

CFE UPDATE  
January-February 2000

**Chapter Fraud Seminar Training and Meeting Dates**

If you've been wondering about whether you failed to receive a Chapter Newsletter, the answer is **NO**. There was simply a delay of one month in sending this current mailing to you. Now you probably want to know why. So, read on for the rest of the story.

The Chapter has changed its bimonthly meeting dates from the odd months to the even months of the year. The reason for this change was to realign our meeting schedule so that there would be no conflicts with activities of the Association of Certified Fraud Examiners. However, there is no change in our meeting location or time. So, we'll still be meeting at the usual place in downtown Seattle (28<sup>th</sup> Floor conference room of the old Key Towers Building) on the last Wednesday of the appropriate month for two hours of Continuing Professional Education from 3:00-5:00 p.m. There is **one exception** to this rule, and it affects our **next** Chapter Meeting.

We will be holding a joint fraud training seminar with the Seattle Chapter of the Institute of Internal Auditors on Wednesday, March 8, 2000. This will take the place of our normal February Chapter meeting. We will also be meeting at a different location in Seattle, the **Washington Athletic Club**. The speaker will be Joe Dervaes, Chapter Vice-President and Member of the Association of CFE's Board of Regents (see attached training flyer). Joe will be using a one hour Association video as he speaks on the topic of "Interviewing Techniques". So, mark your training calendar for this special event. We look forward to meeting and networking with our good professional friends from the Seattle Chapter of the IIA.

Our training schedule for the year 2000 is as follows:

March 8 – Joint Chapter Fraud Seminar with the IIA Chapter, Interviewing Techniques, Washington Athletic Club, Seattle.

April 26 - Chapter Fraud Seminar, Key Towers Building 28<sup>th</sup> Floor Conference Room, Seattle.

June 28 – Chapter Annual Business Luncheon Meeting, Best Western Southcenter, Tukwila.

July 30-Aug 4 – Association of CFE's 11th Annual Fraud Conference, Marriott Marquis Hotel, New York City, NY.

August 30 - Chapter Fraud Seminar, Key Towers Building 28<sup>th</sup> Floor Conference Room, Seattle.

November 2-3 - Joint Association of CFE's and Chapter 2-Day Fraud Conference, Hilton Hotel, SeaTac.

December 12 - Joint Chapter and WSCPA Fraud Conference, Marriott Hotel, SeaTac.

Be sure to mark these important dates on your training schedule and plan to attend. You'll be glad you did.

## **Chapter and Association Scholarship Programs**

Nominations for the Association of CFE's 2000-2001 Ritchie-Jennings Memorial Scholarship Program are due at the Chapter not later than March 31, 2000. The Chapter Board of Officers will review the applications and select a primary and alternate representative. The Chapter will then forward appropriate letters of recommendation to the Association to arrive by the May 12, 2000, deadline for the national competition.

Fifteen scholarships worth \$1,000 each will be awarded this year based upon academic achievement, letters of recommendation, and an original essay explaining why the applicant deserves the scholarship and how the awareness of fraud will affect his or her professional career development. Applicants must be full-time undergraduate or graduate students who are declared accounting or criminal justice majors. There will also be one \$500 scholarship awarded by the Chapter.

Both Chapter and Association scholarship awards will be announced by June 30, 2000, and awarded by August 11, 2000. Best wishes for success to all applicants, especially those representing the Pacific Northwest.

Thanks to President Norm Gierlasinski, Chairman of the Scholarship Committee, for his hard work in making the Chapter Scholarship Program a huge success. Norm will be mailing flyers and scholarship application forms to the appropriate colleges and universities in our Chapter geographic area this week. Anyone may obtain a copy of the scholarship application form from either President Norm Gierlasinski, (206) 439-1259, or Vice-President Joe Dervaes, (360) 337-7102.

## **News About Chapter Members**

Effective January 1, 2000, the Honorable Brian Sonntag, State Auditor, promoted Vice-President Joe Dervaes to be the Director of Special Investigations for the Washington State Auditor's Office. Joe is responsible for managing the Washington State Employee Whistleblower Program and the State Auditor's Office Fraud Audit Program, and supervises a staff of seven auditors and investigators. The Fraud and Whistleblower Programs are two of the highest priority functions in the State Auditor's Office. Congratulations Joe!

## **Semi-Annual Chapter Board of Officers Meeting**

Your Chapter Board of Officers held its semi-annual meeting on Saturday, January 29, 2000, at the Central Washington University SeaTac Center. President Norm Gierlasinski, Vice-President Joe Dervaes, and Director-At-Large Bob Fuhrman attended the meeting. The Board covered the following business matters:

(1) At the August 18, 1999, annual business meeting, we changed the **Chapter By-Laws** to a new Fiscal Year ending July 31, 2000. We extended the term of office for the

existing Board of Officers from 12 to 18 months so that elections would coincide with the Fiscal Year. Therefore, we will have to hold elections at the June 28, 2000, annual business meeting. **If you are interested in being a member of the Board of Officers, please contact either President Norm Gierlasinski at (206) 439-1259, or Vice-President Joe Dervaes at (360) 337-7102.**

(2) At the August 18, 1999, annual business meeting, the Chapter agreed to change our Section 501(c)(3) non-profit organization to a Section 501(c)(6) trade organization to comply with the Chapter Handbook of the Association of CFE's. This involved making an amendment to our **Chapter Articles of Incorporation** and filing the document with the Washington Secretary of States Office and the Internal Revenue Service. Upon further inquiry, we learned that we would not be able to proceed as planned because dissolution required all funds to be transferred to another Section 501(c)(3) organization, not to our new Section 501(c)(6) organization. Thus, in order to retain our hard-earned funds from seven years of successful Chapter operations, we will have to form two organizations. **The existing Section 501(c)(3) organization will be used to administer the Chapter Scholarship Program. A new Section 501(c)(6) organization will be formed to handle all future Chapter operations. The Board of Officers recommended this plan of action be submitted to the membership for approval at the next annual Chapter business meeting (June 28, 2000).** If approved, Vice-President Joe Dervaes will file the appropriate organizational documents with the state and federal governments.

(3) At our April 26, 2000, Chapter fraud training seminar, we plan to show the Association of CFE's video on "Other People's Money – The Basics of Asset Misappropriation". Following the video, there will be a panel discussion to explore practical applications of the material presented. The Board of Officers is seeking Chapter members who would like to assist with this training. We're always looking for new leaders in our Chapter. So, here's your golden opportunity to share your practical fraud experiences with your fellow professionals. **If you would like to participate as a member of this panel, please contact either President Norm Gierlasinski at (206) 439-1259, or Vice-President Joe Dervaes at (360) 337-7102.**

(4) We discussed the fraud training calendar for Calendar Year 2000. It is presented above. Each member of the Board of Officers was assigned specific topics and suggested speakers for Chapter fraud training seminars and the annual fraud conference the Chapter jointly sponsors with the Washington Society of CPA's. This is one of the most important tasks performed by the Chapter Board of Officers. As you might imagine, there is a lot of behind the scenes work accomplished as we work to provide valuable fraud training events and a forum for Continuing Professional Education credits for the membership. We take this matter very seriously. **If you have a suggested fraud seminar topic and speaker, please contact either President Norm Gierlasinski at (206) 439-1259, or Vice-President Joe Dervaes at (360) 337-7102.**

(4) To encourage attendance at our annual Chapter business meeting in June, the Board of Officers agreed to provide the luncheon and fraud training to all Chapter Members and

Associate Members at no cost. Non-members will be required to pay \$15 to attend this fraud training event.

(5) We discussed Chapter representation at the three annual fraud conferences.

(a) Vice-President Joe Dervaes will attend the Association's 11<sup>th</sup> Annual Fraud Conference and the Board of Regents meeting. His expenses are paid for by the Association. However, we are seeking a Chapter member who is planning to attend the conference who would be willing to represent us at the Association's Chapter Meeting on Sunday, July 30, 2000. **If you are interested in this national fraud opportunity, please contact Vice President Joe Dervaes at (360) 337-7102.**

(b) The Chapter Board of Officers will help with registration and administration duties for the joint Association and Chapter 2-Day Fraud Conference in November. The Association provides three complimentary conference registrations in exchange for this assistance. The Board of Officers agreed to pay the conference registration fee of any Board Member who does not receive a complimentary conference registration from the Association to recognize their service to the Chapter membership. The Board of Officers also agreed to pay for the luncheon expenses of any Chapter member who attends this conference as a token of our appreciation for your support of this most worthwhile training event.

(c) President Norm Gierlasinski and Vice-President Joe Dervaes will serve as the Co-Chairpersons for the joint WSCPA and Chapter 1-Day Fraud Conference in December and receive complimentary conference registrations for their participation in this training event. Chapter Member Linda Saunders serves as the liaison with the WSCPA and serves on the Society's Fraud Sub-Committee. The Board of Officers appreciates the leadership of these Chapter members.

(6) Vice-President Joe Dervaes will submit the Nomination Package for Director-At-Large Gail Rogers to receive the Association's Distinguished Achievement Award for 1999. Gail has been a member of the Board of Officers since the Chapter began operations in 1993. She is responsible for publishing the Chapter Newsletter and Chapter Directory, and maintains the Chapter Reference Library. In addition, she has assisted with registration and administration duties for the joint Association and Chapter 2-Day Fraud Conference each year. This award recognizes Gail's leadership in Chapter operations and for the many hours of service she has volunteered to ensure that affordable fraud training is available to the membership each year. She is a respected professional in the fraud community in the Pacific Northwest. The Chapter would not be able to function as we do without her dedication to these important Chapter functions. Thanks a million Gail!

### **Fraud Tips**

By: Joseph R. Dervaes, CFE, CIA  
Director of Special Investigations  
Washington State Auditor's Office

## CHECKING ACCOUNTS FOR NON-ORGANIZATIONAL FUNDS

It's easy, and understandable, for organization managers to want to believe that no trusted employee would commit fraud. However, we have too many fraud cases on record to actually believe this. For example, the Washington State Auditor's Office has averaged almost \$1 million in fraud losses per year for the past five years. Thus, we all have to seriously think about this as we perform our jobs on behalf of our employers. The difficulty is that we trust these employees to a fault, what I call "**blind trust**". We also give key employees too many responsibilities, often creating a segregation of duties problem where one person has the ability to handle specific transactions from beginning to end, the "kiss of death" in fraud cases. We must change.

These are certainly points we must ponder. One question we must all deal with is: who will be next to encounter a major fraud loss. We just don't know. But, I sincerely hope it's not your organization, because these cases are not fun by any stretch of the imagination. They are stressful, detrimental to employee morale, and can cause the public to lose faith and trust in government and stockholders to lose confidence in organization managers, something none of us would want. Another question is: what function or element will be involved in such a case. This is another hard issue to deal with because the answer can be anything. In fact, no aspect of cash receipting or cash disbursing activities is exempt from fraud within the organization.

Understanding these things, we must now ponder what has happened in the past, and learn from the experience to improve the way we do business and evaluate the need for internal controls in the future. In this article, I want to address an area you might initially overlook as you make an internal assessment at your organization, **checking accounts for non-organizational funds**. Employees have the ability to use these accounts as a mechanism to convert unrecorded revenue checks into funds that can be used for their own personal benefit. This is just one way money laundering activities can occur in your midst. So, what's this risk all about?

1. The Fraud. A recent money laundering case in a school district emphasized the importance of knowing about the existence of checking accounts for non-public or non-organizational funds. In this case, an employee stole district miscellaneous revenue checks over a five-year period and deposited them into checking accounts she controlled for both public funds and non-public or non-organizational funds. As the custodian of the advance travel fund (\$55,000 in losses) and an employee association fund (\$133,000 in losses), she then issued checks to herself, "cash", credit card companies, and other businesses for her own personal benefit. Her work was not properly monitored or supervised by district officials.

This isn't the first time we've dealt with this type of fraud, nor the last. One other such case that comes to mind involved a housing authority where an individual used an employee "sunshine fund" for money laundering purposes. The custodian deposited entity revenue checks into the employee checking account and wrote checks to "cash" or

to herself. While endorsements on the revenue checks were irregular, they were sufficient to be processed through the banking system.

2. The Problem (Risk). While your records might tell you about the existence and location of all checking accounts for funds within the organization, **this is not necessarily true for checking accounts involving non-organizational funds**. Since these accounts are controlled by employees who are covered by the organization's personnel dishonesty bonding policy, both auditors and managers **may** have a need to know about the existence of checking accounts for non-organizational funds under certain circumstances. Of course, the risk is that employees will use these non-organizational checking accounts for money laundering purposes just the same as they do for known accounts within the organization. The ultimate question is whether management officials realize this risk and appropriately deal with it by having an independent party receive the monthly statement directly from the bank for all bank accounts, and by ensuring they reconcile them promptly and properly.

The State Auditor's Office has the authority to review checking accounts for public funds during all audits. In addition, if we have an indication, or some other reasonable cause to believe that public funds have been processed through other than public bank accounts, we have the authority to follow the money wherever it goes.

3. Detection. The State Auditor's Office detected the advance travel fund portion of this fraud during a routine audit while reviewing endorsements on canceled checks. We subpoenaed the employee's bank records because she deposited almost all of the checks into her own personal bank account. The review of these personal banking records then detected similar deposits from the employee association checking account. This led to the discovery of the remainder of the losses in this case. **NOTE**: If the employee had used only the checking account for non-public or non-organizational funds to perpetrate this fraud, the primary detection step available to us and to district managers would have been **analytical review procedures** for miscellaneous revenue streams. The objective of this analysis would be to determine what revenue stream is missing, or significantly reduced from your expectations of activity.

#### 4. Steps to Detect Similar Fraud Schemes.

(a) Identify all checking accounts for both official funds within the organization and non-organizational funds which are controlled by employees. When deemed appropriate, review them for money laundering activities to address the risk that employees may have misappropriated funds. In these cases, you might only need to briefly review the bank records for non-organizational checking accounts to assure yourself that money laundering activities are not present.

(b) Review check endorsements for irregularities, and identify instances where the custodian's name or an irregular endorsement name is shown (i.e.; checks made payable to "cash" or for a personal expense).

(c) Test transactions from checking accounts for organization funds to ensure that all disbursements are properly authorized and supported. Review deposit frequencies and amounts to identify potentially irregular transactions.

(d) Review the segregation of duties for custodians of all checking account (i.e.; both organization funds and non-oganizational funds). Ensure the monthly bank reconciliation is promptly and properly performed by an independent party. Bank statements should be mailed directly to the person performing the bank reconciliation rather than to the fund custodian.

(e) Perform analytical review procedures for miscellaneous revenue streams. Search for missing revenue streams, and obtain explanations for unexpected declines in revenue from known revenue sources. Use professional skepticism when determining if you have received the correct explanation for missing or declining revenue from employees. Perform tests of transactions, as required, to verify any explanations received.

(f) Review your procedures for controlling checks which arrive through the mail. Ideally, two people should open the mail, make a list of the transactions, and reconcile revenue totals to subsequent bank deposits using a **bank-validated deposit slip**.

(g) Review check voiding procedures for propriety to ensure that voided checks are handled properly. They should be retained on file for management review and audit. Or, they may be destroyed. If so, there should be a certificate of destruction signed by at least two individuals on file for management review and audit. **NOTE:** If voided checks are not available for review (i.e.; prematurely destroyed without documentation), don't stop; you have one more test to perform. Determine whether these voided checks were actually issued and have cleared the bank. When fraud is present, this is almost always one of the attributes of the case.

Well, that's plenty of food for thought for the moment. We're all involved in assessing the risk that fraud might occur in our midst. I hope this information helps you establish appropriate internal controls that deter at least the type of fraud discussed in this article.

## **INTERVIEWING TECHNIQUES**

This seminar provides participants with the foundation for effective interviewing during fraud audit engagements. The presentation includes a one-hour video on the topic produced by the Association of Certified Fraud Examiners. The use of Miranda Warnings and Weingarten Warnings by auditors will be the primary focus of the session. In addition, the session will include tips on interviewing suspects as well as important information designed to help your organization avoid an unnecessary trip to court. Finally, the session will include reviews of actual interviews conducted during recent fraud cases.

## **BIOGRAPHY**

JOSEPH R. DERVAES, CFE, CIA  
DIRECTOR OF SPECIAL INVESTIGATIONS  
WASHINGTON STATE AUDITOR'S OFFICE

Joe is the Director of Special Investigations for the Washington State Auditor's Office where he is responsible for managing the agency's Fraud Program and Whistleblower Program. He specializes in employee embezzlement fraud within all state agencies (170) and local governments (2400) in the state of Washington. He monitors all fraud audits throughout the state and has participated in the investigation of approximately 450 cases involving losses of almost \$10 million in the past 16 years.

Joe received his Bachelor of Science Degree from the University of Tampa (Florida) in 1963 with majors in both accounting and business administration. He completed graduate studies at Air University, Maxwell Air Force Base, Alabama, in Comptrollership (1975) and Military Science (1977). He is a Certified Fraud Examiner (CFE), a Certified Internal Auditor (CIA), and a retired United States Air Force Lieutenant Colonel. His audit experience includes 20 years with the Air Force Audit Agency and 16 years with the Washington State Auditor's Office.

Joe is the fraud audit training instructor for the Washington State Auditor's Office, and the author of the agency's fraud training courses. He received the agency's "Outstanding Employee Award" in 1986, 1988, and 1999 (2). He also presents fraud awareness seminars to both auditors and management officials of governmental entities and professional associations throughout North America.

Joe is a Life Member of the Association of Certified Fraud Examiners (CFE), a member of the Board of Regents, an adjunct faculty member, and a contributing author of the Second Edition of the "Fraud Examiners Manual". He received the Association's "Distinguished Achievement Award" in 1995. Joe has had two fraud articles published in "The White Paper", the Association's international magazine. He is also the founding President of the Pacific Northwest Chapter of the Association and a frequent speaker at chapter fraud seminars and conferences.