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### The top risk factor for shell companies

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By Gerry Zack, CCEP, CFE, CIA

A recent case<sup>[\[1\]](#)</sup> reminded me of how easy it is to use shell companies to perpetrate fraud. A former associate general counsel who handled allegations of employee misconduct for a company created fake complaints allegedly filed by actual employees. He also started a fake law firm he secretly controlled—the shell company. He then claimed to have reached settlements for these fake complaints, resulting in payments being made to the phony law firm, which he then used for personal purposes.

It's always surprising and disappointing when a fellow compliance professional or someone in a similar role is caught engaging in acts of wrongdoing, since our job is to prevent and detect this very activity. But once you get over the shock, the case is among a very long list of cases in which a shell company is created by an employee to fraudulently disburse funds from their employer. And it also represents another shell company case with the same red flag that organizations repeatedly fail to pick up on.

For these schemes to be successful, the perpetrator is almost always in a position in which their expertise is heavily relied upon—they may be the only ones with the skills needed to solve a particular problem or carry out a certain activity. I've seen it in shell company cases relating to scientific research, complex tax matters, IT, building maintenance, and many other areas involving specialization that also purportedly require the use of third-party service providers. And these service providers, of course, can only be selected and overseen by the one person in the company who possesses expertise in this area. That's a red flag.

What happens next is the chain reaction that occurs if we're not careful. Since one person in the organization has the knowledge needed to select and oversee the vendor, we let our guard down or completely abandon any efforts at separation of duties—nobody else reviews or questions anything about the selection or use of this vendor along the way.

You don't need the same technical expertise to have good separation of duties. Simply having other people involved in reviewing the justification for engaging a new vendor, setting the vendor up in the accounting system, and reviewing invoices goes a long way toward preventing these schemes. The other people along the way need to know their roles and question things that don't look right.

<sup>[1](#)</sup> In the Matter of Glen Roy Fagan, No. S22Y0802 (Ga. July 6, 2022), <https://www.gasupreme.us/wp-content/uploads/2022/07/s22y0802.pdf>.

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