



**ÆGIS** e-journal

***Addressing threats that affect your bottom line***

Volume 2 Number 2, February 1999

From the case files of

The LUBRINCO Group

<http://www.lubrinco.com/>

and

Financial Examinations and Evaluations, Inc.

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## **1. Due Diligence — Investing in China? Watch your assets**

International Trade and Investment Companies (ITIC) in China are the only companies allowed to borrow funds from foreigners and lend them or invest those funds in domestic Chinese companies.

China has 240 ITICs, which are investment arms of various governments or banks. Best-known is the central government's China International Trust & Investment Corporation, or CITIC. Guangdong's ITIC is one of 10 allowed to borrow from foreign sources in foreign currencies. They typically take deposits from businesses and government, raise money elsewhere, and invest in state projects. As such, they have contributed little to economic growth but much to local shenanigans. Since market reforms began in 1980, Beijing has run five crackdowns on provincial governments and their misuse of ITICs - in 1982, 1985, 1988, 1993, and 1995. Typically the provincial lords would go back to their old ways as soon as the crackdown ended. But Zhu, Minister of Guangdong, has a more ambitious agenda: He wants to change the fundamental structure of the country.

CITIC, which had investments in more than 700 projects and properties, was shut down on grounds that cash flow was insufficient to service loans of more than \$3 billion owed to international banks. Under China's system, all foreign loans must be approved and registered by the State Administration of Foreign Exchange (SAFE). CITIC apparently failed to register perhaps as much as \$2.4 billion with SAFE. These "illegal" loans will not be repaid! That has touched off howls of protest in Hong Kong's banking community. Hong Kong monetary chief Joseph Yam even visited Guangdong to plead for the money to be paid back quickly, with no luck. Just how much individual banks stand to lose is not yet clear. Estimates compiled by Financial Examinations & Evaluations, Inc., indicate that 78 banks in Hong Kong alone are owed \$7 billion by all the ITICs that can borrow abroad, and if Zhu's agents shut them all down, Credit Lyonnais reckons that Hong Kong banks alone may be out, at a minimum, over \$3 billion.

These maneuvers show that China has appropriated between 3 and 7 billion dollars of investment capital that was determined to have been invested improperly, and hence the investors are entitled to no compensation or ownership of the entities. This may go down in history as the world's largest theft. China is still a mess, and the People's Revolutionary Army runs a vast majority of the business in China despite repeated pleas for them to divest.

Any transaction with China must have three things:

- 1) Dependence upon suppliers/distributors outside of China that cannot be replaced;
- 2) Rewards for Chinese workers and domestic Chinese partners that will end as soon as they get greedy and want all of the pie;
- 3) Contractual enforcement ability, both within China and outside of China, that has real muscle. Until then, each new venture is little more than new fodder for Ministers like Zhu.

## **2. OPSEC, Economic Espionage, and Competitive Intelligence — Option revaluation and the weakness it causes**

The recent bear market prompted more than 100 companies in October 1998 to cushion the blow of their falling stock prices by repricing their stock options for executives. This is hardly surprising considering that, according to compensation experts, 2/3 of a US CEO's total pay package comes from the cashing in of stock options. As declining stock prices make option targets harder to obtain, companies simply lower the exercise price of existing options so that employees can clear performance hurdles as easily as if the bear market hadn't struck. (Ugh, the stock crashed and ... ugh, we need to lower our goals so we can archive them.)

If you can believe this, Cendant recently revamped its top executives' stock option program after its share price dove from a high of \$41.375 to \$10.00 amid allegations of accounting fraud. A sane investor should question whether the options should have been repriced at all, given Cendant management's napping at the helm.

The reaction is an increasingly loud shareholder protest that executives must suffer the same consequences as do other shareholders. Repricing saddles public owners with the entire loss in stock value and rewards the ones in control of the company for a stock price drop. All this, and they need never see an angry shareholder.

An Institutional Shareholder Services survey of 118 large shareholders from 1997—well before the current surge of repricing— shows that 71% would vote for proposals to prohibit repricing without shareholder approval. Further, in August the US Financial Accounting Standards Board (FASB) said that it may push companies to treat repricings as operating expenses. In response, some companies have devised more shareholder-friendly repricing programs. If the share price rises after a company reprices, it would report the gain as operating expense. High-tech companies are already talking of a counter offensive similar to their efforts several years ago that forced FASB to retreat from a plan to account for options as a charge against earnings.

The repricing trend is beginning to spill into Canada. While some Canadian companies are lowering their option exercise prices without consulting shareholders, others, including Calgary's Bolt Energy, are making repricing contingent upon shareholder approval. Companies can make repricing more shareholder palatable through mechanisms such as granting fewer new options, restarting the vesting schedule, maintaining the term of old options, and seeking shareholder approval. But companies that reprice without regard to investors will likely face growing resistance. This type of raid of shareholder value through excessive dilution will cause nothing but class action suits from shareholders and institutional investors. The management of these companies will be hard pressed to defend their actions. In essence a case would go like this...We (the Executives of the Company - soon to be collectively known as the Defendants) based our compensation on stock prices since shareholder wealth maximization is the most important measurement. Stock prices tumbled and the shareholders lost money and we repriced our options to get paid anyway, even though the shareholders lost money....

Expect class action litigation in 1999 to exceed all of 1997 and 1998 combined, on this issue alone. The tort reforms public companies have sought for so many years are finally in place, but nobody reformed the greedy management of over 100 public companies. The spread of the year: Short company's that repriced their stock options, and go long on law firms!

This article has been put into the Competitive Intelligence section because it points out a unique weakness in those companies that have had "option revaluations". These companies will be subject to shareholder suits and the distractions and management reshuffles they almost always cause. The focus of these businesses will not be on competition, but on how to cover their butts. It further reveals a company that is run by managers, and leadership that has little or no equity stake in the company because of the dilution these executions of options cause. These are mature stale companies with no entrepreneurial spirit - other than to that dedicated to re-arranging their compensation plans.

### **3. Executive Protection — Capital flight occurs concurrent with social destabilization and executive protection opportunities / needs**

People and capital – if you threaten them, they will leave!

Around the world many countries continue to concern their middle and commercial class through unstable governments, high taxes, burdensome

regulations, or wealth redistribution through litigation. The prime candidates for capital flight in 1999 are (drum roll please)...

A) Canada - With the renewed succession calls from Quebec. This French speaking province of Canada consumes more in tax dollars than it generates and will have no trade treaties with anyone, including Canada and the United States. While Quebec is a mineral-rich province, the minerals will stay in the ground due to the cost of environmental regulation and the taxes on employees and labor.

B) Ireland, Italy, Spain and Greece - Because of high taxes and a GNP disparity between other EU nations that will drive prices up and job growth down. This will be as a result of the new EU currency that will begin to circulate January 01, 1999.

C) Argentina – Chavez, who lead an unsuccessful coup several years ago, is now a democratically elected president with big social program ideas. Enough said.

D) Australia - because of a rapid rise in crime brought about by the seizure of legally-registered guns from gun owners. The criminals now know that nobody is armed. The middle class and upper class are looking to hide assets abroad to protect against the growing civil unrest.

E) South Africa - For 15 years money has been leaving South Africa illegally in bags, cars, stuffed animals, etc. Now, since currency controls have been relaxed, many of the Bourse-listed companies are seeking listing elsewhere: London, New York, Toronto – anyplace but South Africa. This nation leads the world in murder per capita, burglaries per capita, and carjackings per capita, and has designed an anti-carjacking devise that will immolate any would-be (now medium rare) carjacker with flame throwers from underneath the car.

F) The United States - will also see its share of capital flight primarily due to increasing regulations, socialization of medicine, tort litigation that is out of control, and a government perceived by many with money as trying to exercise restrictive powers over its citizens.

These countries will experience increased political and social instability because of capital flight and thus provide opportunities / needs for executive protection.

#### 4. Technical Issues — Business tax ID number prefixes and Social Security numbers

##### ***Business tax ID number prefixes***

The Service Center of the Internal Revenue Service assigns business Tax ID prefix numbers. These prefixes are normally assigned according to the mailing address of the taxpayer, however, there are several exceptions to this general rule. These prefixes correspond to the number given to the District Office having jurisdiction over that mailing address area. For instance, a taxpayer with a mailing address of Maryland would normally be assigned a Taxpayer ID number with the prefix of 52.

<b>Number</b>	<b>Service Center/District Office</b>	<b>Number</b>	<b>Service Center/District Office</b>
01	Augusta, ME	52	Baltimore, MD
02	Portsmouth, NH	54	Richmond, VA
03	Burlington, VT	55	Parkersburg, WV
04	Boston, MA	56	Greensboro, NC
05	Providence, RI	57	Columbia, SC
06	Hartford, CT	56	Atlanta, GA
07	Atlanta Service Center	59	Jacksonville, FL
08	Andover Service Center	61	Louisville, KY
09	Kansas City Service Center	62	Nashville, TN
11	Brooklyn, NY	63	Birmingham, AL
13	Manhattan, NY	64	Jackson, MS
14	Albany, NY	65	Fort Lauderdale, FL
16	Buffalo, NY	66	Puerto Rico
17	Cincinnati Service Center	68	Sacramento, CA
18	Austin Service Center	71	Little Rock, AR
19	Brookhaven Service Center	72	New Orleans, LA
22	Newark, NJ	73	Oklahoma City, OK
23	Philadelphia, PA	74	Austin, TX
25	Pittsburgh, PA	75	Dallas, TX
28	Philadelphia Service Center	76	Houston, TX
29	Odgen Service Center	77	San Jose, CA
31	Cincinnati, OH	81	Helena, MT
33	Laguna Miguel, CA	82	Boise, ID

34	Cleveland, OH	83	Cheyenne, WY
35	Indianapolis, IN	84	Denver, CO
36	Chicago, IL	85	Albuquerque, NM
37	Springfield, IL	86	Phoenix, AZ
38	Detroit, MI	87	Salt Lake City, UT
39	Milwaukee, WI	88	Las Vegas, NV
41	St. Paul, MN	89	Fresno Service Center
42	Des Moines, IA	91	Seattle, WA
43	St. Louis, MO	92	Anchorage, AK
45	Fargo, ND	93	Portland, OR
46	Aberdeen, SD	94	San Francisco, CA
47	Omaha, NE	95	Los Angeles, CA
48	Wichita, KA	98	A/C International
49	Memphis Service Center	99	Honolulu, HI
51	Wilmington, DE		

### ***Social Security Numbers***

The widespread use of the SSN creates certain problems and opportunities. Many offices maintaining public or educational records index their files by SSN. To gain access to these records, investigator will frequently have to furnish a job applicant's SSN. With a correct SSN, an investigator is able to obtain a broad spectrum of data of great significance. Without it, however, the investigator will be blocked from receiving accurate information.

The dangers created by this state of affairs are obvious. A clever person with something to hide may intentionally supply a falsified number. Other individuals may carelessly furnish an incorrect number. In either case, obtaining the records necessary for a complete an investigation will often be difficult or impossible. The investigative process may be stymied.

Fortunately, with just a little knowledge about how the social security numbering system works, it is possible for investigators to spot many incorrect or falsified numbers.

## The Social Security Number

The SSN's nine digits can be separated into three basic components. Each of the three sections plays a different role. To illustrate how the portions fit together, we will use a sample number 987-65-4320.

### 1. The Area Number

The first three digits (987-65-4320) constitute the SSN's "area number." This portion of the SSN indicates the state or territory in which the holder resided at the time the card was issued. Each state and territory has been assigned unique area numbers.

For example, the state of Missouri has been assigned areas 486 through 500. All *applications for enrollment* in the social security system showing a Missouri return address will have an area number somewhere within this range.

This geographic cue can significantly aid investigations. If a job applicant lists Alabama as the state of his birth and formative years, but his SSN has a New York area number, a prospective investigator should probably ask about New York contacts. There may be a logical explanation for this discrepancy, but the subject may also be hiding something in his background.

Also, many possible area numbers have not been activated at all. At the time of this writing (June 1, 1998), SSN's have been assigned only within the following ranges:

Active Areas 001-665

667-728

Thus, as of 1998, any claimed SSN with its first three digits outside the bounds of these ranges cannot be valid.

### 2. The Group Number

The second two digits in the SSN (987-65-4320), together called the "group number," constitute another key to spotting falsified or erroneous SSNs.

The group number serves to break down SSNs for a given state into more manageable blocks. Although a group number theoretically may be any two-digit number from 01 to 99, many possible groups within each state's allotment have not yet been used. Any claimed SSN with one of these unused group numbers can be presumed invalid.

Determining which group numbers have been used for a given state's SSNs is actually a fairly easy matter. For each state, the order in which the groups are activated follows the same logical pattern. When you know where in this

pattern a given state is, you can instantly tell which group numbers are valid for the state and which are not.

### 3. The Serial Number

The last four digits (987-65- 4320) are called the “serial number.” This may be any four-digit number from 0001 to 9999. The serial number in a given SSN simply shows its numerical position within a group. Our sample SSN, 987-65-4320, would be number 4320 among SSNs within group 65 and area 987.

No valid SSNs will have a serial number of 0000. Beyond this, any other serial numbers in a valid group and area are potentially valid.

### The Numbering Sequence

For the residents of each state, social security numbers are assigned according to rules. The numbering rules make sense once they are understood, but they do not follow the pattern that most people would expect.

Because of the unusual numbering system, it is quite likely that many applicants who intentionally or inadvertently supply incorrect social security numbers will actually pick “impossible” group and area combinations. Many of these can be easily detected.

There are two basic rules that govern the assignment of SSNs in each state’s areas:

#### Rule 1: The Odd-Even-Even-Odd Rule

The two-digit group in the middle of the SSN is, in some respects, the key to determining validity. Although these numbers may range from 01 to 99, groups for a given state are not assigned in straight numerical order. The Social Security Administration has adopted a unique “odd-even-even-odd” pattern for opening these groups.

For SSNs in each state’s area range, the first groups used are those with odd numbers below 10. These groups are taken in ascending order (01, 03, 05, 07 and 09). After all SSNs allotted in these groups have been issued, even group numbers 10 and above (10, 12, 14, 16...98) are activated, also in ascending order.

When group 98 is reached, the Social Security Administration returns to even group numbers below 10, and then odd group numbers above 10.

From this information, one vital point emerges. When you know the group number currently being used for a given area, you will instantly know which groups have preceded it and which have not yet been used.

The following examples may help your understanding of the Odd-Even-Even-Odd Rule:

Example 1: For Rhode Island residents, SSNs with an 035 area are currently being assigned a group number of 66 (035-66-XXXX). In light of the Odd-Even-Even-Odd Rule, you can conclude the following about SSNs beginning with an 035 area number:

Rule 2: The Group Rollover Rule.

For each state's area(s), all SSNs with a given group number are issued before any with the next group number are issued. Within the group, numbers are issued in all areas from the lowest through the highest.

Example 4: In New Hampshire (areas 001 to 003), the Group Rollover Rule dictates that:

- a. 001-52-5555 was followed by 001-52-5556.
- b. 001-52-9999 was followed by 002-52-0001, not 001-54-0001.
- c. 003-52-9999 was followed by 001-54-0001.

Like the Odd-Even-Even-Odd Rule, this pattern goes counter to what most people would guess. Just remember that the group controls the area, not the other way around.

## A Simple Method

While a basic understanding of the social security numbering system is invaluable, the Social Security Number Table will help with evaluating SSNs.

The first column lists, in order, each possible three-digit area number. Both areas that have been activated, and areas that have not yet been used, are included. For any specific SSN, you can quickly determine if the area number is invalid.

The next four columns, when taken together, show the group numbers that are possible for each area. Individually, these columns reveal the highest active group number in four separate categories:

Odd group numbers less than 10.

Even group numbers equal to or greater than 10.

Even group numbers less than 10.

## ***Social Security number prefixes***

The first 3 numbers on the Social Security card indicate the state of issue. Not all numbers have been issued.

<b>Number</b>	<b>Issuing State</b>	<b>Number</b>	<b>Issuing State</b>
001-003	New Hampshire	478-485	Iowa
004-007	Maine	488-500	Missouri
008-009	Vermont	501-502	North Dakota
010-034	Massachusetts	503-504	South Dakota
035-039	Rhode Island	505-508	Nebraska
040-049	Connecticut	509-515	Kansas
050-134	New York	516-517	Montana
135-158	New Jersey	518-519	Idaho
159-211	Pennsylvania	520	Wyoming
212-220	Maryland	521-524	Colorado
221-222	Delaware	525 & 585	New Mexico
223-231	Virginia	526-527 & 600-601	Arizona
232-236	W. Virginia / No Carolina	528-529	Utah
237-246	North Carolina	530	Nevada
247-251	South Carolina	531-539	Washington
252-260	Georgia	540-544	Oregon
261-287 & 589-595	Florida	545-573 & 602-626	California
268-302	Ohio	574	Alaska
303-317	Indiana	575-576	Hawaii
318-3611	Illinois	577-579	Wash. D.C.
362-386	Michigan	580	Virgin Island
387-399	Wisconsin	580-584	Puerto Rico
400-407	Kentucky	585	New Mexico
408-415	Tennessee	586	Guam, American Samoa & Pacific Territories
416-424	Alabama	587-588 & 425-428	Mississippi
425-428 & 587-588	Mississippi	589-595 & 261-267	Florida
429-432	Arkansas	600-601 & 526-527	Arizona
433-439	Louisiana	602-626 & 545-573	California
440-448	Oklahoma	700-728	Railroad Retirement
449-467	Texas	729-999	Unassigned (as of 1998)
468-477	Minnesota	574-580-586	Some issued to S.E. Asian Refugees

## **5. Real Stories from the Field — Money laundering**

A well-known and successful businessman owned a burger franchise. He had owned this franchise for over 20 years and, yes, he was known as a pillar in the community. He was also a VERY successful money launderer. Every business day he placed his businesses deposits into a bank account at one of the local banks. His deposits were always in cash, and he always purchased change for the business's next days activities. He also made identical deposits and change purchases, each and every day, at four other banks. The four additional deposits made at four different banks were the proceeds of street-level crack pushers and dope dealers in the community. (This is where he went from pillar to pillory of the community.) He was caught when several of the banks, in a few month time span, merged and they found identical deposits to accounts with the same name and tax ID number. Since his average of \$5,500 per day deposits in cash were normal and in the ordinary course of business, there were no SAR (Suspicious Active Reports) or CTR (Currency Transaction Reports). It is estimates that for over 12 years he has laundered over \$7,000,000 per year.

Money laundering has been often associated with the drug trade. These laundered sums come back to the host country in legitimized funds that are than reinvested into the criminal enterprise. The re-investment includes the purchase of safe houses, weapons, and the college education of gang members so they can be the lawyers and business managers of the gangs. In some instances the funds also find their way into municipal elections. This allows the election of gang members to city and county positions, to use the government positions to strengthen the gangs and weaken enforcement against the gangs. Money laundering is a basic support service to most criminal activity.

## **6. Book and Product Reviews**

*SCAM - Shams, Stings and Shady Business Practices  
and How You Can Avoid Them*

Peter H. Engle

St. Martin's Griffin, New York

This book provides a solid introduction to the scams we know and love, and ones we have yet to see. While this is in no way a comprehensive guide to the scams that surround us, it does provide a good solid foundation for the uninitiated on how poorly one human can treat another. It is worth the purchase price.

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