

# The Effectiveness of Money-Laundering Regulations: Evidence from Money-Services-Business Industry in Malaysia

Najihah Marha Yaacob, Amarul Hanif Harun



**Abstract:** *The International Monetary Fund defines money laundering as the process of assets being spawned by criminal activities to hide or make obscure any connections established between the funds and their illegal origins. Nowadays, money laundering has already been labelled as a global crime where global strategies and policies should be developed to curb money laundering. Thus, global courts should be formed to put into trial all money-laundering cases and make sound decisions in reference to punishments and penalties. The aim of this study is to gauge the effectiveness of anti-money laundering (AML) regulations in the Money Services Business (MSB) industry in Malaysia. There are three (3) predictors that have been expected to influence money-laundering activities, namely customers' record-keeping, suspicious transaction reporting, and employee training. The respondents have been selected from MSB officers across Malaysia by using simple random sampling. The questionnaires were distributed to all 344 MSB through the Money Service Association. The compliance officers have been selected as the primary participants in the study since their roles and responsibilities within the MSB correlates with the three constructs identified in the study. The total of 150 (43.6%) questionnaires returned and have been used for analysis. The sample was then analysed using the descriptive and multiple regression analysis. The results revealed that all hypotheses are supported, which indicates that customer record keeping, suspicious transaction reporting, and employees training have a significant impact on combating money laundering. This study proposes that money-laundering activities could be controlled by focusing on customer record keeping, suspicious transaction reporting, and employee training. The findings provide evident on how The Anti-Money Laundering and Anti-Terrorism Financing Act 2001 (AMLATFA) has filled an imperative gap in fight towards combating money laundering in Malaysia. The similar studies could be conducted in other settings with different rules and regulations towards money laundering.*

**Keywords:** *Anti-money laundering (AML), Employee training, Money Services Business (MSB), Record keeping, Suspicious transaction*

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## I. INTRODUCTION

Money laundering is striking as it is one of the biggest issues in the world and no one knows for certain when it started or how it came about (Abel and MacKay, 2016). Tracing back the history, money laundering is believed to have been started by the U.S. mafia when they had to legitimise dirty money that came from various illegal activities, such as prostitution, gambling, and extortion (Shanmugam and Thanasegaran, 2008). To play safe, the mafia bought up and operated a large number of legitimate businesses as shadow businesses or what would appear to be honest cash flows. These phenomena have impacted all sectors and gained their concerns by many organisations especially governments, financial institutions, and police (Rozaiha, Nafsiah and Aisyah, 2015).

The International Monetary Fund ([www.imf.org](http://www.imf.org)) has defined money laundering as the process of assets being spawned by criminal activities to hide or make obscure any connections established between the funds and their illegal origins. Reddington (2011) has defined this as a process of cleaning 'dirty money' or changing the money from illegal to legal one, which is normally derived from criminal activities and hard to trace. In the meantime, Ebikake (2016) has also regarded money laundering as something simple to explain: It is the conversion of assets produced from criminal activities into assets that cannot be traced back to crimes committed previously, and the assets will appear to have been originated from legitimate sources.

Money laundering can bring about upsetting economic, social, and political consequences for countries, especially for developing countries and those countries with vulnerable financial systems (Aurasu and Rahman, 2016). According to a study done by Young (2014), money laundering imposes a negative effect on the global economic and financial growth. It can, unfortunately, steer resources to unproductive activities and even give ways to corruption and crimes. As a result, money laundering could impede legitimate businesses and cripple banks and financial institutions (Rozaiha et al., 2015). There are some obstacles or challenges that have been faced by financial institutions in a way to identify money-laundering activities. According to Ku Mar and Gr (2014),

there are many methods of money laundering, including smurfing, which involves depositing cash at various branches of a financial institution, buying secured bank instruments and postal orders, and buying shares and currency exchanges in money services businesses.

## II. LITERATURE REVIEW

### A. Money Laundering Issues

The Basel Committee is the brainchild of the Central Bank governors of ten (10) countries, which are Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, the U.K., and the U.S.A. (Aspalella, 2013). The committees' main role is to set standards for insurance, banking, and securities sectors for combating money-laundering and financing-of-terrorist activities (Ebikake, 2016). The BCBS has issued 'The Basel Principles' to prevent the use of the banking sector for money-laundering activities (Naheem, 2015). Besides, the organisation has also decided whether or not irregularities or gaps exist when new recommendations and approaches are applied. Also, it has assessed groups that are vulnerable to money-laundering practices and offered assistance in dealing with identified vulnerable traits (Boles, 2015).

Several studies have been conducted to understand efforts taken by organisations, such as financial institutions, banks, and so on, to prevent money laundering. There are a few studies that have found the relationship between money laundering and the implication, and challenges in implementing the preventive acts of money laundering. Jun and Lishan (2010) have studied the international practices of the Customer Due Diligence (CDD) in China against the regulations and guidelines of the CDD and found that, although China has had a set of the CDD provisions in place since 2007, China's compliance with the FATF requirements has still not been satisfactory. Meanwhile, Subbotina (2009) has studied the Russian bank's compliance with the regulatory AML legislation. Looking at the violations reflected in the Central Bank of Russian Federation directive addressing the regulated banks, and through the mass media and interviews held with bankers, the study has reported that the financial institutions have not been able to follow the AML regulation for several reasons, with one being the lack of willingness in combating money laundering.

The Anti-Money Laundering and Anti-Terrorism Financing Act 2001 (AMLATFA) has been studied by Aspalella (2008). The researcher has concluded that the AMLATFA is comprehensive and up to date, compared to other similar laws, but the regulatory authorities need to have more guidelines that can make compliance doable. Secondly, the legislation has not only made a change to the way banks deal with their customers and other banks but also given significant legal risks for non-compliant banks, including the money-services-business industry. Finally, it has also been concluded that money laundering can give a bad implication not only on a country but also its socio-economy.

Ebikake (2016) has offered an assessment of soft law as a technique for repressive and preventive anti-money laundering control (hereinafter AMLC). Its full concentration has been given towards understanding of the nature of the international Anti-Money Laundering (AML) law-making process. The current international effort to combat Money

Laundering (ML) is fragmented although the soft law has been made effective. Part of the problem is the fragile nature of the domestic criminal legislation demonstrated in the choice of predicate crimes and insufficient procedural rules that can identify and enforce the state-level law. Meanwhile, Hamin (2017), who is a local researcher, has taken a closer look at some of the recent changes to the old anti-money laundering and anti-terrorism financing laws, currently known as the Anti-Money Laundering and Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001. The study has measured the newly consolidated money-laundering offences and the newly created offences, being 'smurfing' one of them. The study has employed a doctrinal legal research and secondary data, with the new AML/CFT legislation as the primary source. For a comparative analysis, the legislations of the U.K., Australia, and New Zealand have been examined. Secondary sources, including case law, articles in academic journals, books and online databases, have also been analysed. Based on the study conducted, she has found that the Malaysian government's efforts concerning with complying with the international standards have been set by the Financial Action Task Force (FATF). However, what is important is that the Malaysian government has addressed the remaining instrumental and normative deficiencies in the AML/CFT laws to make sure that the recent legal changes are sufficiently comprehensive, so that the prevention and regulation of money laundering and terrorist financing within Malaysia can be done after all.

Recently, Nobanee and Ellili (2018) have studied the extent of Anti-Money Laundering (AML) disclosures in annual reports and websites by drawing the differences between UAE Islamic and conventional banks. Besides, they have also analysed the effects of the AML disclosures on the UAE banks' performances. A content analysis has been adopted to explore the extent of the AML disclosures in the annual reports and by using the dynamic panel-data two-steps robust system to further examine the impact of the AML disclosures on the banking performance. The findings have shown that the AML disclosures are very low at all the UAE, conventional, and Islamic banks. In addition, the results have also shown that the degree of the AML disclosures on the bank websites is higher than that shown in the annual reports.

### B. Factors Affecting Money Laundering Activities

Many studies undertaken to examine money laundering and the existing legal frameworks have been mostly geared towards evaluating money laundering regulations and the economy or the banking sector (Alice Young, 2014; Brenig, Accorsi and Muller, 2015; Christopher, 2014; Helmy, Zaki, Salah, and Badran, 2016; Soudijn, 2016). Recent studies have outlined multiple constructs, which have been characterised as influencing factors, which can be utilised to ascertain the effectiveness of money laundering regulations. Coherently, notable researches undertaken by multiple scholars such as Jensen and Cheong, 2011; Smet and Mention, 2011; Mugarura, 2011) identified customer record keeping, employee training, and suspicious transaction reporting as the primary constructs that influence the effectiveness of money laundering laws and regulations.

### C. Customer Record Keeping

Customer record keeping is the most important measure to combat money laundering. Selection of criteria and time period for which record should be kept is the crucial part of decision-making. Most recommendations of FATF are related to customer record keeping. It is important to practice information secrecy and information about customer should be revealed where necessary. Shehu (2010) studied about the determinants of customer record keeping, which are customer/owner's background, location, method and frequency of transaction and source of funds. Moreover, Records provide evidence of a work that the relevant persons have undertaken to comply with the statutory requirements and AML/CFT Codes. In addition, records also provide necessary contexts for opinions that may be prepared on the truth and fairness of relevant persons' financial statements by external auditors (Handbook for Regulated Financial Services Business, 2015). Notably, the incorporation technological advancement in the financial sector has facilitated the digitization of customer records, which has enabled swift and effective meanings of storing and monitoring financial transactions relating to a given customer. There are extensive studies, which have been undertaken to examine the relationship between money laundering laws and customer record keeping. Studies conducted by Smet and Mention (2011) on Luxembourg banks, it has been discovered that there are significant relationships between customer record keeping, money laundering, and internal auditing. They have come up with a matrix structure development, which comprises four (4) processes, which have been meant to minimise weaknesses in the process of customer record keeping.

In a study conducted in the U.K. by the Financial Conduct Authority (2017), it has been discovered that business organisations have made tangible progress in their effort to control Anti Money Laundering (AML) since the first time they were visited. They have employed some modern and well-designed control structures. Once these measures have been put to effect, the business organisations are able to identify and mitigate risks effectively. Some lapses have also been highlighted, for instance, client-risk assessments, which are only concerned with a limited number of factors. This may cause inadequate risks based on the result of diligence and monitoring. It has also been discovered that, as the business organisations were embarking on a risk-based approach, they, in some cases, were unable to record the justification for their decisions. This is because some business organisations still struggled to be able to fully comply with changes in the Money Laundering Regulations (MLRs) 2017. These businesses were, nonetheless, expected to examine the implication on their firms of any regulations or legal changes and carry out necessary changes within a considerable timeframe. Therefore, the above provide literature relating to multiple studies sufficient the establishment of the below hypothesis, which states:

**H1:** Customer record keeping has a significant impact on money laundering in the money-service-business industry in Malaysia

### D. Suspicious Transaction Reporting

The process of reporting any suspicious transaction especially by the mean of online platforms has become among the leading twenty-first century contemporary techniques for

tackling money laundering activities globally (Shanmugam et al. 2019a). Ideally, reporting suspicious transactions is considered a mandatory task for any financial institution operation within or outside Malaysia in respect to combating money laundering. Moreover, in reference to the financial Intelligence Act (2011), the elements used as determinants towards reposting any suspicious transactions have been identified as record keeping, knowledge of reporting, unusual business, identification, and report threshold. According to Fanta and Mohsin (2010) the evaluation of anti-money laundering programs and regulations effectiveness to identify suspicious transactions is facilitated the achievement of immense efficiency and sound running of most financial institutions such as money service businesses. Bolton and Hand (2002) revealed within their study that failure my most organizations to detect or report suspicious transactions have led to the increased levels of tax evasions in the United States. Moreover, Aspalella (2013) documented that that the reporting suspicious transactions regime has had a significant impact on the operations of banks in Malaysia.

The latter noted that since Malaysia financial systems are based on sound principles, the effectiveness of the regime is still unknown; implying that the effectiveness of the AML in regard to suspicious transaction reporting has not been cleared stated or defined. However, Mugarura (2011) outlined in his study that anti money laundering regulations, especially the one relating to suspicious transaction are perceived as the best cause of action in respect to fighting graft and money laundering activities especially in Malaysia. The above-mentioned studies have provided sufficient literature, which stipulate that there is a correlation between suspicious transaction reporting and the effectiveness of money laundering laws and regulation within the money service sector. Therefore, the blow hypothesis was formulated in respect to suspicious transaction reporting and effectiveness of money laundering laws.

**H2:** Suspicious transaction reporting has a significant impact on money laundering in the money-service-business industry in Malaysia

### E. Employee Training

The process of training employees within any given institution or organization is considered to be an important aspect necessary for the success or growth of a given institution or government-based organization. Training is defined as a mentoring or coaching process that is geared towards harnessing or elevating the attitude, skills, knowledge, and behavior of an employee's towards the betterment of an organization (Shanmugam et al. 2019b). In contrast, employee training has been acclaimed to be among the leading factors that if well incorporated within a given managerial or oversight structure it can be beneficial to the respective institutions. In essence, employee training has been attributed to have correlation with money laundering. Multiple studied have been undertaken to examine the influence or relationship between money laundering and employee training. Moreover, studies undertaken by Jensen and Cheong (2011) have demonstrated that nations, which have adopted regulations that counter money laundering and

FATF have illustrated rating of 90 percent of developing member countries such as Malaysia have a 72 percent partially compliance rating in respect to employee training. Such ratings have been estimating to be moderate or weak, hence these nations have been encouraged by the latter to improve on employee training towards combating financial crimes such as money laundering. Furthermore, studies undertaken by Sharman (2008) deduced that anti-money laundering regulations, especially in regard to employee training is perceived as among the leading components, which can be used to curb or combat fraud or any other money laundering crime.

There is one drawback in these regulations that makes their impact weak, that is, FATF regulations are not legally bound, and until and unless they are injected in the national law of the country these regulations are not effective. This drawback results in weak compliance among countries around globe. Muhammad (2014), conducted similar study and concluded that there exist an influence between money laundering and employee training- the researcher was undertaken within the banking sector; meaning in order to effectively combat money laundering crimes employees have to well trained and equipped with contemporary skills that would enable these professionals to enhance the effectiveness of the money laundering regulations. In light of the above discussion in regard to employee training and effectiveness of money laundering regulations the following hypothesis was developed.

**H3:** Employee training has a significant impact on money laundering in the money-service-business industry in Malaysia

### III. METHODOLOGY

#### A. Sample Selection and Data Collection

The sample size was obtained from the MSB sector, which plays a crucial financial role of facilitating remittance, wholesale money business, and money transactions in Malaysia. The population of this study consists of 867 MSB compliance officers operating within the 344 MSB across Malaysia. The questionnaires were distributed to all 344 MSB through the Money Service Association in order to reduce distribution costs and time; a ratio of 1:1 in respect to officer: MSB was adopted. Furthermore, the compliance officers have been selected as the primary participants in the study since their roles and responsibilities within the MSB correlates with the three constructs identified in the study. The total of 150 (43.6%) questionnaires returned and usable for analysis.

Data collection has been conducted by utilising the questionnaires which have been distributed in hard copies to the respondents. Each survey kit has contained a cover letter that elucidated the research purpose and assured the respondents of the confidentiality of their responses. This has become a common practice among researchers, whether using more conventional or innovative delivery systems. The survey questionnaire has been sent to each of the MSB institutions, such as remittance providers, money-changing, and other financial institutions. In addition, the survey instrument has also been delivered personally to the respondents who could answer it.

#### B. Research Measures and Analysis

The questionnaire comprises five (5) segments. The first section comprises questions relating to customer record keeping, while the second section consists of questions relating to suspicious transaction reporting. The third section comprises questions relating to employee training and the fourth segment comprises questions relating to the effectiveness of combating money laundering. The last section comprises questions relating to demography.

Questions in Sections A, B, C, and D utilised the Likert type scale, which entailed numeric scales of with 1 = strongly disagree, 2 = disagree, 3 = neutral, 4 = agree, and 5 = strongly agree to measure the responses of the participants. The measurement rating scale is between 1- 5, which enables the respondent to easily offer their responses. The use of Likert-Type Scale provides the advantage of standardizing and quantifying relative effects (Saunders, 2009). In order to decide the total number of points on the Likert-Type Scale, arguably, more points would give the respondents a better selection, so that they can have a better choice. However, it is also contended that this greater choice may become hazy to the respondents, and this does not necessarily produce much richer data. For this study, it has been determined that a neutral position is available from the scale offered.

In order to achieve the study's objectives, a number of statistical techniques have been used for the data analysis, namely the descriptive and inferential statistical analyses.

### IV. RESULTS AND DISCUSSIONS

#### A. Descriptive Analysis

**Table 1** shows the descriptive statistics (mean and standard deviation) of all variables. The mean of the independent variables and dependent variable (money laundering) are moderate. On average, the customer record keeping with the mean of 3.46. Suspicious transaction reporting is 3.74, the employee training is 3.91 years and money laundering is 2.95.

**Table 1:** Descriptive statistics and correlation

Variable	Mean	SD	Max	Min
Customer Record Keeping	3.46	0.54	2.71	4.71
Suspicious Transaction Record	3.74	0.45	2.50	4.67
Employee Training	3.91	0.67	2.17	4.67
Money Laundering	2.95	0.95	1.29	4.57

N = 150

#### B. Multiple Regression Analysis

The assumption of multiple regression has been carried out. The assumptions have been tested by using normality, linearity, homodescascity and multicollinearity. Linearity has portrayed that most of the points fall on the straight line. Meanwhile, homodescascity has shown that the points are at random. Overall, the inspection of the data revealed that there was no serious violation of the basic assumptions. Therefore, the use of regression for subsequent analysis is appropriate.

The multiple regression technique has been utilised to facilitate the relationship between the constructs identified in the thesis against the dependent variable- which is money laundering. The constructs were identified as customer record keeping, suspicious transaction record, and employee training (independent variables). The model of money laundering has shown that 39.9% variance in the outcome variable has been explained by the predictors mentioned. The ANOVA results have demonstrated significance findings, which are  $DF\ 3,146=32.262$ ,  $P<0.05$ , indicating that, at least, one independent variable is significantly associated with dependent variable (Hair et al., 2014).

From the regression table 2, it can be observed that customer record keeping, ( $b=-0.764$ ,  $t=-7.659$ ,  $p<0.05$ ) has a significant negative relationship (0.00) with money laundering as the sig value is below the 0.01. Moreover, the  $t=-7.659$  indicates that the relationship is strong since the value of “much closer” to 1. The result reveals that the effectiveness of money laundering regulation would lower money laundering activities in Malaysia if customer record keeping systems are strengthened. This conclusion resonates with a study conducted in the U.K. by the Central Bank of Ireland (2017), where they discovered that financial institutions have made tangible progress in their effort to control Anti Money Laundering (AML) after introducing modern and well-designed control structures such as customer record keeping systems. Once these measures have been put to effect, these institutions were able to identify and mitigate ML activities effectively.

Moreover, it can be noted that suspicious transaction record ( $b=-0.702$ ,  $t=-4.917$ ,  $p<0.05$ ) has a significant relationship with money laundering since the Sig value (0.000) was below the required threshold. However, the relationship between suspicious transaction record ( $t=-4.917$ ) implies that the relationship is slightly weak in respect to money laundering. The negative sign indicates that there exist an inverse relationship between suspicious transaction record and money laundering as indicated in table 2. The result shows that the effectiveness of money laundering laws in Malaysia in respect to MSB will elevate when suspicious transaction records are strengthened thus lowering ML activities or related crimes. These findings resonate with Mugarura (2011), who outlined in his study that anti money laundering regulations, especially the one relating to suspicious transaction are perceived as the best cause of action in respect to fighting graft and money laundering activities especially in Malaysia. Moreover, similar observations were deduced by Fanta and Mohsin, (2010) they suggested that the evaluation of anti-money laundering programs and regulations effectiveness to identify suspicious transactions has facilitated the achievement of immense efficiency and sound running of most financial institutions such as money service businesses.

The construct of employee training ( $b=-0.3$ ,  $t=-2.409$ ,  $p<0.05$ ) has a significant relationship with money laundering this is evident by the fact that the Sig value of 0.017 was below the required threshold (Hair et al., 2012). Moreover, the negative sign indicates an inverse relationship between the construct employee training and money laundering. These findings resonates with results obtained from other studies

such as Muhammad (2014), who conducted a similar study in the Indian Banking sector and deduced that anti-money laundering regulations, especially in regards to employee training is perceived as among the leading components, which can be used to curb or combat fraud or any other money laundering crime. Similarly, studies undertaken by Jensen and Cheong (2011) have demonstrated that countries, which have adopted FATF regulations have illustrated a rating of 90 percent among the developing member countries such as Malaysia; which has 72 percent partially compliance rating in respect to employee training. Such ratings have been estimating to be moderate or weak, hence demonstrating why Malaysia is considered among the countries being challenged with the menace of money laundering.

**Table 2: Multiple regression results**

Model	Unstandardised Coefficients		Standardised Coefficients		t	Sig.
	B	Std. Error	Beta			
(Constant)	9.530	.804			11.855	.000
Customer Record Keeping	-.746	.097	-.528		-7.659	.000
Suspicious Transaction Record	-.702	.143	-.330		-4.917	.000
Employee Training	-.300	.125	-.172		-2.409	.017

a. Dependent Variable: Money Laundering

[DF3,146=32.262] / [R-Square=0.399]

**V. CONCLUSION**

The main objective of this study is to gauge the effectiveness of AML regulations in the MSB industry in Malaysia. There are three (3) predictors that have been expected to influence money-laundering activities, namely customers’ record-keeping, suspicious transaction reporting, and employee training. Three (3) hypotheses have been developed:

- H1:** Customers' record-keeping has a significant impact on money laundering in the money-service-business industry in Malaysia.
- H2:** Suspicious transaction reporting has a significant impact on money laundering in the money-service-business industry in Malaysia.
- H3:** Employee training has a significant impact on money laundering in the money-service-business industry in Malaysia.

Data were obtained from a total of 150 samples of MSB officers through survey methods. The sample was then analyzed using the descriptive and multiple regression analysis. The results revealed that all hypotheses are supported, which indicate that customers' record-keeping, suspicious transaction reporting, and employee training have a significant negative impact on combating money laundering.



The findings provide evident on how the AMLATFA has filled an imperative gap in fight towards combating money laundering in Malaysia. This means that AMLATFA translates the international standards on anti-money laundering and counter terrorism financing measures into a national law, which has been demonstrated as a comprehensive and innovative legislation that has been dedicated to combat money laundering in Malaysia. Moreover, the study has been able to identify three constructs to ascertain the effectiveness of money laundering regulations in Malaysia. The antecedent's factors, namely suspicious transaction reporting, employee training, and customer record keeping were found to be imperative towards influencing individual MSB compliant officers were ware tasked on implementing the money laundering regulations through their respective MSBs. Therefore, the findings of this study would be beneficial to the money business service sector and other stakeholders to develop policies and strategies that would enhance the effectiveness of money laundering regulations in Malaysia.

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