NAHMA'S NEWSLETTER FOR NATIONAL AFFORDABLE HOUSING PROFESSIONALS winter 2014

# NAHP Update

# Maintaining Trust—With Eyes Wide Open

JOHN E. LEONARD

## IN THIS ISSUE



For some, the impulse to steal comes from family dilemmas and financial problems.

For others, it's driven by a desire for more of the good life.

And for others, a sense of personal injustice—and the possibility of getting payback for perceived wrongs—pushes people to take the chance that defrauds their organizations and derails their lives.

Multifamily housing managers, even those operating at a modest level, handle large amounts of money: incoming payments from tenants, outgoing payments to contractors and suppliers, and paychecks for employees. Hundreds of touchpoints each year could crack and result in a misappropriation of funds.

HUD and other regulatory and funding bodies at the federal, state and local levels prescribe financial management guidelines for the affordable housing industry. They also produce helpful tips, training and toolkits to help owners and administrators successfully manage the finances of their properties.

Beneath all of the tactical expertise offered is one constant, however—the power of an individual to fly right or to veer toward acts that defraud an organization of its resources. Or, the power of a manager, through leadership and modeling high-quality financial stewardship, to set an atmosphere where every dollar achieves impact and every year yields a good audit.

## FINANCIAL MANAGEMENT AND FRAUD AVERSION

While financial mismanagement in the category of fraud and embezzlement is a small percentage of all transactions, each case that makes the head-

NATIONAL AFFORDABLE HOUSING MANAGEMENT ASSOCIATION (NAHMA)—Protecting the Interests of Affordable Housing Property Managers and Owners

lines leads many in the public and in elected office to question industry safeguards.

HUD's Office of the Inspector General (OIG), in a recent *Integrity Bulletin*, focused on the avoidance of fraud and embezzlement in public housing administration. The OIG documents point out that the very human but very lethal combination of management's trust in its employees combined with an individual's access to funds and assets leads to many of the problems.

In these unfortunate cases, familiarity not only breeds contempt but negative outcomes. Says OIG in the *Bulletin*, "Embezzlements are often committed by persons who have been with the organization a long time. … After identifying or uncovering embezzlement, it is not uncommon to hear statements like "I can't believe it, he was our most trusted employee" or "It's not possible. She has a nice family and a good reputation in the community."

Although the rules for administering public housing and assisted housing vary across programmatic areas, the OIG's experience in investigating fraud and embezzlement is instructive for any property manager, owner or staffer. OIG points out that "Next to tenant fraud, embezzlement and theft are the next leading types of cases investigated by the Office of the Inspector General."

This level of fraud is one of the things that no one wants to talk about, so it's difficult to gauge the true breadth of the problem. For example, because of non-disclosure agreements and lack of reporting to authorities such as OIG, some perpetrators are able to move from one housing operation to another. This situation raises the stakes for what is a standard operation for owners/administrators: a thorough background check and due diligence before hiring new employees.

Staying on top of the financial situation is not a one-off proposition, warns OIG. "A Bureau of Justice Statistics study showed that 66 percent of fraud offenders were rearrested within three years," says OIG, "so the rate for repeat offenses by embezzlers is high."

## THE ROOTS OF FRAUD AND EMBEZZLEMENT

According to OIG, fraud occurs when a person knowingly signs a form with information that the individual knows to be false or misleading. For example, a tenant misrepresents income and asset information. Or a financial manager authorizes a payment known to be based on fraudulent data.

Embezzlement pertains to what many investigators call the classic "inside job" —a person (a manager, employee, board member, or volunteer) misappropriates the assets entrusted to him or her, says OIG.

OIG cites criminologist Donald Cressey and his concept of the fraud triangle: situational pressures, opportunity, and personal integrity.

**Situational pressures** come from life events—divorce, a developing drug or gambling habit and plain old greed. Administrators should keep an eye out for sudden changes in behavior or mood or displays of affluence beyond the employee's paycheck.

**Opportunity** arises when the employee has access to funds and assets and also understands the systems well enough to know that the chances of being nabbed are slim. In small operations, this atmosphere may arise from few staff and staff solely assigned to certain tasks. In large ones, the complexity of the systems may open up opportunities for fraud. Internal controls are critical. Separation of duties will help, but for small operations without the bandwidth for such separation of duties, increased supervision and random check-ins are in order.

These tactics are not about distrusting employees; they're about framing a practical strategy of trust so that the blinders are off and professional skepticism can help protect the funds entrusted to the operation.

**Personal integrity** may be the trickiest of all for a manager to handle. According to the OIG bulletin, risk surveys by the Chubb insurance group indicate that "60 percent of an organization's employees might steal (30 percent 'definitely' and 30 percent 'maybe')" if the *situational* pressures and the *opportunity* pressures line up the right way.

If these numbers are even close to accurate, a manager's goal is not to reach inside a person and flip an integrity switch. Rather, it's to set an explicit tone of expectations and honest behavior. Adopt and keep current a risk management policy and make sure employees have a copy and training on what it means. Make regular ethics training available. Celebrate examples of good financial and asset stewardship. But also be crystal clear on the processes for reporting abuse and the penalties for fraud, embezzlement and theft.

## SCOPING OUT THE TECHNIQUES OF FRAUDSTERS AND EMBEZZLERS

| SCHEME | WEAKNESS | BEST PRACTICE |
|---|---|---|
| **Stealing cash** | • Allowing one person to handle cash<br>• Employees in positions of trust not bonded | • Two people handle cash—conduct surprise cash counts<br>• Employees in positions of trust are bonded |
| **Credit card misuse** | • No dollar limit on the credit card<br>• Bills paid by same person<br>• Receipts verified by person who ordered items<br>• No control over the number of cards<br>• Same person orders, pays, and reconciles | • Establish maximum dollar limits for single and total purchases<br>• Require two signatures<br>• Verify receipts by another person<br>• Limit the number of cards issued<br>• Have an independent person reconcile credit card statement |
| **Falsifying accounting records** | • Computer logins and passwords in a visible locations or shared<br>• No separation of duties<br>• Not requiring vacation or staff rotation<br>• Using pre-signed checks<br>• Accepting altered documents instead of originals | • Document a clear electronic audit trail stressing the need for accounting system security<br>• No checks may be made out to CASH<br>• Periodically rotate staff and have mandatory vacations<br>• Do not use pre-signed checks<br>• Require original documents, and double check bills, receipts and checks that have been altered |
| **Unauthorized or forged checks** | • No security of signature stamps<br>• Not recording amounts of checks and deposits correctly<br>• Only one signature required on checks | • Require security of signature stamps if used<br>• Independently reconcile checks, deposits, and bank statements monthly<br>• Require two signatures |
| **Fraudulent billings** | • No documentation to support payment<br>• Billings for services not ordered | • Require receipts, supporting documents, and bills<br>• Require receipts, supporting documents, and bills: use pre-numbered purchase orders |
| **Payroll scheme—Ghost employee** | • Not reconciling payroll payments to valid employees listings<br>• Unclaimed checks not verified | • Require for payroll reconciliation<br>• If not using direct deposit, follow up on unclaimed checks or require employees to personally pick up checks |
| **Misappropriation of property** | • Personal use of supplies, equipment, or construction materials | • Establish inventory control procedures, limited access, locked storages, and sign-out logs |
| **Misappropriation of services** | • Services performed for personal use or benefit | • Independently validate receipt of services |

**SOURCE:** *AVOIDING EMBEZZLEMENT OF PUBLIC HOUSING FUNDS,* HUD OFFICE OF INSPECTOR GENERAL, INTEGRITY BULLETIN, VOL. 1 NO. 4, FALL 2013

For operators of affordable housing, strong financial performance means juggling trust and teamwork with employees while setting up systems to thwart the outliers who would betray their mission for personal gain.

HUD concurs with the imperative of active leadership in deterring fraud. "The managers of HUD-assisted rental housing programs can make a positive difference with an aggressive commitment to preventing fraud and addressing fraud when it is suspected," HUD OIG has said.

"Increasing fraud awareness among tenants and employees may be one of the most effective fraud prevention measures available to all managers. Fraud prevention and fraud awareness are the first steps in rooting out fraud and saving taxpayers' dollars." **NU**

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BY BRIAN CARNAHAN AND MELANIE SHAPIRO

# Internal File Audits

## Ensure Quality and Avoid Noncompliance

A robust internal file audit can be the difference between a successful project and an unsuccessful project. Properly administered, an internal file audit helps a project take advantage of the Bright Line by identifying non-compliance that can be corrected before a state housing credit agency visit. It can also prevent non-compliance by catching potential errors at move-in.

In addition, internal audits can identify procedural weaknesses and training needs, allowing the owner, investor or property management company to develop plans to avoid similar internal findings. No matter the circumstances, these audits help to reduce noncompliance which can result in a loss of housing tax credits or other funding, such as a Section 8 subsidy.

While no one system for conducting file audits is recommended, there are a few steps and issues an affordable housing organization should consider to ensure it has a proficient internal file audit process.

**...INTERNAL AUDITS CAN IDENTIFY procedural weaknesses and training needs, allowing the owner, investor or property management company to develop plans to avoid similar internal findings.**

**1. Create clear procedures.** Know who reviews what and when. Some points to consider include:

Are files reviewed for a pre-approval or as part of routine periodic audits? The answer to this question impacts timing and sample size, as discussed below, but also frequency and effectiveness.

The timing of file reviews and responses are both critical to ensure that move-ins and recertifications happen in a timely manner. How much time will internal auditors have to review files? How much time is allotted for corrections by the staff member who prepares the paperwork?

If you are conducting a random audit, consider how many files should be reviewed. Who selects the files? Are files pulled by the director of compliance or another key compliance staff member? If pre-approval reviews are not being conducted, review all new move-ins as soon as possible. It may be helpful to review the same percentage as the state housing credit agency monitors. In any case, files should be selected with the goal of reducing risk.

Even if there is no in-house compliance "expert" available, peer reviews can be helpful, provided the expectations are properly outlined. Peer reviewers have to enter into the process with a willingness to be honest and professional about issues with a given file. This process can be challenging if peers have difficulty acknowledging the mistakes of others.

Which programs are being reviewed? Are only files for the Housing Tax Credit program reviewed or are all program requirements for a project, including Section 8 or HOME program, reviewed? The best scenario is a review of all program requirements at a project. However, that is not always possible given time or staffing constraints. If only one program is reviewed, the limitations of the audit need to be acknowledged so that no one assumes that compliance risks that are not being mitigated are being addressed.

Remember to safeguard the

confidentiality of tenant information throughout the review process. This may include ensuring electronic systems are properly secured as well as having a system in place for handling paper documents.

**2. Establish clear standards.** Whose standards are applied? The state agency's, the investor's, or your company's own internal standards? There is nothing wrong with having a rigorous internal standard, provided it does not violate existing laws or regulations, or impair the owner's/manager's ability to participate in future deals.

Review compliance reports to identify key targets and areas of concern. The reports of compliance monitors can be an excellent source of information about areas for improvement. For example, does the monitor regularly cite an issue with signature dates? Or, is the wrong verification form frequently used?

**3. Develop clear lines of authority and responsibility.** Who has final approval of move-ins and recertifications? Does the regional manager or compliance director approve files or does someone else? Who approves any exceptions to the standards? Are the exceptions properly documented?

**4. Build in quality assurance testing and follow up on the testing.**

Review the corrections to ensure they were actually implemented and retained properly.

Review the auditor's work for thoroughness and accuracy. This is a step where proper lines of authority and clear reporting relationships are important.

**5. Track performance and establish some performance measures.** For example, keep track of common mistakes. While it can be somewhat threatening, it is also helpful to know who is making mistakes. Such information can provide an opportunity for training and development.

**6. Practice accountability, but also celebrate accomplishment.** As noted above, it is important to know who is and who is not performing their duties so that you can acknowledge high-performing individuals. The stress of keeping an affordable housing project in compliance can be intense. Taking time during staff meetings or other occasions to acknowledge accomplishments can go a long way in mitigating the effects of stress.

An internal file audit process should focus on prevention. The driving force should be avoidance and learning, not just the identification of problems and related consequences. The recommendations mentioned in this article are one approach. Some companies elect to hire an outside firm to conduct file audits. The questions and considerations in this article will help you evaluate the company you select. No matter what system or approach you select, pick one. Your credits and subsidy may depend upon it. NU

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# A Newspaper Ad Leads to a Long Career

**NAME:** Sara Baker

**MANAGEMENT COMPANY:** American Apartment Management Co.

**POSITION:** Property Manager

**DATE OF CERTIFICATION:** 1988

Sara Baker is far too modest to consider herself a one-woman wonder. Still, she manages Magnolia Manor, an 80-unit Section 8 property for the elderly/disabled, with the help of one full-time and one part-time maintenance staff. The property also has a service coordinator.

The property was only three years old when Baker answered a newspaper ad from American Apartment Management Co. (AAMC) for a property manager in 1984. She was hired by then-district manager and current president of AAMC Patty Ownby. All together she has worked for AAMC for 24 years, 12 years at Magnolia Manor, and 12 years at the multifamily Gulf Mist Apartments on the Gulf Coast.

She worked three years at a conventional property for another company. However, she didn't like management of conventional properties because she was not using her Section 8 skills, which she "worked too hard to get to not use them." So when the position at Magnolia Manor came open, she went back.

The property has maintained an Above Average rating on all MORs and REAC inspections. It has also earned the Community of Quality© designation.

Magnolia Manor residents are fairly independent and can do a lot for themselves. They enjoy the various activities that Baker schedules for them. These include karaoke, trivia contests, cook outs, pot luck luncheons, birthday parties, bingo and other theme activities. A band and singers also come to the property to entertain. The service coordinator partners with organizations in the community to provide blood pressure checks and other health programs.

Baker was born and raised in Vicksburg, Mississippi. She has four grown children, five grandchildren and two great-grandchildren. She says that with all the many hats property managers have to wear, she stays plenty busy with work, family and church. She says she has no plans to retire at this time—"or I might!" NU

PROTECTING THE INTERESTS OF AFFORDABLE HOUSING PROPERTY MANAGERS AND OWNERS

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