

Austin Area Chapter Association of Certified Fraud Examiners

President's Corner

Tracy Bohmer, CFE, CPA

Please note: We will have no April luncheon this month. Our **Spring Seminar** is planned for **April 14th** and will **NOT** include a luncheon only option. We have a great line up of Speakers so be sure and check it out. See the seminar flyer for details on <http://www.austinacfe.com>.

Please consider attending this great opportunity. The Board is excited about the speakers and hope you will take advantage of this great training on fraud related topics. We are always seeking good speakers with interesting topics for the luncheons, as well as the seminars. Please let any Board member know if you hear of someone that might have something to share with us. Or if any member has recently handled an interesting case, we would love for you to present your trials and tribulations.

Seminar Location:

Catfish Parlor Restaurant 4705 E. Ben White

You can order non-fried food. Just let them know when you order.

The Annual Business Meeting will be held at our May Chapter Luncheon Meeting. The Chapter Bylaws require an annual presentation of financial statements. Copies of the statements will be available at the May meeting, and the Board will answer questions you might have. This brief presentation will be followed by our usual program. The ballot has been sent for selecting our Chapter Officers and Board Members. Please return it by our April 2, 2010.

Spring Seminar

Time: 8:00 a.m. to 4:30 p.m.

Location: Catfish Parlour
4705 E Ben White Blvd

Cost: Seminar Fee: Members (\$125.00)
Non-members (\$175.00)

Date: April 14, 2010

See brochure for details at

<http://www.austinacfe.com/docs/2010springseminar.pdf>

Register on line:

<http://www.austinacfe.com/register.htm>

or call 512-923-8656

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What You Missed

By Mike Garner, CFE, CIA



If you were not one of the 68 able to attend the March 1, 2010 chapter meeting you missed a presentation on "Fraud Detection and Prevention at the Texas General

Helen Young March Speaker

Land Office by Ms. Helen Young, MBA, CFE, CIA, CISA, Deputy Commissioner of Internal Audit, Texas General Land Office. Ms. Young received her MBA from UT and has been a Chief Audit Executive in State Government for over 14 years. In conducting audits, investigations, and presentations she strives to achieve the results as conveyed in the following quote. *"Do all the good you can, By all the means you can, In all the ways you can, In all the places you can, At all the times you can, To all the people you can, As long as you ever can."* — John Wesley, 18th-century Anglican clergyman. The point emphasized by Ms. Young is that doing good is a continuous, never-ending process.

Ms. Young started her presentation with a brief background of the Texas General Land Office. The Republic of Texas Congress established the General Land Office in 1836 shortly after Texas won its independence from Mexico. The General Land Office (GLO) was originally responsible for managing the public domain by collecting and keeping records, providing maps and surveys and issuing land titles. Since then the GLO's duties have evolved, but its core mission is still the management of state lands and mineral-right properties totaling 22 million acres. Included in that portfolio are the beaches, bays, estuaries and other "submerged" lands out to 8 miles in the Gulf of Mexico, institutional acreage, grazing lands in West Texas, timberlands in East Texas, and commercial sites in urban areas throughout the state. In managing that property, the land office now leases drilling rights for oil and gas production on state lands, producing revenue and royalties which are funneled into the state's Permanent School Fund.

The dividends and interest from Permanent School Fund investments go into the Available School Fund, and from there money is distributed to school districts on a per-pupil basis, helping to offset local property taxes. Since the Permanent School Fund was established in 1854, the Texas General Land Office has deposited into it more than \$6.8 billion, mostly from oil and gas leases and real estate trades and sales.

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AUSTIN AREA CHAPTER OF
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More than \$700 million a year is earned from public lands to help finance public school education.

Texas is the only public-land state with complete control over its public lands and over the proceeds resulting from the administration and sale of lands. As of 1992 GLO was the management agency for 20.5 million acres of state lands and mineral-right properties, including submerged lands out 8 miles in the Gulf of Mexico. As a result GLO is also responsible for oil spill cleanup and took the lead responsibility for Hurricane Ike clean-up.

Ms. Young showed a copy of the Institute of Internal Auditor's Internal Audit Capability Model. Reading it helped her view things as being along a continuum and to understand that you cannot do everything at once, but if you keep taking steps forward, you will move along the continuum. The Internal Audit Capability Model Matrix shows five levels (initial, infrastructure, integrated, managed, and optimizing) for six internal audit capabilities (services, people management, professional practices, performance management and accountability, organizational relationships and culture, and governance structures). Specific criteria have been established for each capability at each level. One goal is to master each capability at the level () you are currently, prior to progressing up to the next level.

Ms. Young had just finished reading Ms. Cynthia Cooper's book "Extraordinary Circumstances." Ms. Cooper is the former Vice President for Internal Audit at WorldCom. Ms. Young then described the lessons learned as expressed in this book. She was impressed by the "incredible fortitude" Cynthia and her internal audit staff demonstrated throughout the internal audit process. It started with a capital spending audit and grew to the discovery of an \$11 billion fraud involving "prepaid capacity" (this accounting term was only used at WorldCom). This fraud had devastating consequences for the company, for its executives, for those involved in the fraud, for Cynthia and her internal audit staff, for her family, and for the entire community in which they lived.

Ms. Young indicated that the fraud could possibly have been stopped if the staff accountants (Mr. Troy Normand and Ms. Betty Vinson) who were first asked to make unsupported entries that they didn't understand and didn't feel comfortable making, had refused to do so and instead reported the situation to Internal Audit or to a fraud hotline. Mr. Normand and Ms. Vinson even prepared their resignation letters and were prepared to leave the company.

But instead of leaving the company and reporting the entries, they made the entries and were sentenced to federal prison for three months and five months respectively.

In other WorldCom sentencing the accounting supervisor (Mr. Buddy Yates) and the accounting manager (Mr. David Myers) that allowed these entries were each sentenced to one year and one day (the one day was added so that they would be eligible for a 25% reduction in their sentence for good behavior). The Chief Financial Officer, Mr. Scott Sullivan, received five years. Although he was the fraud's "architect," he was also the "model cooperator" and was the key factor in the successful prosecution of Mr. Bernie Ebbers, Chief Executive Officer. Mr. Sullivan voluntarily relinquished most of his assets including the proceeds of the sale of his Boca Raton mansion as well as the remainder of his retirement savings, towards civil-suit settlements.

The Chief Executive Officer Mr. Bernie Ebbers received 25 years in federal prison - down from the sentencing guidelines recommendation of 30 years. Although the judge suggested a minimum security facility in Mississippi close to his family the Federal Bureau of Prisons assigned him to a medium-security prison in Oakdale, Louisiana 200 miles from his family. One of the factors in sentencing is the loss to share holders, but the critics brought up the point that how can you tell what factors reduced the stock - was it the fraud or was it the market? The fraud was perpetrated to forestall and conceal the impending demise that happened after the fraud was announced. Therefore the critics of the sentencing guidelines brought up the point that the investors would have just lost their stock value due to market factors and management decisions regardless of whether the fraud ever occurred. Although this may have been true to a degree, the sentence was upheld because there was such a large fraud (\$11 billion) that even a small loss of value would have hit the \$100 million needed for the maximum sentencing.

The civil suits were settled so that the codefendants would distribute over \$6.13 billion, plus interest, to over 830,000 individuals and institutions that had held stocks and bonds in WorldCom at the time of its collapse. In addition, the Security and Exchange Commission levied a \$750 Million fine against MCI-WorldCom to be paid when it came out of bankruptcy. After coming out of bankruptcy the company was sold to Verizon (a company that WorldCom had tried to buy prior to its collapse).

GLO developed and issued a Fraud Prevention Policy that assigned all employees the responsibility for preventing and detecting fraud and assigned Internal Audit with the responsibility for investigating it. Three GLO employees formed a collaborative and supportive study group to pass the CFE exam. After these three were certified two of them started giving short presentations at the monthly senior staff meetings on the Key Components of the GLO Fraud Prevention Program. The other CFE conducted an internal audit on the GLO ethics program.

GLO Internal Audit developed a Fraud Risk Assessment tool and added it to the Annual Risk Assessment tool that all managers prepare and submit to Internal Audit each year. The agency implemented an external fraud hotline that is available to all GLO employees. The agency appointed an ethics officer who coordinates with Internal Audit.

In regards to agency training, Internal Audit conducted a training class on "Fraud Prevention Basics." This was well received by the agency and then Internal Audit was requested to present a mandatory training class on fraud. To prepare for this presentation, Ms. Young attended the IIA conference that included a fraud track where she gathered a lot of useful information. She then prepared the presentation entitled "Fraud Prevention – Beyond the Basics."

In making the presentation to all 600 GLO employees that were required to attend, Ms. Young wanted to make the presentation real to the agency employees rather than discussing the abstract. She was able to get everyone's attention by starting her presentation with information about a substantial fraud in GLO's counterpart agency in Oklahoma involving former Director of Audit for Oklahoma's Commissioners of the Land Office's royalty audit division Mr. Roger Melson.

Mr. Melson was indicted on 174 counts of embezzlement that accuse him of taking more than \$1.16 million in royalty payments from oil and gas leases during the last five years. The embezzlement came to light in April 2009 when a delinquency notice was issued by the Land Office for an overdue royalty payment from an oil and gas producer on public lands. But the producer provided the cancelled royalty check it sent to the Land Office, and investigators traced it to a private bank account Mr. Melson had opened. Investigators eventually discovered that Mr. Melson had diverted 174 Land Office royalty checks to the private account. He was indicted in June 2009 and accused of embezzling more than \$1.16 million in royalty payments from oil and gas leases over a five-year period. He set up fictitious companies and bank accounts to conceal his fraud.

He registered with the Secretary of State an entity called Commissioner of the Land Office and opened a bank account referenced Roger Q. Melson, Jr. DBA Commissioner of the Land Office (the legitimate name was Commissioners of the Land Office). He used the money to support a gambling habit and when indicted only had \$23,000 left in his bank account. Mr. Melson's lawyer admitted that he had a gambling problem and had been in treatment for the past decade.

Mr. Melson was able to compromise the system of internal controls that could have prevented or at least detected it sooner.

- Access Restrictions - As director of audits, Mr. Melson knew what payments were likely to be audited by the external auditor and was able to divert the audit away from these transactions. Mr. Melson should not have been allowed to have access to the list of accounts scheduled for external audit.
- Segregation of duties – Mr. Melson volunteered regularly in the mail room. Knowledge from his position as director of audits allowed him to know privileged information that compromised the segregation of duties. Although there were two people opening the mail they were opening different mail and were not reviewing each other.

After Ms. Young was able to get their attention with this real life example, she was then able to help them think through potential fraud scenarios in their operations and processes. She wanted to make sure that a strong message was sent to these employees that it is much better to report something that is potentially fraudulent than to unknowingly commit an act or know about an act and do nothing that is later determined to be fraudulent. She then referenced back to Cynthia Cooper's book that mentioned that some executives lost their way and then led others astray as well. They embarked on a slippery slope – once they had begun to deceive, they did not regain their footing.

Ms. Young emphasized the need to pay attention to risks and then respond to them. Major changes create risks and we need to make sure that they are managed appropriately. In eight years WorldCom grew from revenues of \$1.5 billion to over \$38 billion. New leadership and new system implementations can cause risks or changes such as disaster funds received through FEMA or reinvestment funds received through ARRA.

Acknowledging these risks and ensuring that there are sufficient controls in place and working would mitigate the risks to a level that can be accepted by the organization.

Watch for red flags, as Ms. Cooper mentioned in her book that she and her team grew increasingly suspicious of some entries in WorldCom's books. The more they investigated, the stranger the reactions from some of their colleagues became. No one would give them a straight answer.

Ms. Young mentioned that she was working on a Case Study for the IIA Austin Chapter's Research Project. In preparing this case study she interviewed the President of Audit for the Aditya Birla Group headquartered in India. The company is the largest producer of aluminum rolled products in the world and is the fifth largest global producer of carbon black. The company is also a market leader in Viscose Staple Fibre (VSF) and has a significant presence in copper, ready-made garments textiles, business process outsourcing, financial services, insurance, retail, and telecommunications. The President of Audit has 13 Chief Audit Executives and their associated Audit Committees that report to him. Ms. Young indicated what an honor it was to interview someone of his stature and internal audit responsibilities. One of the areas that she discussed with him was how he was able to maintain focus with such diverse responsibilities. He indicated that he and the organization follow five value principles which are integrity, commitment, passion, seamlessness, and speed. To further the learning process the company has developed a pack of cards with 52 values statements that relate to these five value principles.

In closing Ms. Young emphasized the importance of encouraging, promoting, and following ethical principles and practices. Although nothing matters more than the tone set at the top, every employee can influence this tone by their words and actions. If you are doing your job as an auditor or fraud examiner, there is usually someone that doesn't want to hear what you are saying but that is even more reason to make sure that it is said to, understood, and acknowledged by the highest level of the organization.



The Spotlight's On You!

A special feature focusing on members of the Austin Area Chapter of ACFEs

Dale Hernandez

But maybe you didn't know...



Job Description:

Internal Auditor at the Texas Lottery Commission.

What I'm working on now:

There are many exciting things going on at the Lottery. Right now I am wrapping up a project on jackpot estimations and have started working on a project related to the payment of prizes. It is always fun when a winner comes in to claim their prize.

Best part of my job:

I am a shy person so getting to meet different people is fun for me.

Ambition and/or Goals:

I would like to continue to learn new things and keep my brain limber. I also want to retire and then re-enter the workforce closer to home to minimize commuting.

Years of state service:

15 years of State service and 11 with the City of Austin.

My first job:

I did a lot of babysitting but my first "real" job was as a selector at Owens-Illinois. We made glass containers (beer bottles) and selectors watched the bottles as they came down the line, discarded bottles with flaws and packed finished bottles for shipment to the breweries.

Hobbies:

Bowling, miniature golf, reading, and fishing.

Favorite Movie:

One Flew Over the Cuckoo's Nest. My favorite genre is zombie films and I also enjoy other cheesy horror films. The Leprechaun series is particularly cheesetastic.

Last books I read:

I just finished The King and Dr. Nick: What Really Happened to Elvis and Me by Dr. George Nichopoulos. I just started A Thousand Splendid Suns by Khaled Hosseini.

Favorite foods:

I eat almost anything as long as it doesn't have raisins in it. Absolute favorites are popcorn, Italian Beef sandwiches, and Mexican food.

Favorite Restaurants:

Mangia Pizza. Most Mexican restaurants. Still looking for a place in Austin that serves good Italian Beef.

My pet(s):

Dog Shimmy who is a 5 year old Beagle/Lab mix and master escape artist and food sniffer-outer.

It's a good day when:

I can take time to relax and I am not responsible for anything or anyone but myself.

Pet Peeves:

Line cutting, shoving, rudeness and people who make fun of my name.

What I would do with a surprise afternoon off:

Go to a matinee at the movies or window shop at the San Marcos Outlet Mall.

I'm most proud of:

Graduating from college. I almost quit because I was young, tired of school, and making "big bucks" as a selector at Owens-Illinois. Layoffs and rotating shift work convinced me to stay in school.

Most people probably don't realize:

I want to learn to play the harmonica.

2010 Scholarship Winners



Amy Brunner



Stephanie Hayes



Brian Mueller



Catherine Rutherford



Rebecca Takahashi