



# SHELL SHOCKED

WHAT EVERY FRAUD EXAMINER  
SHOULD KNOW ABOUT  
THE PANAMA PAPERS

BY DICK CAROZZA, CFE



The leak of the huge cache of offshore data in the Panama Papers reveals decades-old shell companies — many of which fraudsters have used to launder money and hide crimes. How can fraud examiners use the data? Will the revelations cause governments to overcompensate with overbearing regulations? Or will the exposé ultimately be ignored because unethical systems are so entrenched?

The shelling continues. The Panama Papers have revealed scores of global politicians, business leaders and celebrities as beneficiaries of shell companies — some suspicious, others legitimate. On April 3, the International Consortium of Investigative Journalists (ICIJ), German newspaper *Süddeutsche Zeitung* and more than 100 other news organizations released a leaked cache of 11.5 million records from the Mossack Fonseca law firm in Panama (<http://tinyurl.com/h22lx7c>). Some 400 journalists secretly collaborated for more than a year to publish or broadcast the story on the same day.

And on May 9, the ICIJ posted a searchable database of the nearly 214,000 offshore entities created in 21 jurisdictions — from Nevada to Hong Kong and the British Virgin Islands. The database also displays information about more than 100,000 additional offshore entities ICIJ had already disclosed in its 2013 Offshore Leaks Investigation (<http://tinyurl.com/hl3kzht>). Just plug in a name, and find the dirt.

We've read all those headlines, but what do the Panama Papers mean for fraud examiners? Can we use these databases in

our jobs? Will the release of this immense amount of information even incrementally nudge corporations toward greater transparency and encourage governments to greater regulation?

#### **Work for fraud examiners**

"For those fraud examiners who have skills in investigating international money laundering, bribes, tax evasion and similar acts, it will present many opportunities for investigative work," says Regent Emeritus Bruce Dubinsky, CFE, CFF, CPA, managing director at Duff and Phelps, LLC.

"For example, hedge funds that operate throughout the world should be examining the entities with which they're conducting business to ascertain if in fact they are mere shell companies," Dubinsky says. "The last thing you want if you're a hedge fund are the regulators — or worse yet — law enforcement showing up on your front step with subpoenas. That doesn't make for a good Monday morning."

Dubinsky says multinational companies also need to take a close look at the list of entities with whom they're doing business for the same reasons.

---

*The opinions expressed in this article aren't necessarily those of the ACFE, its Board of Regents and employees. — ed.*

“You’ll most certainly see an uptick in enforcement from the IRS and other taxing authorities worldwide. If you have a tax background as well, working with clients and assisting them with these investigations will be very important,” Dubinsky says. “Most law enforcement policy makers will tell you that using an independent outside party to conduct the investigation or assist during an investigation brings much needed credibility to a situation that already may be sorely lacking such credibility.”

Martin S. Kenney, CFE, managing partner of Martin Kenney & Co., an international fraud and asset recovery law firm based in the British Virgin Islands, says the Panama Papers will be helpful to fraud examiners as a source of leads and intelligence for investigations. He laments, however, that the ICIJ’s release of names of the companies, directors and shareholders isn’t helpful enough for fraud examiners.

“We need access to the emails, the invoices, the payment records, and most importantly of all, the ‘ultimate beneficial owner’ (UBO) identification and know-your-customer (KYC) documents collected on each company formed by Mossack Fonseca,” says Kenney, the 2014 recipient of the ACFE’s Cressey Award.

But therein lies the crux of this massive information deficiency. Corporations (and shell company formation firms) should use their KYC protocols to identify the UBOs, but many don’t do it for fear of what they might find. Or they just don’t care.

### Shadowy shell games

Before we delve into the shady side, it’s important to know that all shell companies aren’t necessarily illegal. “The mere use of a corporate entity in jurisdictions that protects the disclosure on the actual owner or owners is not, in and of itself, a

problem,” Dubinsky says. “For instance, many celebrities use corporations and LLC’s in these jurisdictions to provide proper privacy and for legitimate asset protection from potential lawsuits.”

Dubinsky says that shell companies, as the name suggests, are basically hollow. “They’re legally formed entities that have no employees, no real operating business, no real assets — other than maybe money passing through them and in many in-



Bruce Dubinsky,  
CFE, CFP, CPA



Martin S. Kenney,  
CFE



Jeffrey Robinson

stances, no real business purpose,” he says.

Kenney says the term “shell company” is vague. “If it is formed or used for benign purposes — such as to hold legitimately earned assets or to give effect to a lawful plan of tax avoidance — there is nothing wrong or improper about its use,” Kenney says. However, if it’s a company that’s formed to conceal or wash the proceeds of a fraud, Kenney says, it’s but a “mask” that

a fraudster “holds before his face in an attempt to avoid recognition by the eye of equity,” or so said English High Court Justice Russel. [*Jones v Lipman* (1962) 1 WLR 832]

Jeffrey Robinson, bestselling author and an expert on organized crime and fraud, says that law enforcement has to force the “gatekeepers” to recognize the UBOs even when the beneficial owner is 15 borders and 30 shell companies away. “Because once you know who’s got the money and where it’s coming from, you can say this is a politically exposed person or it’s drug money or it’s money laundering or tax evasion or it’s just some guy trying to hide the money to keep his ex-wife from it,” Robinson says.

“These guys in Panama have been selling time bombs for the global economy because they know what these things are being used for and they don’t care about the beneficial owners. They distanced themselves from any responsibility,” he says. “If you sell me a shell company knowing that it’s owned by another shell company and way on down the line you don’t care who the beneficial owner of the money is, then you’re aiding and abetting because you should be made to know. And that’s how you change things.” (Robinson says he exposed Mossack Fonseca in 1998. Listen to “An expert’s take on the leak,” ACFE.com/panamapapers, a podcast interview with Robinson, by Sarah Hofmann, ACFE public relations specialist.)

“I’ve worked on dozens of high-profile, offshore, tax-shelter cases both for the U.S. Department of Justice — civil and criminal — and the IRS over the past decade,” Dubinsky says. “In every single one of the cases, offshore shell corporations were formed for the sole purpose of evading U.S. income and gift taxes. In many of the cases, the so-called corporate board directors used were the same names as in other unrelated tax shelters.

“And quite frankly, it’s not just about offshore shell companies,” he says. “Many

of the abusive tax shelters I've investigated also involved the use of domestic shell corporations established in either Nevada, Delaware or Wyoming, all of which have corporate entity laws aimed at shielding the identity of the true beneficial owners of these entities."

### **No shock and awe here**

Despite this article's headline, Kenney, Dubinsky and Robinson aren't surprised what the Panama Papers have revealed. "Mossack Fonseca has frustrated some of my firm's fraud investigations in the past," Kenney says. "The firm had a reputation for not complying with KYC anti-money laundering [AML] rules robustly. Arguably, an apparent culture of non-compliance with AML rules represented the firm's competitive advantage.

"When the Panama Papers first broke, Ramon Fonseca was quoted on a national Panamanian TV news show as saying that his firm 'could bear no responsibility' for what its customers would do with the companies that it formed," Kenney says. "He likened Mossack Fonseca to an auto manufacturer where, he argued, 'no one charges the manufacturer with a crime when one of its cars is used as a getaway vehicle in an armed robbery.' This is a silly non sequitur. Mossack Fonseca has been a party to a bargain with its regulators for many years.

"The Panama Papers reveal that in one two-year period, one offshore regulator requested the identities of the UBOs of 100 companies administered by Mossack Fonseca," Kenney says. "In only five of the 100 instances in question was Mossack Fonseca able to show the identities of the UBOs involved."

Dubinsky says it's hard to know exactly what due diligence, if any, Mossack Fonseca conducted. "The fees earned by these so-called 'legal professionals' involved in providing services such as setting up

complicated and often illegal off-shore tax structures — and frequently also finding directors and nominee shareholders who act as mere straw men — are exorbitant.

"I'm not referring to the quick, online incorporators who charge \$1,000 to set up simple shell companies. I'm talking about those law firms that are charging tens of thousands of dollars for establishing complicated, multi-tiered, offshore structures used to assist people in evading taxes and sometimes even laundering dirty money.

"As CFEs, we're all taught to look at things with a heightened level of professional skepticism and ask ourselves, 'Does this make sense?' In these cases, when 'legal' fees are such a distorted large part of the transaction costs, red flags should be popping up faster than a prairie dog crossing the field," Dubinsky says.

Robinson says that those who can stop crooked shell companies in firms like Mossack Fonseca are the bankers' lawyers, accountants, company formation agents and brokers who are doing the money laundering. "The very ones who can stop it are the ones who have absolutely no incentive to stop it because they're making a fortune," Robinson says.

"Now, Mossack Fonseca throws their hands up and says, 'No, no, no — we're only making kitchen knives. If some woman goes into the kitchen, takes the knife and kills her husband, we can't be held responsible for that murder. We just made the knives for legitimate use.' They know what these companies were being used for."

### **A specific scheme common to shell companies**

Fraudsters often set up shell companies to perpetrate false billing schemes or account payable fraud, Dubinsky says. "With a laser printer and some basic word-processing software, a fraudster can create an invoice with a corporate name, address, phone, email, and even a federal

tax ID number and submit a fake invoice for services to a company," he says. "Usually assisted by an insider, the invoice is processed for payment, payment is made to the shell company, the fraudster withdraws the money from the shell company and divides the money with the inside accomplice. When the investigation leads back to the shell company, the company has no assets, the money and fraudsters are long gone and the trail many times goes cold," Dubinsky says.

Kenney says false billing schemes rely on a weakness in internal controls over payments and procurement and the basic infrastructure designed to support such a fraud. "In most instances, this infrastructure includes a string of shell companies used to (a) issue false invoices for payment of phony goods or services and (b) another string of dummy companies through which to wash and conceal the *fructus sceleris* — or the fruits of fraud," Kenney says.

"Having access to a plentiful supply of anonymous companies is crucial for a fraud of this kind to be sustainable. This is why companies are formed, ironically, in under-regulated incorporation centers like Nevada, Delaware and Wyoming. No information regarding the ownership or control of shell companies formed in these jurisdictions is collected or housed there.

"In contrast, in the offshore world, incorporators of companies are required to collect and house this data for use by regulators and law enforcement," Kenney says. "This latter system breaks down though when a regulated offshore company formation agent doesn't embrace a culture of robust compliance. Mossack Fonseca is an interesting study because it's a traditional offshore Panamanian incorporator that also maintains company formation factories in the states of Wyoming and Nevada."

# Sources of Information

CPE Credit: 4  
 Course Level: Overview  
 Prerequisite: None

**\$119 Members / \$159 Non-Members**

## **Hopeless hand-wringing or helpful solutions?**

The Panama Papers won't be the last time a journalistic association, a private nonprofit or a passionate zealot releases leaked data that demonstrates methods of unrestrained criminals.

Regardless, when we again see such a black thread coursing through the economic markets of this tired globe, as CFEs we yearn to see how the private and public sectors might try to prevent and deter the stuffing of hollow shells with laundered cash that enable heinous frauds and other crimes.

"The Panama Papers have given rise to some degree of hysteria on the part of Global Witness [globalwitness.org], The Guardian and other progressive-leaning media outlets or NGOs who have for some time now called for the closure of offshore financial centers," says Kenney. "The law of unintended consequences holds that these think tanks and media outlets will be shocked by what will likely happen if the regulated offshore world is shut down," he says.

"Voluminous quantities of valuable investigative material will be lost as fraudsters will migrate to under-regulated incorporation centers," Kenney says.

"In today's world, facts are often not neutrally reported. The initial impact of the Panama Papers has been to cause some politicians in Europe to call for sanctions against offshore financial centers.

"The leader of the Labour Party in Britain, Jeremy Corbyn, has suggested that Britain should take the extraordinary step of removing the power of locally elected legislators in the British Virgin Islands — where my law firm is located — the Cayman Islands and other British Overseas Territories, and to impose direct rule from London as in the 18th Century model of imperial colonialism," Kenney says. "There are two sides to this debate, and there are many honorable people who live and work in offshore centers. Unfortunately like everywhere else, we have a minority of liars and cheats."

Kenney says that much of the fallout from the Panama Papers has to do with confusion between tax avoidance — which is lawful — and tax evasion — which is criminal — and onshore tax policy



To conduct a successful fraud examination you must be knowledgeable about laws and regulations restricting access to information, the relevant sources of information for certain types of searches and the types of records specific to different types of fraud schemes.

*Sources of Information* will teach you to conduct more effective examinations and find better information in less time and at less cost.

## **Key Takeaways:**

- Types of information that can be obtained from internal sources
- Where to look for information that is created, stored and disseminated electronically
- Ways to gather information through human intelligence
- Information that can be obtained from public records and online sources
- Types of records that are relevant to specific types of fraud schemes
- Methods used to find information worldwide

**Visit [ACFE.com/Sources](https://www.acfe.com/Sources) to learn more.**

muddled up with offshore tax neutrality and tax competition.

“The offshore world has acted as the plumbing infrastructure for globalization, which requires the tax-efficient movement of capital from developed to developing nations,” Kenney says.

“What we see from the Panama Papers is temptation seemingly run amok by reason of imperfections in regulation — coupled with a rejection by the regulated to accept the new normal — namely that ‘bad business is not good for business,’” he says.

“The offshore world needs to improve its regulatory and investigative infrastructure,” Kenney says. “Equally, the onshore world must accept responsibility for its own money-laundering hazards: the unregulated incorporation centers of Delaware, Nevada and Wyoming, and the tendency of many lawyers, bankers and accountants to continue to possess willful blind-eye knowledge of obvious red flags of money-laundering risk. Fixing Panama without also fixing Delaware is like curing cancer to one side of the body and ignoring it on the other. A partial fix just won’t work.”

Dubinsky says that when we witness an exposé such as the Panama Papers, tremendous attention and scrutiny follows — first from the law enforcement community, legislative bodies and then a responsive effort from the private sector. “I think we’ll see more of shareholders’ activism in which behaviors like this — certainly from public companies — won’t be tolerated and once outed will cost the company and management dearly.

“We’ll also see new anti-money laundering legislation like U.S. House of Representatives Bill H.R. 4450, the Incorporation Transparency and Law Enforcement Assistance Act [<http://tinyurl.com/gwf8egu>], which will ensure that persons who form corporations or limited liability companies in the U.S. disclose the beneficial owners of those corporations or limited liability companies, in order to prevent wrongdoers from exploiting U.S. laws for criminal gain and other purposes. The U.S. Senate has a similar version now pending, S. 2489 [<http://tinyurl.com/hpn6qr7>].”

Dubinsky says he’d like to see a balance between the right amount of government regulation and the ability to conduct business in a way that’s legal and

yet protects privacy and other legitimate business needs.

“This is where the business communities affected need to come together with regulators and legislators to work together to create a business-friendly atmosphere that rewards those for playing by the rules and heavily penalizes those that don’t,” he says.

“I think the recent actions in some of the large U.S. Foreign Corrupt Practices Act cases that have been publicized show that the U.S. and some foreign counterparts are in fact upping the ante in the ongoing cat-and-mouse game of international fraud detection,” Dubinsky says.

“Stay tuned,” he says. “There’s a whole lot more to come. This is just the tip of the iceberg.” ■ FM

**Dick Carozza, CFE**, is the editor-in-chief of *Fraud Magazine*. His email address is: [dcarozza@ACFE.com](mailto:dcarozza@ACFE.com).

#### ONLINE CONTENT

Read more on the Panama Papers at [ACFE.com/PanamaPapers](http://ACFE.com/PanamaPapers).

## Robinson says Guernsey is a “huge success story”

“Guernsey — one of the Channel Islands — is a fascinating study because it’s the one that got turned around,” says Jeffrey Robinson, an expert on global fraud.

“My friend, Geoffrey Rowland, who served as bailiff of Guernsey — the chief justice and attorney general — from 2005 to 2012, instituted a regime that drove out dirty money and corporate corruption in favor of one that would reward honest businesses with a sort of Good Housekeeping Seal of Approval.”

Robinson says in the early 2000s a competent outside law

enforcement authority asked Rowland for information about a business licensed in Guernsey. “Rowland fully complied with the inquiry because he was sick and tired of having dishonest businesses tarnish his birthright, and he didn’t want to allow that business to hide behind previously constructed offshore duckblinds,” Robinson says.

“Next, he announced that Guernsey would turn itself into a transparent offshore entity by complying with any and all inquiries from competent law enforcement authorities,” he says. “As a direct result, the dirty money fled to less-stringent,

less-dangerous jurisdictions while the businesses that remained could brag that they had nothing to hide and were worthy of their clients’ trust. “It’s a huge success story. If you have a company in Guernsey everybody knows that you’re a legit operation because you don’t risk having dirty money there,” Robinson says.

“Years later, Geoff told me that Guernsey made more money as a transparent financial center than they ever did as a typically opaque offshore entity.”