


How to Detect Shell Companies

2021 Albany Fraud Conference

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Speaker



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CEO Fraud Auditing, Inc.

Mr. Vona is the author of three books published by Wiley, *Fraud Risk Assessment: Building a Fraud Audit Program* and *The Fraud Audit: Responding to the Risk of Fraud in Core Business Systems*, *Fraud Data Analytics Methodology: The Fraud Scenario Approach to Uncovering Fraud*.

Wiley has referred to Mr. Vona as a worldwide renowned authority on internal fraud risk.

Mr. Vona's trial experience is extensive, including appearances in federal and state courts. He is qualified as an expert witness, as a CPA and a CFE, and is cited in West Law for the successful use of circumstantial evidence.

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Today's Agenda

- Fraud Auditing, Inc. methodology
- Building the fraud data profile for a shell company
- Conducting the Fraud Audit of Shell Companies
- Illustration of concepts through real life experiences

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What this Class is About

The diagram consists of two blue arrows pointing towards each other. The left arrow is labeled 'Fraud Risk Assessment' and the right arrow is labeled 'Artificial Intelligence'. In the center, where the arrows meet, is a blue circle containing the text 'FRAUD: Patterns, Anomalies, Discrepancy, Characteristic'. At the bottom left of the slide is the date '11/12/2021', at the bottom center is '2021 ALBANY FRAUD CONFERENCE', and at the bottom right is the number '4'.

Common Techniques

- Statistical
 - Calculate statistical parameters
 - Probability distributions
 - Regression analysis
- **Artificial intelligence**
 - Data mining
 - Pattern recognition
 - Expert systems: Rule Based System; Cognitive Computing
- Machine learning and data mining
 - Supervised learning
 - Unsupervised learning

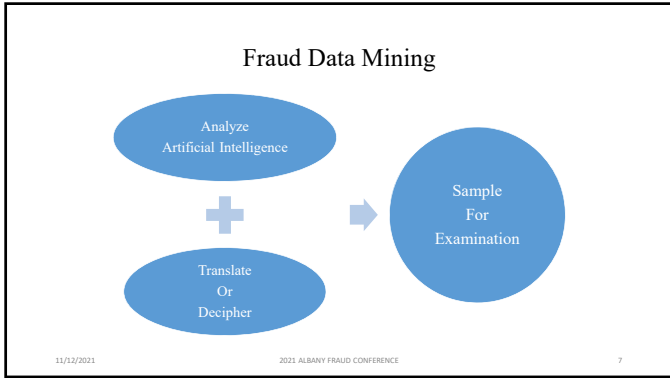
At the bottom left of the slide is the date '11/12/2021', at the bottom center is '2021 ALBANY FRAUD CONFERENCE', and at the bottom right is the number '5'.

Understand the Language

- **Predictive:** encompasses a variety of statistical techniques from data mining, predictive modelling, and machine learning that analyze current and historical facts to make predictions about future or otherwise unknown events
- **Prescriptive:** entails the application of mathematical and computational sciences and suggests decision options to take advantage of the results of descriptive and predictive analytics

• Source: Wiki

At the bottom left of the slide is the date '11/12/2021', at the bottom center is '2021 ALBANY FRAUD CONFERENCE', and at the bottom right is the number '6'.



Polling Question - 1

What was the original name of the FBI

- A. FBI
- B. BOI
- C. DOI

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Straw Companies

- A shell corporation is a corporation without an active business operation or significant assets.
- Straw companies are known as:
 - Shell
 - Paper
 - Fictitious
 - Ghost
 - False
 - Front

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Which Shell Company are you Looking For?

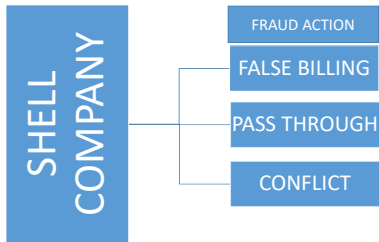
- What is the primary type of shell company?
 - Created shell company
 - Assumed identity shell company
 - Hidden shell company
 - Limited use shell company
 - Conflict of interest shell company
- Each primary category has several secondary categories

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What fraud action do you think is occurring?



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Traditional Shell Company

- **The created shell company:**
- Starts with the specific identification strategy on master file data
 - Missing information
 - Anomaly in existing information
 - Matching to other data bases
- Internal control avoidance strategy
 - Off period creation

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Traditional Shell Company

- Missing Data Elements (person is trying to control access)
- Primary street
- Secondary street
- Vendor address: City, State, Postal & Country
- Vendor bank account
- Vendor Gov't #
- Vendor telephone number
- Vendor email address
- Contact person

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Traditional Shell Company

- Anomaly in data elements:
 - Missing address and bank account number
 - Mail box service company in address fields
 - Mail box forwarding company in address fields
 - Email address: non business email
 - Company name
- Internal Control Avoidance:
 - Created non-working hours
 - Created non-working days
 - Created by someone other than primary person

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Traditional Shell Company

- Do not be surprised if Human Resources blocks you
- Key word is match
- Matching to Human Recourses
 - Street Address
 - City, State and Zip code
 - Bank number
 - Bank account #

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Assumed Identity Shell Company

- Starts with the **specific identification strategy**
 - The key search word is change
- There are three primary categories
 - Permanent or temporary take over of dormant vendor
 - Temporary take over of an active vendor
 - Theft of a real vendor identity, entity is added to the master file

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Searching for Assumed Identity: Dormant on Master File

- Dormant on master file
 - Code test
 - Activity test
- How to search for change
 - Change transaction file
 - Compare master file in scope period to a prior master file
 - Payment table

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Searching for Assumed Identity: Dormant on Master File

- Start with change to key fields
 - **Address**
 - **Bank account**
 - Telephone #
 - Government Id#

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Searching for Assumed Identity: Temporary Real Company Not Complicit

- Temporary real company not complicit
 - In order to process a transaction
 - Search on change fields
 - Search on payment identity
 - Anomaly in transactional data
 - Date
 - Transaction number

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Searching for Assumed Identity: Permanent Real Company Not Complicit

- Steals the identity of a real company operating in the market place
- Permanent real company not complicit
 - Similar to created company
 - Complete take over of identity
 - Does not lend itself to master file data analytics

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What Is a Hidden Entity?

- Any company that is operating under two or more names in your business system
 - Does occur due to internal control weaknesses
 - Does occur with intent to circumvent internal controls
- Hidden entity tends to be:
 - Shell company
 - Conflict of interest
 - Real company with two or more names

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Hidden Entities

- Key is to identify a linkage between two or more entities in one master file. Key word is duplicate.
- E-mail, telephone number, address, bank account

- Caution: Real company's: broker, manufacturing rep, agent

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Hidden Entity: Categories of Hidden Entity

- Hidden entity with intent
 - Absent of a data elements
 - Anomaly in a data elements
- Hidden entity: multi entity numbers
- Hidden entity: look a like vendor

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Hidden Entity

- Duplicate entity in:
 - **Same data file**, e.g. two vendors
 - Same name same identifying information
 - Same name different identifying information
 - Different name same identifying information
 - **Different data file**, e.g. vendor and employee
 - Same name different identifying information
 - Different name same identifying information

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Hidden Entity

- Duplicate testing starts with exact match
- Duplicate test cleans data for unintentional differences
- Duplicate test cleans data for intentional differences

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Multiple Entity Numbers

- Occurs for many reasons
 - Merged data bases
 - Set up at different times by different employee
 - Change in address on source documents
 - Creates false positives
 - Creates the opportunity to commit fraud

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Temporary Entity

- Look to company one-time vendor procedures
- Isolate all one-time vendors or one-time payments

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Look-a-Like Entity

- Focus on company name or variations of the name
- Differences between entities from same corporation but different offices
- Does not lend itself to FDA
- Fuzzy Logic tends to create false positives

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Correlate to Transactional Data

- Correlate master file search to dollar activity
- Dollar activity as to
 - Dollar value
 - Number of transactions
 - Average value of transaction
 - Maximum or minimum

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Name: Red Flags

- Non descriptive
- Initials
- LLC's
- Globally, LLC has different Initials

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Address: Red Flags

- Street address
- US Mail P.O. Box
- Mail box service address
 - Public company
 - Private company
- Virtual offices
- Mail box forwarding address
- Redirect address
- Professional service provider address

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Bank Account Red Flags

- Banks with known poor CIP
- Foreign Bank Account for domestic company

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E-mail, Telephone & Gov't Identification #

- Missing, duplicate or match
- Emails with public domain
- Country code or Area code not consistent with physical location

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Key Transactional Data

- Identify the key transactions: Purchase order, invoice and payment
- The five key fields by transaction
 - Control number
 - Amount
 - Date
 - Description
 - General ledger account

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Fraud Data Analytics: Amounts

- **Always, the first report I create:**
- Match to Master File to exclude dormant vendors
- The maximum, minimum and average report
- Vendor number and name
- Creation date
- Aggregate dollars
- Frequency of records
- Maximum, minimum and average

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Fraud Data Analytics: Amounts

- Below or above control threshold
- Duplicate amount, linking to control number, date or description
- Two or more in aggregate above control threshold correlate to date or control number
- Even amount
- Recurring amount
- Contra amount

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Fraud Data Analytics: Invoice Number

- **My favorite**
- Pattern and frequency of invoice numbers and amounts
- Compare beginning invoice number to ending invoice number
- Compute invoice number range
- Compute date range
- Correlate to creation date
- Search for sequential pattern or limited range pattern
- Search for low invoice numbers

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Fraud Data Analytics: Dates

- The primary tests for dates are:
 - Illogical order
 - Circumvent order
 - Speed of processing the transaction
- Comparison of dates between two transactions
 - Purchase order date to invoice date
 - Invoice date to payment date

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Fraud Data Analytics:

- Line item descriptions: alpha or numeric or both
 - Matching line item descriptions
 - Missing alpha
 - Missing numeric
 - String length analysis

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Fraud Data Analytics: Frequency

- Correlates to transactional analysis
- Number of transactions consistent with search routine
- Frequency of event or transaction
 - Number of instances
 - Below control range
 - Same amount
 - Same date
 - Number known to individual

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Polling Question-2

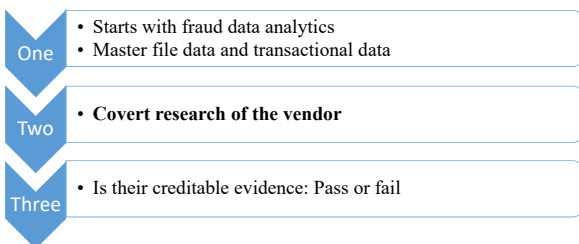
- Does the FBI use shell companies to conduct surveillance in the USA.
- True
- False

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The Fraud Audit Process



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The Fraud Audit Process

- Four**
 - Overt research of internal selection process
 - Overt testing of fraud action statement
- Five**
 - Examine internal documents
 - Conduct interview of internal person based on covert research
- Six**
 - Is their creditable evidence to perform investigation
 - Write report of facts and circumstances and explain necessary procedures for investigation

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Audit Strategy For Shell Company

FRAUD SCENARIO	FRAUD RESPONSE
<ul style="list-style-type: none"> • Shell Company 	<ul style="list-style-type: none"> • A/P System check • Invoice check • Legal background check • Physical address check • Telephone check • Web site review • Business owner background • Business capacity

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Key the eye on the Ball versus the Internal Control!

- Does the company have the attributes of a real company operating in the market place?
- Does the company have the infra structure of a real company operating in the market place?
- Based on the available public data, are there any fraud red flags?

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Invoice Examination: absence or anomaly

- Telephone number
- Web Site
- Invoice number
- Line item description
- General ledger / cost center
- Software used to create invoice
- Invoice approvals
- Invoice documentation

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Shell Company Document Indicators

- Lack a company logo, website or email address
- Are produced from low cost business software, word processor or spreadsheet

Documents:



- Appears new
- Has no fold marks
- Paper stock or printing is not consistent with company size
- Type font not consistent with company size, style
- Copied, faxed or missing

Document condition:



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What do I want to know about invoice history

- Pattern and frequency of:
 - Invoice numbers
 - Invoice amounts
 - Invoice dates
 - Approver
 - Cost center

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Determine The Legal Existence

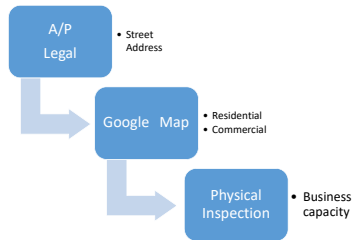
- Does the corporation exist?
- Do names on the corporate registration correlate to your payroll file?
 - First Name / Last Name
 - Address
 - Exact or close match
- Does the address on the corporation registration match your accounts payable file?
- Date the business was incorporated?
- Date of first purchase order or invoice?

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What do we know about the address



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Determine The Physical Existence

- Street address
- US Mail P.O. Box
- Mail box service address
 - Public Company
 - Private Company
- Virtual offices
- Mail box forwarding address
- Redirect Address
- Professional service provider address
- Is the address consistent with:
 - Type of business
 - Spend level

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Telephone Check

- Is the telephone answered in a business professional manner?
- What can we learn about the company?
- What can we learn about the physical location?



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Web Site Review

- When was the web site created?
- Does it describe the goods or services you are purchasing?
- What do we know about the management team?

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Business owner background

- Business owner: Perform internet search on business owner, does owner have business qualifications
- Link in?
- Speaks at conferences?
- Publishes papers or books?
- Professional organizations?
- Work history?
- Certifications?

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Business Capacity

- Company is:**
 - Not recognized by competitors
 - Not recognized by other members of management
- Company has:**
 - No membership in any logical business associations
 - No proof of insurance certificate
 - No secured debt
 - Advertising

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Remember: The Score Card

- Seldom does one piece of evidence cause an investigation
- The key phrase is “totality of evidence”
- The key concept is the authenticity of the evidence

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It is the weight of the evidence

Real False

Pass Test Pass Test

Fails Test Fails Test Fails Test

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Polling Question- 3

When building the FBI, what professions did J. Edgar Hoover look for

- A. Lawyers
- B. Accountants
- C. Reporters

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Today's Agenda

- Fraud Auditing, Inc. methodology
- Building the fraud data profile for a shell company
- Conducting the Fraud Audit of Shell Companies
- **Illustration of concepts through real life experiences**

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Created Shell Company: False Billing

- A vice president of Ambiva Corp. added R. Consulting Inc. to the vendor master file. The vice president stole \$130,000 in one month through four invoices numbered in a sequential pattern: 1, 2, 3 and 4. The first two invoices bore the same date, and each invoice was below the control threshold. However, the two invoices together exceeded the control level. All transactions were recorded to the same cost center . Invoice descriptions all were "consulting services." We identified this as a created shell-company scheme.

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Created Shell Company: Tipping Point

- A perpetrator created three different shell companies — all with different addresses in different states. The transactional analysis revealed the scheme because all three companies used the same invoice numbers, dates, errors and invoice amounts. They also charged to the same cost center. The organization’s losses from the shell company were \$19,800, and the total losses from all the perpetrator’s schemes exceeded \$150,000.

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Created Shell: Pass Through Fraud Scheme

- Lunoid Inc. outsourced computer programming services for more than \$5 million per year. We investigated a potential shell company that provided programmers who worked remotely. First, we identified the general-ledger categories that would lend themselves to a pass-through scheme. Next, we compared invoice-number patterns among all vendors in the same general-ledger category to determine the normal pattern of vendor invoices. The invoice-number analysis didn’t reveal any strong clues. However, anomalies in the line-item description fortunately revealed the perpetrator. Though line-item descriptions usually aren’t useful in identifying shell-company schemes for services, we followed the old adage, “If you don’t look, you can’t see.”

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Created Shell: Pass Through

- In this case, no single red flag was glaring enough to reveal the fraud scheme. We were only able to uncover the fraud by using multiple analyses. The contract officer at Infraloo Corp. had discontinued purchasing from a historical supplier and had begun purchasing from a new vendor, North Atlantic Supplies, by explaining that it was a registered minority vendor. However, our fraud data analytics revealed a series of red flags about North Atlantic Supplies. A change analysis that compared prior-year to current-year purchases showed that the previous vendor was a publicly traded company, but North Atlantic Supplies was a privately held company. We noticed that the purchase orders for North Atlantic Supplies had been issued after the invoice date. The invoice-number pattern was a limited-range pattern, which provided the illusion that the vendor had other customers. A limited range pattern occurs when the perpetrator issues invoices in a random ascending pattern, but the number range between the first invoice and the last invoice isn’t consistent with a real vendor.

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Created Shell: Pass Through

- Infracorp Corp. initially paid invoices consistent with its company policy, but over a twelve months the speed of payment increased — from 30 days to 15 days. The invoice description fields failed both our alpha and numeric tests. Finally, the master-file data analysis indicated that the vendor was preferred and revealed the lack of data commonly found in the company’s master file. Our investigation eventually identified losses totaling \$500,000 paid to North Atlantic Supplies.

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Conflict of Interest

- In another case, Manunte Inc. used a vendor, SLP Consulting Inc. The invoice-number pattern was sequential, but we didn’t see patterns in the invoice dates or amounts. The invoices started with a five-digit invoice number to provide the illusion of an existing company. Our investigation determined that the wife of the vice president of human resources at Manunte was providing these consulting services for a total cost of \$120,000. We identified SLP Consulting as a conflict-of-interest shell company.

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Polling Question -4

What’s the name of the robber who parachuted out of an airplane and still has not been caught?

- A. Leonard W Vona
- B. D. B. Cooper
- C. Clyde Westrow
- D. C. Allen Toussaint

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Thank you

- That's all Folks!
- Questions: lvona@leonardvona.com
- Please visit my web site Leonardvona.com
- Down load my E-Book which will sign you up for automatic monthly blog series
- I promise not a marketing ploy

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