to tax advisors for violations in ML and TF fields. The failure for the penalties to function as a preventive measure is also demonstrated by the number of reports received by FIU Latvia, namely, after the inspections carried out and penalties imposed by SRS, the number of reports submitted during the reporting period has not increased.

### Outsourced accountants

- 5.22. Similar to tax advisors, outsourced accounting services can also be provided by anyone who has registered economic activity at the Register of Enterprises of the Republic of Latvia or SRS tax payer register. Outsourced accounting service providers or outsourced accountants do not have any requirements imposed for education or professional qualifications. Thus, similar to tax advisors, the regulatory framework should be supplemented with provisions limiting accounting services if specific qualification criteria are not met. SRS which is the supervisory and control authority for outsourced accountants has already started such initiative.
- 5.23. Code of Conduct has been develop that is binding to outsourced accounting service providers who are members of the Association of Accountants of the Republic of Latvia.<sup>46</sup> However, the participation in the mentioned association is voluntary and the Code of Conduct is not binding to all representatives of this profession. Moreover, the only penalty that can be imposed for not complying with the rules of conduct is exclusion of the association/organisation which may not be effective enough for promoting compliance with the rules of conduct.

<sup>44</sup> Risk assessment of money laundering of the obliged entities under the AML/CTF Law on the Prevention of Money Laundering and Terrorism Financing under the supervision of the State Revenue Service.

<sup>45</sup> Information on the obliged entities under the AML/CTF Law on the Prevention of Money Laundering and Terrorism Financing under the supervision of SRS and the imposed penalties is available here: [https://www.vid.gov.lv/sites/default/files/06\\_02\\_info\\_par\\_subjektam\\_piemerotajam\\_sankcijam.pdf](https://www.vid.gov.lv/sites/default/files/06_02_info_par_subjektam_piemerotajam_sankcijam.pdf)

<sup>46</sup> Available at: <http://www.lrga.lv/sertifikacija/gramatvedibas-profesijas-vertibas-un-pamatprincipi>

- 5.24. During the Reporting Period, SRS has carried out supervisory measures for over 828 outsourced accountants:

Number of supervisory measures for outsourced accountants under SRS supervision			
2017		2018	
On-site inspections	Off-site inspections	On-site inspections	Off-site inspections
3	582	152	91

- 5.25. SRS (supervisory and control authority of outsourced accountants) has stated that during the performance of supervisory measures there are many cases of outsourced accountants identified where they provide services to legal entities with accounts in other countries, for example, in Lithuania, Czech Republic, Poland, Russia whose beneficial owners are residents of third countries. Also, there are many cases when the outsourced accountants are helping non-residents (natural persons) to register economic activity in Latvia, thus helping them become a legal entity — a resident by opening an account in Latvian credit institutions and providing them a leasing service for a registered address. Often in such cases, the actual economic activity is not performed in Latvia, but financial reports are submitted and tax payments are made, and transfers to the accounts of related companies in other countries are ensured.
- 5.26. Also, as a result of supervisory measures SRS has concluded that outsourced accountants create close cooperation with clients which is based on personal contact. Therefore, outsourced accountants have some difficulties to report about their clients' suspicious transactions, even if they are obvious.
- 5.27. Such findings of SRS, as well as the lack of knowledge of critical industry representatives in the field of ML/TF are also confirmed by the number of reports received by FIU Latvia. Namely, FIU Latvia did not receive any reports from outsourced accountants in 2017, while in 2018 FIU Latvia received 22 reports. It must be noted that only 2 outsourced accounting companies have submitted reports in 2018 and only 1 (total of 22 reports) was used in the documents sent to the law enforcement agencies.

Number of reports submitted to FIU Latvia by outsourced accountants	
2017	2018
Number of submitted reports	Number of submitted reports
0	22

- 5.28. Since 1<sup>st</sup> of July, 2018, SRS has imposed penalties to outsourced accounts 22 times, namely, giving 4 warnings, 15 fines and in 3 cases decisions on termination of activity was taken. SRS stated that in certain cases the obliged entities under the AML/CTF Law supervised by the SRS have tried to avoid having on-site inspections and do not cooperate with the supervisory authority. In such cases SRS suspend the company's activity denying the possibility to continue to perform economic activity which may have violated the requirements of the AML/CTF Law.

Imposed penalties by SRS to outsourced accountants for the violation of ML/TF requirements in 2018				
Warning	Warning and a fine (number of cases)	A fine (number of cases)	A fine (amount in EUR)	Decision on termination of activity
4	19	15	7980	3

- 5.29. SRS has concluded that the majority of penalties have been imposed in the field of outsourced accounting which is not surprising taking into consideration that it is the largest sector in which the largest amount of on-site inspections are being carried out.
- 5.30. At the same time, SRS draws attention to a positive trend — it seems that the administrative penalties are starting to achieve their objective — the criminal is punished and precedent for violation prevention is set.<sup>47</sup>
- 5.31. However, the preventive nature of the respective penalties should be assessed very carefully taking into consideration that the penalties are imposed starting only from 1<sup>st</sup> of July, 2018. The effectiveness of preventive function of the penalties can be assessed at the repeated inspections of the obliged entities under the AML/CTF Law by analysing, whether the imposed penalty refrains the obliged entities under the AML/CTF Law from committing further or repeated violations.

<sup>47</sup> Risk assessment of money laundering of the obliged entities under the AML/CTF Law on the Prevention of Money Laundering and Terrorism Financing under the supervision of the State Revenue Service.

## Independent legal service providers

- 5.32. Legal services can be provided by any performer of economic activity who has been registered at the Register of Enterprises or SRS tax payer register as a performer of economic activity. In theory, legal education is needed in order to provide legal services, however, in practice it has been observed that legal services are provided by commercial companies whose employees do not have law degrees. No criteria have been introduced for the commencement of the specified economic activity, nor do licensing requirements exist.
- 5.33. Independent legal service providers may offer and do offer clients wide range of services. Legal services may be used both separately by concluding an agreement for legal services and together with accounting and tax consultation services which are described above. However, as it was specified before, as opposed to the providers of accounting services and tax advice, independent legal service providers are deemed to be obliged entities under the AML/CTF Law only if specific services are being provided<sup>48</sup>.
- 5.34. Regarding aforementioned, SRS believes that it is possible for independent legal service providers to avoid compliance with the requirements of the AML/CTF Law by indicating that legal advice is provided, which does not include any of the four services listed in Section 3, Paragraph one, Clause 4 of the AML/CTF Law.
- 5.35. Considering that legal service providers also provide outsourced accounting services and tax advice at the same time, these service providers may be both members of the Association of Accountants of the Republic of Latvia and Latvian Tax Consultant Association, who are bound by the relevant association's Code of Conduct. However, the participation in the associations is voluntary and the Code of Conduct is not binding to all representatives of the profession. Moreover, the only penalty that can be imposed for not complying with the rules of conduct is exclusion of the association or organisation which may not be effective enough for promoting compliance with the rules of conduct.<sup>49</sup>
- 5.36. During the Reporting Period, SRS has carried out supervisory measures for 357 independent legal service providers:

Number of supervisory measures of independent legal service providers carried out by SRS			
2017		2018	
On-site inspections	Off-site inspections	On-site inspections	Off-site inspections
1	196	82	78

- 5.37. As a result of the respective supervisory measures, since 1<sup>st</sup> of July, 2018, SRS has imposed the following penalties to independent legal service providers: 1 warning, 6 fines and in 3 cases decision on termination of activity has been taken.

Imposed penalties by SRS to independent legal service providers for the violation of ML/TF requirements in 2018				
Warning	Warning and a fine (number of cases)	A fine (number of cases)	A fine (amount in EUR)	Decision on termination of activity
1	7	6	4,960	3

- 5.38. SRS concluded that professionals in the sector concerned have insufficient understanding of suspicious and unusual transactions, thus very low number of reports has been submitted, as well as the lack of knowledge and competence of employees responsible for the enforcement of the AML/CTF Law does not provide an opportunity to identify unusual and/or suspicious transactions in all cases. SRS also has concluded that Professional Service Providers have difficulties to report about their clients because often they have been in business relationship for years.
- 5.39. This is also confirmed by the fact that no reports submitted by independent legal service providers have been identified in FIU Latvia during the Reporting Period. It demonstrates serious lack of knowledge in the respective sector.
- 5.40. It must be noted that under the parallel reporting system according to Section 22.2 of the Law on Taxes and Duties, the SRS received 8 reports from independent legal service providers in

<sup>48</sup> Law on the Prevention of Money Laundering and Terrorism Financing. *Latvijas Vēstnesis*, 116 (3900), 30.07.2008; *Latvijas Republikas Saeimas un Ministru Kabineta Ziņotājs*, 16, 28.08.2008 — Section 3, Paragraph one, Clause 4

<sup>49</sup> Risk assessment of money laundering of the obliged entities under the AML/CTF Law on the Prevention of Money Laundering and Terrorism Financing under the supervision of the State Revenue Service.

2018. However, the number of submitted reports indicates serious issues regarding the ability to identify unusual and/or suspicious transactions.

- 5.41. Within the framework of supervisory measures, SRS has stated that, among other things, the following reasons for the inability to identify unusual or suspicious transactions have been recognised:
- 5.41.1. formal application (or absence) of internal control system procedures;
  - 5.41.2. low levels of qualification for employees;
  - 5.41.3. insufficient monitoring of clients and their transactions by the responsible employee which also might be due to the fact that the functions of the responsible employee is performed by a person who is the manager of the company and who also works on attracting clients.<sup>50</sup>
- 5.42. In addition to the obliged entities under the AML/CTF Law reviewed in the Report, Section 3 of the AML/CTF Law also lists service providers for establishing and ensuring activity of legal arrangements or legal entities. It should be noted that ML/TF threats, vulnerabilities and risks of these obliged entities under the AML/CTF Law are to be assessed identically as the risks of independent legal service providers considering that professional activity of both sectors in practice overlaps.

### LATVIAN COUNCIL OF SWORN ADVOCATES

- 5.43. As of 31<sup>st</sup> of December, 2018, under the supervision of the Latvian Council of Sworn Advocates (hereinafter — LCSA) there were 1369 sworn advocates and assistants of sworn advocates, including 19 advocates from European Union (hereinafter — the EU) Member States.<sup>51</sup>
- 5.44. The Latvian Collegium of Sworn Advocates (hereinafter — the LCSA) performs the functions of a supervisory and control authority for sworn advocates under the AML/CTF Law. LCSA consists of 9 Council Members who are elected at the General Meeting of Sworn Advocates. The fact that LCSA Council Members are not a subject to additional requirements for knowledge in the field of ML/TF prevention should be looked at critically - all they need to comply with are the requirements for general knowledge of the rights and duties of advocates in ML and TF prevention which are applicable to all sworn advocates. Also, there is no separate structural unit in LCSA responsible only for ML/TF issues.

### Sworn advocates

- 5.45. Part of services provided by sworn advocates may be attractive to criminals who want to conceal the origin of proceeds derived from crime. There is a risk that sworn advocates may be unintentionally involved and/or used in ML, e.g. in the preparation of documents necessary for transactions, establishment of legal structures which allow to conceal the origin of criminal proceeds and/or beneficial owners.<sup>52</sup> Also, criminals may use the advantages of sworn advocates' status, by authorising a representative of the profession to act in client's interests, e.g. to buy real estate. At the same time, sworn advocates may be unintentionally used in fictitious proceedings.<sup>53</sup> In practice, cases have been identified where employees of law firms provide services acting as nominee owners / members of the governing bodies of client companies.
- 5.46. In 2018, LCSA carried out the process of identifying legal aid provided by 1369 sworn advocates. According to the results of the identification process of legal aid provided by sworn advocates, mentioned advocates can be classified as follows:
- 5.46.1. 23.1 % of all sworn advocates at their main place of practice provide legal aid only in courts and criminal proceedings, thus they fall under the lowest risk category;
  - 5.46.2. 32.1 % of all sworn advocates at their additional place of practice provide legal aid only in courts and criminal proceedings, thus they fall under the lowest risk category;
  - 5.46.3. 28.7 % of all sworn advocates at their main place of practice provide legal aid mainly in courts and criminal proceedings, but partially also in transactions;
  - 5.46.4. 23.1 % of all sworn advocates at their additional place of practice provide legal aid mainly in courts and criminal proceedings, but partially also in transactions;
  - 5.46.5. 21.4 % of all sworn advocates at their main place of practice provide legal aid in courts, criminal proceedings, and transactions equally;

<sup>50</sup> Risk assessment of money laundering of the obliged entities under the AML/CTF Law on the Prevention of Money Laundering and Terrorism Financing under the supervision of the State Revenue Service.

<sup>51</sup> Sectoral risk assessment of the Latvian Collegium of Sworn Advocates as of 31 December 2018

<sup>52</sup> The Updated Latvian National ML/TF Risk Assessment Report of 22 June 2018. Available at: [http://kd.gov.lv/images/Downloads/useful/NRA\\_LV\\_FINAL.pdf](http://kd.gov.lv/images/Downloads/useful/NRA_LV_FINAL.pdf) 4.5.228 — Page 59

<sup>53</sup> See more. FATF Report: "Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals", June 2013. Available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20vulnerabilities%20legal%20professionals.pdf>

- 5.46.6. 18.3 % of all sworn advocates at their additional place of practice provide legal aid in courts, criminal proceedings, and transactions equally;
  - 5.46.7. 22.3 % of all sworn advocates at their main place of practice provide legal aid mainly in transactions, but partially also in courts and criminal proceedings;
  - 5.46.8. 17.2 % of all sworn advocates at their additional place of practice provide legal aid mainly in transactions, but partially also in courts and criminal proceedings;
  - 5.46.9. 4.5 % of all sworn advocates at their main place of practice provide legal aid only in transactions, thus they fall under the highest risk category;
  - 5.46.10. 9.3 % of all sworn advocates at their additional place of practice provide legal aid only in transactions, thus they fall under the highest risk category.<sup>54</sup>
- 5.47. Contrary to the obliged entities under the AML/CTF Law supervised by SRS, i.e. tax advisors, outsourced accountants and independent legal service providers, sworn advocates have strict requirements for commencement of activity. The existence of such requirements and control reduces the risk of involvement in ML/TF schemes by these professionals.
- 5.48. According to Section 34, Clause 1 of the Advocacy Law, LCSA competence includes to take a decision regarding the admission and inclusion of sworn advocates and assistants to sworn advocates<sup>55</sup>, the exclusion, suspension or dismissal of sworn advocates and assistants to sworn advocates, as well as the suspension of the activities of individual sworn advocates and assistants to sworn advocates.
- 5.49. Sections 14 and 15 of the Advocacy Law specify high demands regarding education, experience and reputation for persons who want to become a sworn advocates, incl. persons need to have a faultless reputation; persons cannot be declared suspects or the accused in criminal proceedings regarding committing an intentional criminal offence; sworn advocates cannot be persons against whom the criminal proceedings regarding committing an intentional criminal offence have been terminated for reasons other than exoneration; sworn advocates cannot be persons who have been convicted for committing an intentional criminal offence regardless of extinguishing or setting aside the criminal record, and other requirements, as well as persons must pass the advocate examination. Only Doctors of Law are exempted from the advocate examination.<sup>56</sup>
- 5.50. It is important to note that in order to pass the examination of sworn advocates or assistants to sworn advocates, the applicant must be familiar with the rights and duties of advocates in ML and TF prevention.
- 5.51. Regardless of aforementioned, the number of reports received by FIU Latvia demonstrates the lack of knowledge of sworn advocates in the field of ML/TF and serious issues in identifying suspicious or unusual transactions and submitting reports on suspicious activities. During the Reporting Period, sworn advocates submitted 6 reports. The number of reports demonstrates a negative tendency in comparison to the Second National Risk Assessment for 2013-2016 which identified that the monitoring and effectiveness of the reporting of unusual and suspicious transactions by sworn advocates during the relevant Reporting Period is moderate. During the Reporting Period, sworn advocates had submitted reports about 142 suspicious transactions.

Number of reports submitted to FIU Latvia by sworn advocates	
2017	2018
Number of submitted reports	Number of submitted reports
6	0

- 5.52. In addition to aforementioned control mechanisms for commencement of activity, the Code of Conduct of Sworn Advocates of Latvia is binding to all sworn advocates.<sup>57</sup> In accordance with Section 73 of the Advocacy Law, sworn advocates shall assume disciplinary liability, including the debarring from the numbers of sworn advocates, if the professional rules of conduct have been violated. At the same time, it must be pointed out that no such cases have been identified during the Reporting Period, however, criminal proceedings have been initiated about a possible involvement in fraud and ML by a sworn advocates office.

<sup>54</sup> Same as previous

<sup>55</sup> The procedure of admission and inclusion of sworn advocates is stipulated by Sections 39-41, 41<sup>1</sup>, 41<sup>2</sup>, 41<sup>3</sup>, 42-47 of the Advocacy Law.

<sup>56</sup> Sectoral risk assessment of the Latvian Collegium of Sworn Advocates as of 31 December 2018

<sup>57</sup> Available at: <http://www.advokatura.lv/lv/dokumenti-par-advokaturas-jautajumiem/radit/23/>

In 2017, FIU Latvia received a report on a sworn advocate named X in relation to possible abuse of their powers and ML. The report received by FIU Latvia explains information and suspicions related to possible fictitious seizure of real estate involved in insolvency proceedings. Due to the decision on the forced sale of the real estate concerned, the first auction of the sale of the property was announced, in which the real estate was purchased by SIA A for EUR 150,000. One month after the closing of the auction, an assignment agreement was concluded between the sworn advocate X — LSIA B insolvency administrator and SIA C, in which it was agreed to transfer all the rights of claim to real estate of LSIA B to SIA C. The assignment agreement was drawn up one day prior the aforementioned auction, while the signatures thereof were certified by a notary one day after the auction.

Criminal proceedings have been initiated for this case and currently under examination.

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- 5.53. It must be noted that contrary to SRS, LCSA has not carried out supervisory measures during the Reporting Period and accordingly no penalties have been imposed for failure to comply with the requirements of the AML/CTF Law or for violations. The aforementioned indicates to serious shortcomings within the supervisory process of sworn advocates.<sup>58</sup> However, LCSA pointed out that they performed an unplanned on-site inspection in 2018 based on a complaint received about a sworn advocate regarding a possible case of ML which was not confirmed during the inspection.
- 5.54. At the same time, attention must be paid to the fact that LCSA could not be considered as a completely independent supervisory institution in ML/TF prevention. Namely, in accordance with provisions of Section 22 of the Advocacy Law of the Republic of Latvia, the funds of the Latvian Collegium of Sworn Advocates shall consist of the sums paid in accordance with the procedure and amount specified by the Latvian Council of Sworn Advocates for the membership in the Latvian Collegium of Sworn Advocates. It follows from the above that the supervisory measures carried out by LCSA are financed by the payments of supervised subjects of the AML/CTF Law, which clearly indicate the lack of independence of LCSA and the likelihood that supervisory measures could be carried out in a biased manner.
- 5.55. In the circumstances considered, reforms in the framework for the implementation of the supervision of sworn advocates and independent legal service providers would be necessary, possibly by placing supervision of the obliged entities under the AML/CTF Law at the disposal of one supervisory authority.

### **LATVIAN COUNCIL OF SWORN NOTARIES**

- 5.56. As of 31<sup>st</sup> of December, 2018, under the supervision of Latvian Council of Sworn Notaries (hereinafter — LCSN) there were 99 sworn notaries.<sup>59</sup>
- 5.57. Similar to sworn advocates, in accordance with the regulatory framework, namely Section 3, Paragraph one, Clause 4 of the AML/CTF Law, sworn notaries shall be considered an obliged entity under the AML/CTF Law only when carrying out specific activities. When interpreting the specific activities in relation to the rights and obligations of sworn notaries stipulated in the Notariate Law, sworn notaries shall be considered to be obliged entity under the AML/CTF Law:
- 5.57.1. by making notarial deeds or private transaction projects in accordance with Section 116, Paragraph four of the Notariate Law regarding the purchase or sale of immovable property, shares of a commercial company capital;
  - 5.57.2. by accepting bailment within the meaning of Section 65, Clauses 3 and 3<sup>1</sup>, namely, management of a client's money, financial instruments, and other funds;
  - 5.57.3. by providing other legal aid within the meaning of Section 66, Paragraph one, Clause 4 of the Notariate Law, namely, establishment, management or provision of operation of legal persons or legal arrangements.<sup>60</sup>
- 5.58. When preparing the sectoral risk assessment of sworn notaries, LCSN has concluded that in general, only 1 % (one percent) of notarial activities performed in 2018 are referable to the duties specified in Section 3, Paragraph one, Clause 4 of the AML/CTF Law, but it is important to emphasise that, when assessing mentioned 1 % of notarial activities, based on the amount of

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<sup>58</sup> Even before the Reporting Period there were shortcomings identified within the supervisory process of sworn advocates. See the Updated Latvian National ML/TF Risk Assessment Report of 22 June 2018. Available at: [http://kd.gov.lv/images/Downloads/useful/NRA\\_LV\\_FINAL.pdf](http://kd.gov.lv/images/Downloads/useful/NRA_LV_FINAL.pdf) 8.4.5 — Page 136

<sup>59</sup> Risk assessment of the activities of sworn notaries of the Latvian Council of Sworn Notaries.

<sup>60</sup> Risk assessment of the activities of sworn notaries of the Latvian Council of Sworn Notaries.

transactions, they represent 29.78 % of the total amount of all transactions concluded at the sworn notary.<sup>61</sup>

- 5.59. The Chamber of Sworn Notaries of Latvia (hereinafter – CSNL) performs the functions of a supervisory and control authority for sworn notaries under the AML/CTF Law. CSNL consists of 9 Council Members who are elected at the General Meeting of Sworn Notaries. CSNL Council Members do not have any requirements imposed for knowledge in the field of ML and TF prevention. There is no separate structural unit in CSNL responsible only for ML/TF issues, however, there is one responsible lawyer appointed whose duties include dealing with issues regarding the field of ML/TF.

### Sworn notaries

- 5.60. Sworn notaries may be used to certify economically irrational and unwarranted transactions, including contracts in transactions concluded at a price which clearly does not correspond to market value (for example, in cases where in addition to the amount indicated in the transaction for real estate extra payment is done outside the notary office by means of cash or means of unknown origin), as well as to certify fictitious transactions, thus giving the impression of a real transaction.<sup>62</sup> There is also risk that sworn notaries may be used in real estate fraud schemes or to certify fictitious contracts.
- 5.61. Similar to sworn advocates, sworn notaries have strict requirements for commencement of activity – the profession of sworn notaries is regulated very strictly. Laws and regulations prescribe a specified number of sworn notaries, educational criteria, examination procedures, regular and extraordinary qualification examinations, professional activity insurance, the remuneration amount, the geographical location of positions, internal control systems and the procedures for providing individual services and transaction inspections. In addition, the number of sworn notary positions during the current state's economic activity is limited to 125 positions, as the principle of *numerus clausus* is an essential part of the notary system, which means that the number of notary positions is re-evaluated and determined according to the needs of the state and society. Meanwhile, for violations of the Notariate Law and rules of conduct they assume disciplinary liability.
- 5.62. It should be noted that CSNL has not imposed any penalties to sworn notaries for violating the AML/CTF Law during the Reporting Period. However, the number of reports received by FIU Latvia shows a negative change in the ability of sworn notaries to identify unusual and suspicious transactions – in 2017 twice as many reports were received as in 2018. At the same time, the number of notaries who submitted reports has reduced. Namely, there were 28 sworn notaries who submitted reports to FIU Latvia in 2017, but in 2018, there were only 18. However, the statistics show a positive tendency if compared to the number of reports submitted during the Second National Risk Assessment reporting period, namely, FIU Latvia received 25 suspicious transaction reports from sworn notaries in the respective Reporting Period.

Number of reports submitted to FIU Latvia by sworn notaries	
2017	2018
Number of submitted reports	Number of submitted reports
75	37

- 5.63. Positive side should be highlighted, namely, unlike any other obliged entity under the AML/CTF Law assessed in the Report, a sworn notary provides a notary service only and solely in the presence of a client – it is not possible to receive the services of sworn notaries without the personal presence of the client, anonymously or through an agent.
- 5.64. It must be stated that services that are similar to certain services provided by sworn notaries, such as certifying a signature on a request for corroboration, may also be received in the Orphan's and Custody Court, which is not an obliged entity under the AML/CTF Law.<sup>63</sup> Taking into consideration the aforementioned, an assessment should be carried out whether the

<sup>61</sup> A total of 570,070 notarial activities have been carried out in 2018 (in 2017 – 600,725), including the certification of authenticity of the signature and the capacity to act for corroboration to the Land Registry Office – 107,477 (in 2017 – 113,197) and the certification of authenticity of the signature and the capacity to act on the documents to be submitted to the Register of Enterprises – 24,268 (in 2017 – 25,356), but the duties set out in Section 3, Paragraph one, Clause 4 of the AML/CTF Law were applicable to 5,889 (in 2017 – 7,027) activities, which represent only 1 % of all the notarial activities, while 29 % of the total amount of transactions made at sworn notaries is subject to the control of rule of law in the field of ML/TF. See LCSN sectoral risk assessment.

<sup>62</sup> The Updated Latvian National ML/TF Risk Assessment Report of 22 June 2018. Available at: [http://kd.gov.lv/images/Downloads/useful/NRA\\_LV\\_FINAL.pdf](http://kd.gov.lv/images/Downloads/useful/NRA_LV_FINAL.pdf) 8.5.4 and 8.5.5 – Page 138.

<sup>63</sup> Law on Orphan's Courts. Latvijas Vēstnesis, 107 (3475), 07.07.2006; Latvijas Republikas Saeimas un Ministru Kabineta Ziņotājs, 15, 10.08.2006 – Section 61

Orphan's and Custody Courts should be included in the list of obliged entities under the AML/CTF Law, or the functions carried out by the Orphan's and Custody Courts should be reviewed by possibly removing the notary activities.

### **LATVIAN ASSOCIATION OF CERTIFIED AUDITORS**

- 5.65. As of 31<sup>st</sup> of December, 2018, under the supervision of the Latvian Association of Certified Auditors (hereinafter — LACA) there were 169 sworn auditors and 124 commercial companies of sworn auditors.<sup>64</sup>
- 5.66. LACA performs the functions of a supervisory and control authority for sworn auditors under the AML/CTF Law. LACA is managed by a Board of 7 sworn auditors who are elected at the General Meeting. Taking into consideration that the elected Members of the Board are professionals in the field, they are required to possess general knowledge in the field of ML/TF as any other sworn auditor. At the same time, it should be noted that there is no separate structural unit in LACA responsible only for ML/TF issues during the Reporting Period, however, there is an employee in LACA who specialises in ML/TF field.<sup>65</sup>
- 5.67. It is important to mention that according to the existing practice sworn auditors and commercial companies of sworn auditors who provide tax advice and outsourced accounting services are supervised simultaneously by 2 supervisory institutions, namely LACA and SRS. SRS supervises sworn auditors in regards to provided tax consultations and outsourced accounting services. Thus, the professional services provided by sworn auditors and the commercial companies of sworn auditors are supervised by LACA, while consultations on taxes and outsourced accounting services — by SRS.
- 5.68. This is clarified by Section 45, Paragraph two of the AML/CTF Law, namely, the SRS supervises tax advisers and outsourced accountants. Thus, SRS also supervises and controls the services provided by sworn auditors and commercial companies of sworn auditors, which are provided as tax advice or outsourced accounting services.
- 5.69. Taking into consideration that sworn auditors and commercial companies of sworn auditors are included in the list of obliged entities under of Section 45, Paragraph one of the AML/CTF Law, LACA believes that the current supervisory model results from incorrect interpretation of the provisions of the AML/CTF Law.
- 5.70. LACA states that such interpretation creates additional burden to the profession because sworn auditors and commercial companies of sworn auditors are being controlled by several different supervisors.<sup>66</sup>
- 5.71. FIU Latvia also believes that the application of said supervision model is considered to be ineffective. However, the issue to which of the supervisory authorities the supervision of sworn auditors and commercial companies of sworn auditors should be subject to is unclear, namely, whether the supervision of the respective obliged entities under the AML/CTF Law should be fully transferred to LACA or SRS.

### **Sworn auditors and commercial companies of sworn auditors**

- 5.72. Audit service is the review (audit) of a client's annual financial statement, also consolidated financial statement, laid down in laws and regulations, and provision of an auditor's report, the performance of an audit task by the request of the commercial register institution specified by law, an investigative institution, a prosecutor, a judge or a court in cases prescribed by law, the financial audit of state and local government institutions and the preparation of audit reports, as well as provision of an opinion regarding economic annual financial statements, the performance of an audit task provided for by other laws and regulations or an audit service contract, the limited review of a client's annual financial statements laid down in laws and regulations, and provision of a review report. Only sworn auditors and commercial companies of sworn auditors are entitled to provide audit services.
- 5.73. Taking into consideration the specific knowledge of sworn auditors, they should be assessed together with tax advisers<sup>67</sup>, however, sworn auditors, unlike tax advisers, have control mechanisms for the commencing of activity in place. In addition to audit services, which is their

<sup>64</sup> Sectoral risk assessment of auditor services of the Latvian Association of Certified Auditors.

<sup>65</sup> There is a separate standing committee established in 2019 which is responsible for ML/TF issues.

<sup>66</sup> Same as previous

<sup>67</sup> Supranational Risk Assessment Report on Money Laundering and Terrorism Financing of the European Commission assesses sworn auditors together with tax advisers, accountants.

primary activity, a part of sworn auditors also provide tax advice. In such cases, there is a risk that a sworn auditor may be used for auditing and validating fictitious financial results. Such certifications can successively be used to, for example, prove the transaction to SRS. Also, particular attention should be paid to the provision of audit services to financial institutions.

- 5.74. Similar to tax advisors, there is a risk that sworn auditors, when giving consultations on financial accounting, taxes and commercial activity, or giving practical suggestions for the improvement of accounts and transaction consultations, may be used to structure transactions for tax evasion or ML.
- 5.75. In addition to aforementioned, sworn auditors may be used for validating annual financial statements, thus giving the impression of the legality of the transactions carried out by the audited company, for example, in cases where the company has included transactions in the balance sheet that have not actually been performed.<sup>68</sup>
- 5.76. In the light of the above mentioned, it should be noted that mandatory audits are subject to less than 5 % of all commercial companies, associations, foundations and political parties registered in the Register of Enterprises of the Republic of Latvia, as well as to state and local government agencies and institutions.
- 5.77. As regards the customer base of sworn auditors and commercial companies of sworn auditors, 455 clients with characteristics of increased ML/TF risk, or 5.8 % of all clients, have been identified initially when conducting customer due diligence. All in all, 71 of those were identified as high ML/TF risk clients. For 324 customers, their members or parent companies are established in countries associated with high levels of cross-border ML threats, or are nationals of those countries. After customer due diligence, out of all 455 customers who initially were identified as high ML/TF risk customers only 64 were confirmed as high-risk level customers or 0.82 % from all the customers who received audit services.
- 5.78. In the context of the control of the commencement of activity, attention should be paid to the fact that sworn auditors and commercial companies of sworn auditors also have control of the commencement of activity in place, or certification and licensing requirements, as specified in the AML/CTF Law on Audit Services<sup>69</sup>, as well as binding rules of the Code of Conduct<sup>70</sup> for the violation of which sworn auditors bear disciplinary liability.
- 5.79. The number of reports received by FIU Latvia highlights serious issues in identifying unusual and suspicious transactions. Namely, sworn auditors and commercial companies of sworn auditors have submitted 13 reports in 2017 and 10 reports in 2018. The number of obliged entities under the AML/CTF Law submitting the reports has also dropped; in 2017, FIU Latvia received reports from 3 commercial companies of sworn auditors, while in 2018 — only 2 commercial companies of sworn auditors. At the same time, it should be noted that the statistics show a positive trend if compared to the number of reports submitted during the Second National Risk Assessment for 2013-2016 reporting period, namely, FIU Latvia received only 5 suspicious transaction reports from sworn auditors in the respective Reporting Period.

Number of reports submitted to FIU Latvia by sworn auditors	
2017	2018
Number of submitted reports	Number of submitted reports
13	10

- 5.80. It should be noted that LACA have not imposed any penalties to sworn auditors and commercial companies of sworn auditors during the Reporting Period.
- 5.81. At the same time, attention should be paid to the fact that, similar to LCSA, LACA could not be considered as an independent supervisory and control authority because, according to provisions of Section 6, Paragraph five of the AML/CTF Law on Audit Services, for the financing of the operation of LACA its members pay an annual fee in the amount specified by the General Meeting of the Association, which in turn indicates to possible lack of independence and capacity.

<sup>68</sup> See also the Updated Latvian National ML/TF Risk Assessment Report of 22 June 2018. Available at: [http://kd.gov.lv/images/Downloads/useful/NRA\\_LV\\_FINAL.pdf](http://kd.gov.lv/images/Downloads/useful/NRA_LV_FINAL.pdf) 8.6.5 — Page 139

<sup>69</sup> Law on Audit Services. Latvijas Vēstnesis, 78 (2465), 22.05.2001; Latvijas Republikas Saeimas un Ministru Kabineta Ziņotājs, 12, 21.06.2001

<sup>70</sup> Available at: <http://lzra.lv/%C4%93tikas-kodeks.html>

# 6. Assessment of ML and TF risks

## Assessment of ML risks

- 6.1. When carrying out in-depth risk assessment of Professional Service Providers analysed in the Report, it was concluded that the risks identified in the Updated Latvian National ML/TF Risk Assessment Report of 22<sup>nd</sup> of June, 2018, need to be reassessed and categorised as follows:

Assessment of ML threats, vulnerabilities and risks and TF risks of Professional Service Providers				
Obligated entity	Level of threats	Level of vulnerability	ML risk	TF risk
Tax advisers	MH	MH/H*	MH/H*	L
Outsourced accountants	MH	MH/H*	MH/H*	L
Independent legal service providers	MH	MH/H*	MH/H*	ML
Sworn advocates	MH	MH/H*	MH/H*	L
Sworn notaries	MH	M	MH	ML
Sworn auditors	M	MH	MH	L

- 6.2. The Supranational Risk Assessment Report on ML and TF of the European Commission also has assessed the risk level of non-financial sector as high.<sup>71</sup>
- 6.3. The main ML risks of Professional Service Providers in the Reporting Period are:
- 6.3.1. insufficient knowledge of Professional Service Providers on ML/TF, the non-existence of high-quality internal control system and inability to identify suspicious and unusual transactions can facilitate unintentional involvement of the representatives of the sector in activities with ML/TF purposes which criminals may use in their advantage due to the in-depth knowledge the Professional Service Providers possess;
  - 6.3.2. when weak or non-existent control of the commencement of activity or supervisory functions exist, dishonest professionals in the sector can facilitate ML or provide professional ML services by using their knowledge;
  - 6.3.3. the possibility to receive non-specific services (also remotely) can facilitate unintentional involvement of Professional Service Providers in ML/TF schemes.

## Assessment of TF risks

- 6.4. In May 2019, the first National Terrorism Financing and Proliferation Financing Risk Assessment Report 2017-2018 of Latvia was finished and published. The report provides informative summary and analysis of the threats, vulnerabilities and the resulting risks of national terrorism and proliferation financing.
- 6.5. The report concluded that national terrorism financing threats and vulnerabilities can be deemed as low and, thus, the financing risk is also low. However, it must be noted that one of the most significant TF risks identified is the "possible use of funds from non-governmental organisations in TF. Redirection of donations obtained for seemingly legal purposes to terrorist organisations or their members."<sup>72</sup>
- 6.6. After the assessment of TF risks of Professional Service Providers, it shall be noted that TF cases indicating that there is an actual threat to the subjects were not identified, but the possibility of its occurrence cannot be excluded. In the assessment of vulnerability factors, the specific nature of TF should be taken into account, namely, TF contrary to ML is often carried out with the help of small transactions. Taking into account the risks identified in Europe and the National Terrorism Financing and Proliferation Financing Risk Assessment Report 2017-2018, additional attention should be paid to the establishment of NGOs which have been used on several occasions to collect and transfer funds for TF purposes, as well as for the cooperation with clients from jurisdictions with high threats of terrorism. Additionally, attention should be paid to clients

\* The overall risk level in the sector is high but some individual representatives have a medium or even low risk level.

<sup>71</sup> Supranational Risk Assessment Report on Money Laundering and Terrorism Financing of the European Commission.

<sup>72</sup> National Terrorism Financing and Proliferation Financing Risk Assessment Report 2017-2018. Available at: [http://kd.gov.lv/images/Downloads/useful/Nacionalais\\_TF\\_PF\\_zinojums\\_2017\\_2018.pdf](http://kd.gov.lv/images/Downloads/useful/Nacionalais_TF_PF_zinojums_2017_2018.pdf)

that are related to the movement of goods of strategic significance and the trade of Middle-Eastern cultural articles. The TF risks of Professional Service Providers are mainly characterised by a serious lack of information and awareness about TF. Taking into consideration the aforementioned and assessing which of the Professional Service Providers offer NGO establishing services, the TF risk levels are as follows:

<b>TF risk assessment of Professional Service Providers</b>	
Obligated entity	TF risk
Independent legal service providers <sup>73</sup>	ML
Sworn advocates	ML
Tax advisors	L
Sworn notaries	L
Outsourced accountants	L
Sworn auditors	L

<sup>73</sup> The TF risk of service providers for establishing and ensuring activity of legal arrangements or legal entities should also be assessed at an equal level.

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# 8. ANNEX NO. 1

