

fraud alert

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**Shell companies
leave businesses
washed up**

**Getting a confession
from a fraud suspect**

**Contract and
procurement frauds
let the worst vendor win**

**When write-offs wipe out
GOOD debts**



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Shell Companies Leave Businesses Washed Up

What's in a shell? Unfortunately, money that doesn't belong there. In this scam, businesses receive fraudulent bills from fake "shell" companies set up by dishonest employees. It's easy for a business to fall victim to a shell company deception if its purchasing cycle involves a large number of transactions and accounts and it lacks strong enough internal controls to ensure that all vendors are on the up-and-up. But careful forensic accounting can help attorneys uncover and document shell company schemes.

HOW IT'S DONE

In a basic shell company rip-off, a corrupt employee forms one or more companies that submit inflated — or totally bogus — invoices to the employer. The fraudster generally is in a position to either authorize purchases or approve payment for them. The result: The fake invoices move briskly through the billing process and get paid along with legitimate ones.

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Dishonest employees who've formed shell companies use several kinds of overbilling schemes to cheat their employers. In a typical pass-through fraud, the shell company is the "middleman" for goods or services the employer purchases regularly. The fraudster buys goods from a legitimate supplier and has them drop-shipped directly to the employer. But the supplier has instructions to

invoice the shell company, which issues its own bill to the employer — including a healthy markup.

Of course, for a shell company scheme to succeed, the fraudster has to get his or her employer to pay the bill. How hard that is to do depends on the company's internal controls.

In companies with poor controls, an employee with sole payment approval responsibility can simply OK bogus bills for payment. If the company has instituted proper separation of duties and requires that two employees sign off on each voucher, the fraudster has to work a little harder. For instance, he or she may create fake purchase orders or vouchers, forge the signature of the person in charge of preparing them, then go ahead and approve payment.

"Rubber stamp" managers are a big help to employees running shell company schemes. Inattentive or overly trusting supervisors approve purchase orders or vouchers without examining whether the costs are competitive or the technical specifications appropriate. Result: The company overpays.

When a dishonest employee can't personally approve a bogus purchase and lacks a sufficiently apathetic supervisor, he or she may need to generate not only false purchase orders, but also receiving reports and vouchers (and associated approvals) to dupe accounts payable into issuing a check.

Finally, instead of one corrupt employee using innocent colleagues to funnel money to the shell company, several employees may participate in the scheme. This is usually a bigger problem than one employee acting alone, and can severely challenge even well-designed internal controls.

HOW IT'S STOPPED

A qualified forensic accountant can help detect shell company fraud at a business, gather evidence and report to you and your clients. He or she also can give you advice on how your clients can prevent future shell company problems.

What a financial expert can do. If a client suspects a shell company fraud, a forensic accountant can take an in-depth look into the matter. The investigator may start with a public record investigation of the vendor company and its principals. Does it appear to be legitimate? What does its Dun & Bradstreet report indicate? Who are its officers? And do any of the names or addresses match those of company employees?

Employees who create shell companies may list completely fictitious owner names, but they frequently use an associate's name, for instance the employee's spouse (or in the case of a wife, her maiden name), close relative or friend. The shell's address is generally a post office box or mail drop, although, as noted above, some fraudsters have actually used their home addresses.

The expert then examines bills of lading, air bills and other shipping documents to determine the actual source of the goods purchased. He or she may also check the fair market value — the prices real vendors charge for the same items.

To find out just how much business the employee has been doing with the shell company, the forensic accountant assembles and examines transaction documents, including purchase orders, invoices, receiving reports, approved vouchers and canceled checks. Listing and sorting invoices by dates, items and amounts reveals patterns. The expert compares pricing and quantities invoiced to those ordered, checking the identities of the people who placed orders, confirmed receipt and authorized payment.

If enough evidence is available, he or she then prepares a damage estimate. And having completed the vendor audit, the fraud expert reports to you

and your clients so that you can decide whether to take internal action, pursue a civil suit or seek a criminal referral.

What a business can do. To prevent shell company schemes, your clients need a combination of basic purchasing due diligence, stringent segregation of duties and associated internal controls. For instance, a simple method of preventing over-billing is to regularly and thoroughly examine invoices submitted for payment. Suspect invoices may lack a telephone number, sequential numbering or appropriate descriptive language.



Another useful preventive measure is adding a “right to audit” clause to clients’ purchase orders, granting a business the right to conduct an on-site audit of the suppliers’ books and records. The audit can help establish whether the supplier is bona fide, and if not, whether it made payments to company employees or to entities under their control. Even if the purchase order doesn’t include the right to audit, you might advise requesting an examination if there’s cause for suspicion. To safeguard future business, a legitimate supplier will likely comply.

WHY WAIT?

Corrupt employees and their shell companies drain thousands of dollars from unsuspecting businesses each year. Please call us if you think one of your clients may have fallen victim to this scam. We can investigate the client’s books and records and thoroughly document any shell company fraud. 🔑

How To Interview A Fraud Suspect

If a client tells you he or she suspects an employee is stealing, your first advice is probably not to confront the suspect, because premature confrontation can open the business to liability and make it harder to get the evidence you need to prove the theft.

After discussing the matter with counsel, many business owners decide to let an expert talk to the suspect and conduct the financial investigation. A forensic accountant can gather and review evidence, then use it to interview the suspect and others who may be involved. Here's how it works.

PLANNED STRATEGY

A forensic accountant who is a skilled interviewer knows exactly how to get from the beginning to the end of the investigation without giving the suspect any unintentional advantages. He or she can uncover key evidence for prosecution or help you prepare for a civil suit leading to a judgment against the suspect's assets. During the interview with the suspect, in most cases the expert aims at getting a signed confession. Just as important, he or she presses to find out where the stolen funds are and whether they can be returned to your client.

It's a step-by-step process. To gain the best chance of securing a confession, the interviewer needs documentary evidence the suspect committed the fraud. So he or she starts by examining company books and records, as well as insurance claim reports, management reports and, if available, police reports. It's also important to get acquainted with the suspect's duties, responsibilities, authority in the company and work history.

Having done this, it's time to plan the interviews. Before questioning the primary suspect, the expert

Regular Interviews Stop Fraud in the Making

To head off fraud before it happens or while it's in the early stages, some companies call in financial experts to conduct periodic employee interviews. During the interviews, the experts (usually forensic accountants) gather tips about possible fraud and gauge the probability of malfeasance.

After establishing some rapport with the interviewee (so he or she doesn't feel like the subject of an interrogation), a fraud investigator might ask the following questions:

- Do you think fraud is a common business concern?
- Is there a fraud problem here?
- If employees or managers were stealing from this company, why do you think they would do it?
- What would you do if you knew another employee was stealing?
- How would you respond if someone asked you to do something unethical?
- Do you know of anyone who might be stealing or taking unfair advantage of the company?

Conducting interviews from time to time, even if management doesn't suspect fraud, can highlight internal control weaknesses and build a company culture of accountability. Management can use the information to strengthen controls and cut short any fraud in the making.

talks to other employees who may know of the scheme. Even those least likely to be involved can sometimes provide useful information. Next come people who may be helping the fraudster, then the suspect him- or herself.

An innocent employee won't mind an extended interview, but a guilty one wants it to end as soon as possible.

Often an interviewer will write down key points to guide the talks, although writing actual questions isn't a good idea as it inhibits spontaneity — and the interviewee might read them and plan his or her answers!

SKILLFUL EXECUTION

Of course, the suspect doesn't have to agree to be interviewed, but refusal raises a big red flag, so most employees will consent. An expert questioner knows how to create a “comfort zone” for the suspect so he or she will feel at ease going into the interview and be less likely to clam up while it's in progress.

How do they do it? Part of a forensic accountant's job is asking tough questions — but without being too intimidating or pointed early in the encounter. Starting with general topics, the expert builds rapport. Body language is as important as spoken answers, so he or she is carefully watching the subject's facial expressions and body movements.

A good interviewer doesn't talk too much but truthfully answers the suspect's questions about why they're being interviewed — for instance, “We're auditing the company's financial statements and would like your help.” He or she avoids becoming defensive and maintains a positive attitude even if the subject becomes aggressive or threatening.

Expert questioners take their time and make sure they understand all the financial facts the suspect provides. They know that an innocent employee won't mind an extended interview, but a guilty one wants it to end as soon as possible so he or she doesn't begin contradicting earlier answers.

FINAL STEPS

Skilled fraud interviewers know that numbers aren't everything in eliciting a confession. When the subject understands the documentary evidence against him or her and seems ready to confess but is still stalling, some fraud experts will suggest a motive other than greed. “Family financial problems” often works well. Indeed, a “nobler” motive lets the subject save face, whether his or her real motive was honorable or not.

When the subject has confessed, the questioner goes to work to pin down the total amount stolen, in case some evidence has yet to surface. Numbers the suspect initially provides can be understated by as much as half, so persistence counts. This is also the



time to ascertain exactly where the stolen money is and whether the company can get it back.

Finally, experts agree that it's crucial not to leave the interview without a written statement. This may be the only time the fraudster is willing to put it all in writing and affix a signature. The interviewer then signs as a witness.

MISSION ACCOMPLISHED

If you think a client company has fallen victim to embezzlement and you need a forensic accountant's help with the investigation, please contact us. We'll help uncover and document the fraud, locate the stolen funds and obtain a confession from the suspect. 📍



Fraud To Watch For: WRITE-OFFS KEEP THEFTS INVISIBLE

Do your business clients know whether their companies' bad debts are really so terrible? A particularly difficult-to-detect form of skimming receivables is when an employee writes off an account as uncollectable, then keeps cashing the unsuspecting customer's checks.

The account is no longer active, so nobody but the fraudster expects payments. The books are balanced but the company is not getting the money it's entitled to, and the customer isn't getting credit for payments made. Calling in a forensic accountant to investigate may be the best course to uncover a bogus write-off scheme.

Lifting the Fog. If your client has recently noted a larger number or dollar value of write-offs, as well as customer complaints about their accounts, a fraud may be in progress. Gaps in the sequence of invoices could indicate a fraudster is invoicing a customer for payments and then embezzling them. Duplicate credit memo numbers can mean a fraudster is processing credit memos twice.

When a forensic accountant is called in to investigate possible write-off fraud, he or she

goes over the company's books and records for documentary evidence, and also checks for lax supervision of employees who can adjust receivables accounts. If the owners don't require write-off exception reports or personally approve all proposed write-offs, dishonest employees have the freedom they need to write off good debts.

Another potential problem situation is failing to rotate assignments among staff members and letting one person assume responsibility for a single transaction from beginning to end. Forensic accountants check who is opening the mail, logging transactions and reconciling daily cash receipts and bank statements. If the same person is performing all these functions and fraud is indicated, this could be the suspect.

Likewise, staffers who refuse to take vacations may be afraid the checks they're skimming will arrive during their absence. Some employees will even refuse promotions that would interfere with their (more lucrative) frauds.

Out in the Open. If you suspect a client is the victim of a fraudulent write-off scheme, give us a call. We can investigate whether there's a problem and help you bring the matter into the open.

Unfair Advantage

CONTRACT AND PROCUREMENT FRAUD

Contract and procurement frauds are popular with dishonest employees and their partners in crime — corrupt vendors. If you suspect these frauds are occurring at a client's firm, a forensic accountant can help you and your client decide what action to take.

WHAT'S OUT THERE

The frauds of this type forensic accountants most often encounter are:

Kickbacks. Most common are money, gifts, debt forgiveness, secret commissions, hidden interests, and buying or selling assets at bargain prices. Vendors offer employees these benefits hoping to get their business. Of course, the dishonest vendor's quality won't compare favorably to an honest company's.

Overbilling. Here a vendor submits inflated or fictitious invoices, usually in collusion with a corrupt employee getting a kickback. Companies with a large transaction volume and poor billing oversight run the greatest risks.

Bid rigging. Normally, vendors base bids on a company's precise specifications and deliver proposals by a set date. But a dishonest vendor may bribe an employee (often the one soliciting bids) to gain advance knowledge of the competition's figures, so he or she can bid late and come out ahead.

BAD SIGNS


Often the initial clues in contract and procurement fraud cases are employees' or vendors' suddenly or inappropriately grandiose lifestyles. Dishonest employees also may suffer from addictions or personal financial problems. Seeing these signs, the forensic accountant thoroughly investigates the employee's and vendor's backgrounds, preparing financial profiles and net-worth analyses.

Of course, weak internal controls can also trigger fraud. Concentration of company authority among few individuals and a poor bookkeeping system, including failure to segregate recording and payment function duties, can leave a company vulnerable. So experts also look for increased blanket purchase orders, many sole-source vendors, excessive inventory, and frequent quality problems with purchased goods and services.

Other warning signs include P.O. boxes for vendors' addresses — or one address for bidders for the same contract. A lack of bidders' conferences informing vendors of major project specifications may also signal trouble, as might a failure to obtain a minimum number of bids, last-minute bid specification changes and bid withdrawals, and improper acceptance of late bids.

If several alerts pop up, the investigator will check for earlier overcharge- or fraud-related lawsuits against the vendor and perform an on-site audit to uncover payments to the employee or his or her shell entity. Bribes and kickbacks are rarely paid in cash, so the forensic accountant also must trace the payment method. He or she can then perform further analysis and damage calculations as needed.

STRAIGHT AND NARROW

If you suspect a client's company has a problem with their contract and procurement functions, please contact us. We'd be happy to help. 

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Craig L. Greene, CFE, CPA

An internationally recognized public speaker, Craig has lectured on topics involving fraud and its detection to auditors, investigators and attorneys. He is a faculty member of the Association of Certified Fraud Examiners and Institute of Internal Auditors.

Craig works as a consultant and expert witness for major corporations, law firms, law enforcement and governmental agencies on cases involving allegations of fraud and misrepresentation. Craig is frequently quoted in major newspapers and publications throughout the U.S.

Specialists in Fraud Examination and Litigation Services

If a business hasn't yet been a victim of fraud, it's been fortunate. According to the Association of Certified Fraud Examiners, fraud costs businesses in the United States billions of dollars every year. Small businesses are especially vulnerable because they often do not have controls in place to reduce the likelihood of fraud.

This is where McGovern & Greene LLP can help. Our firm specializes in helping corporations, attorneys, lenders, law enforcement and governmental agencies analyze financial records and contracts, identify and prevent fraud, recover and analyze evidence, and provide expert testimony in all of these matters. Our highly-experienced team of professionals includes certified fraud examiners and certified public accountants that are experts in the fields of fraud examination, forensic accounting, computer forensics, damage calculations, business valuations and audit services.

Our professionals can assist you in a wide range of matters, including:

- Fraud Examination
- Financial Investigations
- Forensic Accounting
- Asset Recovery
- Internal Audit Services
- Computer Forensics
- Training & Seminars
- Healthcare Audit
- Business Valuation
- Litigation Services
- Government Contracts
- Economic Damages
- Intellectual Property
- Contract Claims
- Construction Audits
- Electronic Discovery
- Profit Recovery
- Due Diligence

We welcome the opportunity to discuss your needs and answer any questions you might have about our fraud examination and litigation services.

Please contact us at 312.419.1961 or visit us at www.mcgovernngreene.com and let us know how we can be of assistance.

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