

# Preventing and Detecting Fraudulent Activity

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November 7, 2022  
Savannah, Georgia



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# What is fraud?

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- ▶ Fraud – wrongful or criminal deception intended to result in financial or personal gain, carried out by misappropriation of assets.
- ▶ Fraud can also mean an intentional misstatement of financial information



# How is waste & abuse different?

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- waste – means a thoughtless or careless expenditure, consumption, mismanagement, use, or squandering of resources.
- Abuse – excessive, or improper use of something, or the use of something in a manner contrary to the natural or legal rules for its use.



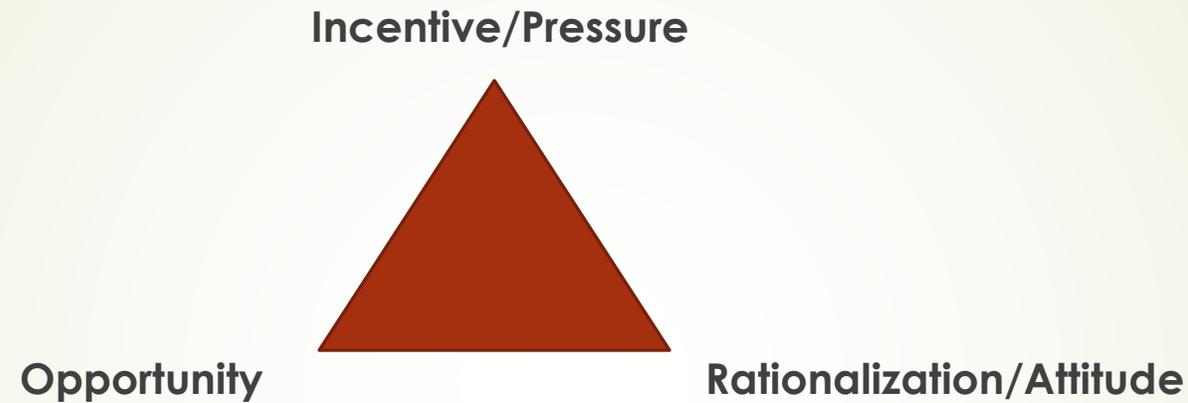
# Fraud schemes in housing

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- ▶ Altering rental checks or cash received for rent
- ▶ Fake landlord – setting up hap payments to p.o. box
- ▶ Friends at the hardware store
- ▶ Maintenance employee with sticky fingers
- ▶ Construction fraud – bidding collusion
- ▶ Converting housing authority materials inventory
- ▶ Payment of management fees – to fake company
- ▶ Petty cash fraud – taking laundry money
- ▶ Travel fraud and abuse
- ▶ Complex investments
- ▶ Payroll fraud (pension payments)
- ▶ Using maintenance employees to build a mansion

# The Fraud Triangle

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- ▶ These three conditions are generally present when fraud occurs:
  - ▶ Incentive/Pressure – a reason to commit fraud
  - ▶ Opportunity – ineffective controls or override of controls
  - ▶ Rationalization/Attitude – justification of fraudulent behavior

# Elements of the Fraud Triangle

**Pressure** is what causes a person to commit fraud.



Can be derived from:

- ▶ Threatened financial stability or profitability
- ▶ Excessive pressure to meet financial targets
- ▶ Pressures created by personal financial obligations
- ▶ Incentives to maintain compliance criteria

Often, the perpetrator rationalizes their problems need to be solved in secret.

# Elements of the Fraud Triangle

## **When Opportunity Exists Fraud Potential Increases.**

- ▶ Created by weak or non-functioning internal controls, poor management oversight, and/or misuse of one's position and authority.

Opportunity to commit fraud can be found in:

- ▶ Complex or unstable organizational structures
- ▶ Ineffective monitoring of management
- ▶ Susceptibility of assets to misappropriation

Of all the fraud risk factors, Authorities have the most control over employee opportunity to commit fraud.

# Elements of the Fraud Triangle

**Rationalization** is the personal justification that the perpetrator's fraudulent actions are in line with commonly accepted notions of decency and trust.

Some common rationalizations include:

- ▶ The employee labeling the theft as borrowing, and intending to pay the stolen money back at some point.
- ▶ A strained relationship between the employee and management because of job dissatisfaction and the belief that something is owed to them.
- ▶ The employee believes committing fraud is justified if it is saving a family member or loved one.

# Potential Fraud Situations

- ▶ Check into any variations in cash deposits – especially in small accounts like laundry and vending machines.
- ▶ Watch for large fluctuations in operating income and expense accounts.
- ▶ Periodically check your landlord list to verify the eligibility of HAP payments and the validity of landlords.



# Limiting Fraud

- ▶ Emphasize the separation of duties. This is critically important when employees change positions and their official duties change or when new functions or processes are put into place.
- ▶ Train your employees to step back and examine the data objectively. Do the numbers you are looking at make sense?
- ▶ Keep your guard up; most often, embezzlement is done systematically in small amounts which makes it particularly hard to identify.



# Preventing & detecting fraud

## Cash:

- ❖ Person who collects money does not prepare the deposit slip
- ❖ Person who prepares deposit slip does not complete the bank reconciliations
- ❖ Bank reconciliations are signed off by either the director of finance or executive director
- ❖ Rotate staff in cash functions
- ❖ Monitor petty cash reimbursements
- ❖ Stop accepting cash payments
- ❖ Have approved authorization for wire or ach transfers

# Preventing & detecting fraud

## Tenants accounts receivable:

- ❖ Someone should “spot-check” posting entries
- ❖ Review all material adjusting entries
- ❖ Perform analytics – comparison of end of month dso with general ledger control, review the level of net dwelling rental charges between months and years, monitor the level of tenants accounts receivable.
- ❖ Thoroughly analyze the write-off of bad debts
- ❖ Review “other charges” for propriety
- ❖ Make sure security deposits are properly reconciled and stated.

# Preventing & detecting fraud

## Review IT protection:

- ❖ Are computers password protected?
- ❖ Is the accounting software modules accessed and available to the correct employees?
- ❖ Is access to certain modules restricted? And are the permissions reviewed periodically?
- ❖ Is critical tenant, employee and vendor information secure?
- ❖ Hire an independent security consultant to review systems – preferably someone who isn't trying to sell you something.

# Preventing & detecting Fraud

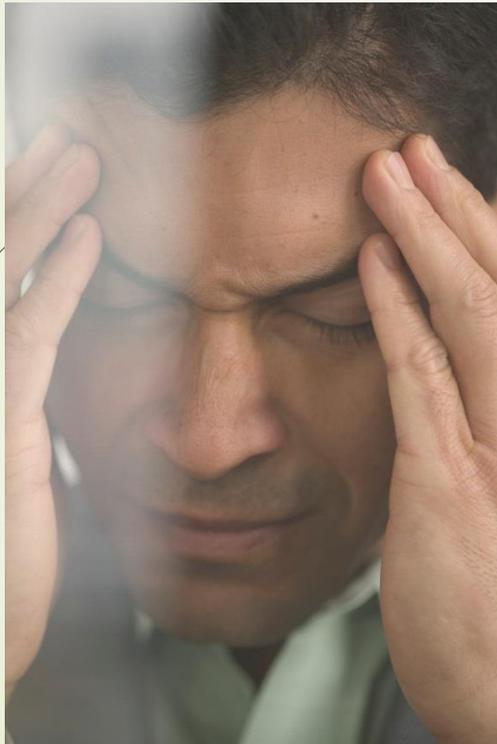
- ▶ Periodically check your vendor list, verifying that everyone being paid is a valid business with a physical address – not just a post office box. Scrutinize all vendors having family connections to your staff.
- ▶ Monitor the purchase order process. Ensure the purchase orders are always approved prior to the receipt of goods.
- ▶ Maintain consistent inventory of Capital Assets and who is responsible for each asset.
- ▶ Change bidding procedures or people who are monitoring the rfp process.



# Limiting Fraud

- Periodically change how deposits from tenants and others are handled – both the timing of the deposits and who handles them. Have another employee confirm the deposits.
- Review those in control of access to materials inventories, as well as ensuring that all materials used on work orders are appropriately charged to the tenant.
- Monitor payments for travel to conventions and other meetings to verify that spouses and other non-employees are not being paid for by the Authority.

# Warning Signals of the Possible Existence of Fraud



- ▶ Employee shows unusual or erratic behavior
- ▶ Employee refuses to take vacation or leave time or refusal to share job responsibilities, especially as they relate to cash, payables, or receivables
- ▶ Employee's lifestyle is more lavish than their pay scale
- ▶ Employee has family problems or a change in lifestyle
- ▶ Employee refuses promotions or changes in responsibilities

# Warning Signals of the Possible Existence of Fraud

- ▶ Managers are performing clerical duties
- ▶ Any sign of an employee being involved in gambling or drug/alcohol abuse
- ▶ Employee exhibits signs of job dissatisfaction such as a decrease in productivity, change in attire, irregular work attendance, or frequent complaining about perceived biases or work issues
- ▶ Close relationships between employees and tenants/vendors

# Avoiding Fraud and Abuse

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- Begins with the “tone at the top” – the attitude and actions of leadership.
- Be clear with employees when addressing what actions and attitudes will not be tolerated.
- Key points for management to address:
  - Integrity
  - Competence
  - Management Philosophy
  - Organizational Structure
  - Role Assignment
  - Promotion and Training



# Remain Vigilant



- Employees at every level of an organization can affect internal control.
- Employees at every level of an organization have the potential to commit fraud.
- What is being displayed may not be indicative of someone's true character.

# Internal Controls – Protecting your Agency

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# Do we need an asset management policy and why?

- This policy is not required by HUD
- This policy is only to document the rationale for the fees being charged, programs applicable and methods used for fee for service
- Absent a policy there is only the HUD 7475 supplement for asset management and limited CFR regulations
- With the changing environment of Housing converting to RAD is asset management still needed?
- Is there ever a cause for using allocations and totally doing away with the COCC model and asset management?

# Do we need a Financial management control policy and why?

- This policy is not required by HUD directly
- Where in the agency are the internal controls documented?
- Why does a housing authority need the policy or procedure document?
- What does the agency have to document the compliance with green book and COSO?
- Adequate internal controls is a requirement of State Law, Federal Law and always required with grant revenue.

# Financial management control policy what to include

- Cash management
  - Treasury management – including investments and wire transfers
  - Ach transactions vs cash disbursements
  - Cash collections – receipts
  - Cash disbursements – vendors & payroll
  - Credit card usage
- Payroll – process and controls
- Equipment usage policy
- Monthly reporting requirements – including Board reports

# Financial management control policy what to include

- Monthly general ledger accounting and reconciliation process – including adjusting entries and recording journal entries
- Budgetary process & controls
- Materials inventory usage and control
- Capital asset inventory process
- Annual financial reporting – financial data schedule preparation
- LOCCS draw procedures

# What are the requirements for Cash & Investments?

- Contained in the annual contributions contract
- The Code of Federal Regulations
- The HUD 7475, Low Rent Financial Management Handbook
- The HUD PIH Notice 96-33
- The General Depository Agreement

# Cash Management Principles

- HUD wants to see cash for each program.
- HUD wants to see restricted cash for restricted or trust deposits, and restricted Net Position.
- The OIG believes that interfund accounting is not authorized per HUD regulations; consequently, the Housing Authority should reimburse at least monthly all interprogram expenditures.
- HUD considers the FDS to not be a GAAP presentation, but the numbers should be GAAP. Some financial analyst believe that Cash is “cash and cash equivalents” and that investments are “non cash equivalents.”

# Keeping Cash Management Simple

- Almost everyone should be able to understand successful cash management
- Its as simple as cash balance, collectible receivables and current payables
- Its as simple as predicting the next 3 months of cash resources and expenditures
- Its as simple as predicting the next 12 months of cash resources and expenditures
- You should never rely on the “diamond in the rough.”
- Successful cash management is simple management!!

# Control Features of Banking Activities

- What type of controls do you have over cash?
  - Who can withdraw funds – and who knows when the funds have been withdrawn?
  - Who deposits funds, and is there a check and balance between depositing funds and posting the collection of funds? Who can draw funds from eLOCCS?
  - Who receives the bank statements and reconciles the bank accounts?
  - Who reviews the bank reconciliations?
  - Who can open and close an account?

# Procurement Defined

- ▶ The term procurement includes procuring, purchasing, leasing or renting the following:
  - ▶ Goods, supplies, equipment and materials,
  - ▶ Construction and maintenance; consultant services,
  - ▶ Architectural and Engineering services,
  - ▶ Social services, and
  - ▶ Other services.

# Procurement Planning

- ▶ Planning is essential to managing the procurement function properly.
- ▶ What is the goal in procuring?
- ▶ Prior purchases and future needs should be reviewed often:
  - ▶ For efficiency and cost-effectiveness
  - ▶ To maximize competition and competitive pricing
  - ▶ To decrease costs
  - ▶ To ensure that supplies and services are obtained without any need for re-procurement

# Problems in Procurement

- Can't really be done by property managers
- Rules are complicated – and do not always apply to situation
- External influence – Pressure from HUD, City & politicians
- Internal influence – Board members & employees
- Too many people involved in the compliance process
- Because of COVID no one wants to work or complete the paperwork for a federal job.
- We already like the people we use – why can't we stay with them?

# Developing a Procurement Policy

- ▶ Authorities shall issue a procurement policy to give direction for all procurement actions, regardless of the source of funds, which should incorporate all procurement for the entire agency.
  
- ▶ Therefore, you must incorporate references to at a minimum the following:
  - ▶ The Code of Federal Regulations (24 CFR 85.36)
  - ▶ The HUD Procurement Handbook (HUD 7460.8)
  - ▶ The applicable State and Local laws

# Developing a Procurement Policy

- ▶ The objectives of a procurement policy include:
  - ▶ Providing for a system of quality and integrity;
  - ▶ Providing for the fair and equitable treatment of all persons or firms involved in purchasing;
  - ▶ Ensuring that supplies and services are procured efficiently, effectively, and at the most favorable prices available;
  - ▶ Promoting competition in contracting;
  - ▶ Assuring that purchasing actions are in full compliance with Federal standards, HUD regulations and State and Local laws.

# Developing a Procurement Policy

- ▶ Other guidelines to be defined should include policies regarding:
  - ▶ Assistance to small and other businesses
  - ▶ Board approval of procurement action (threshold amounts)
  - ▶ Delegation of contracting authority
  - ▶ Documentation
  - ▶ Funding availability
  - ▶ Approved vendor list

# Developing a Procurement Policy

- This policy should also include additional guidelines regarding:
  - Cost and price analysis
  - Solicitation and advertising – including time restrictions, form requirements, cancellations, notifications, and use of credit (or purchasing) cards
  - Bonding requirements
  - Contractor qualifications, duties and pricing agreements
  - Contract clauses and administration

# Scope of the Procurement Policy

- ▶ A procurement policy should be designed to offer guidance on all purchases:
  - ▶ Petty Cash
  - ▶ Small Purchases
  - ▶ Using sealed bids for awards should be defined:
    - ▶ When and how to use sealed bids
    - ▶ Solicitation and receipt of bids
    - ▶ Bid openings and awards
    - ▶ Corrections and withdrawals of bids

# Scope of the Procurement Policy

## ☞ Competitive Proposals – Request for Qualifications

- ▶ Conditions for use; form of solicitation; evaluation; negotiations; award
- ▶ A/E Services – qualifications required

## ☞ Noncompetitive Proposals

- ▶ May be used only when the award of a contract is not feasible using the other procedures
- ▶ Justification must be supported by a written document and included in policy

# Ethics in Public Contracting

- Procurement policy should be used as a code of conduct.
- Conflicts of interest should be avoided (i.e. persons with a financial or other type of interest in a firm competing for the award).
- No gratuities, factors or kickbacks accepted; additionally no use of confidential information for personal gain.
- Solicitation of commissions or other contingent fees is prohibited.
- Overriding the procurement process

# Uniform Administrative Requirements



- ▶ Effective December 26, 2013
- ▶ “This final guidance supersedes and streamlines requirements from OMB Circulars A-21, A-87, A-110 and A-133.”
- ▶ The purpose is to consolidate guidance and streamline the format that aims to improve clarity and ease of use.
- ▶ Raises the Single Audit threshold from \$500,000 in Federal awards per year to \$750,000.
- ▶ A bunch of rules and regulations to follow – which ones are the FEDs interested in you following?
- ▶ For information call the White House at 202-395-3080.



# Property Standards

- ▶ Title to property & equipment acquired under an award vests upon acquisition
- ▶ Equipment can be used for other projects or programs provided that it does not interfere with its original purpose. Property may only be used for its original intended use.
- ▶ Property records must be maintained that include a description of the property, a serial or identification number, source of the property, acquisition date, use of property, percentage of Federal participation in the cost of the property, and its current location.



# Depreciation

- ▶ Depreciation is the method of allocating the cost of fixed assets to periods benefitting from their use.
- ▶ Depreciation is based upon the acquisition cost of the asset.
- ▶ An entire building, including its shell and all components, can be treated as a single asset and depreciated over a single useful life. A building may also be broken down and depreciated into three components with three useful lives. These components would include:
  - ▶ Building Shell – construction and design costs.
  - ▶ Building Services – elevators, HVAC, plumbing systems, etc.
  - ▶ Fixed Equipment – glassware, washers, sterilizers, etc.



# Procurement Standards

- ▶ All procurement transactions will be conducted in a manner providing full and open competition.
- ▶ Sealed Bids are purchases over the \$150,000 threshold and must be publically solicited. Purchases may not be broken down to avoid this limit. For example, thirty invoices of \$5,000 would be in aggregate of the Federal threshold and would require formal solicitation.
- ▶ Grant recipients must perform cost or price analysis in connection with every procurement action in excess of \$150,000. As a starting point, recipients must make independent estimates before receiving bids or proposals.



# Record Retention

- ▶ Financial records and supporting documentation must be retained for at a minimum three years from the date of the annual financial report.
- ▶ Originals may be copied into electronic format provided that they remain readable and are reviewed periodically for quality control.
- ▶ The Federal awarding agency, Inspector General, or any other authorized representative may have right to full access to documentation at any time



# Auditor Selection

- Overall objective is to obtain high quality audits
- Factors to be considered in the evaluation process include:
  - Responsiveness to proposal
  - Relevant experience
  - Professional qualifications
- Organization should request copy of the auditors peer review report which is required under GAGAS



# Good Auditee Practices

- ▶ Auditee should prepare financial statements that reflect its financial position, results of operations and changes in assets, and a statement of cash flows for the year under audit.
- ▶ The auditee should also prepare a schedule of expenditures of Federal awards for the period under audit. This should include but not limited to:
  - ▶ Individual Federal programs by Federal agency
  - ▶ Total amount expended under each program along with the identifying CFDA number

# Uniform Administrative Requirements

Specific regulations in paragraph 200.431 – Compensation & Fringe Benefits:

- ▶ Must be reasonable for the services rendered and conform to established written policy of the non-Federal entity.
- ▶ Has a better description of what “reasonableness means”
- ▶ Provides for “incentive compensation.”
- ▶ Gives requirements that charges for salary and benefits should be based upon a system of internal control which provides reasonable assurance that the charges are accurate, allowable and properly allocated.
- ▶ Should not exceed 100% of compensation.

# Uniform Administrative Requirements

***There is increased emphasis on internal control over compliance requirements of Federal Awards.***

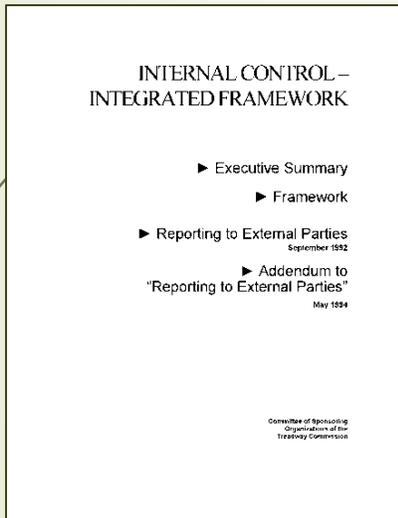
- ▶ Transactions are properly recorded and accounted for in order to permit the preparation of reliable financial statements and federal reports.
- ▶ Maintain accountability over assets
- ▶ Demonstrate compliance with Federal statutes, regulations, and the terms and conditions of the Federal award.
- ▶ Transactions are executed in compliance with statutes.
- ▶ Funds, property, and other assets are safeguarded.

# Uniform Administrative Requirements

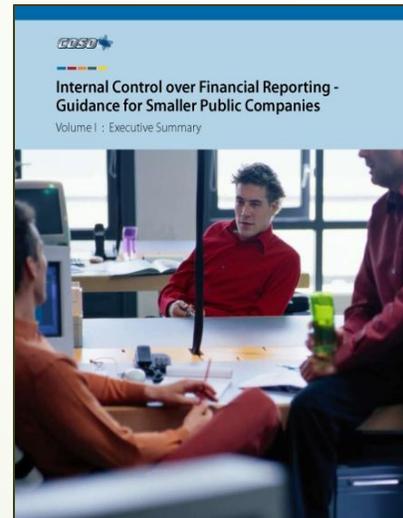
- ▶ Specific regulations in paragraph 200.303 – Internal Controls – required for non-Federal entities.

***Internal controls should be in compliance with guidance in “Standards for Internal Control in the Federal Government” issued by the Comptroller General of the United States and the “Internal Control Integrated Framework”, issued by the Committee of Sponsoring Organizations of the Treadway Commission. (COSO).***

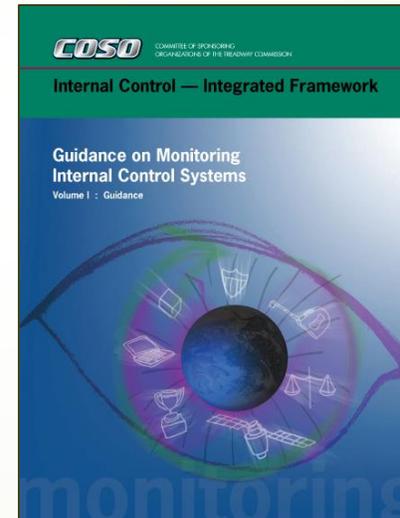
# COSO Overview



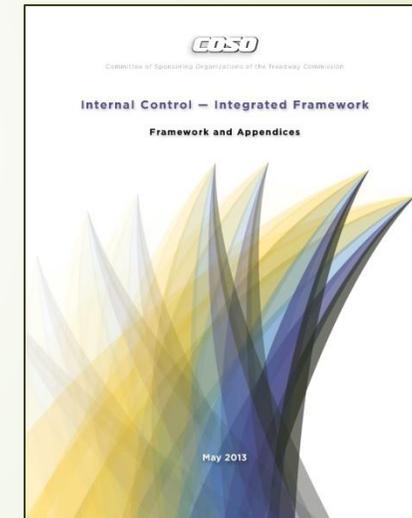
1992



2006



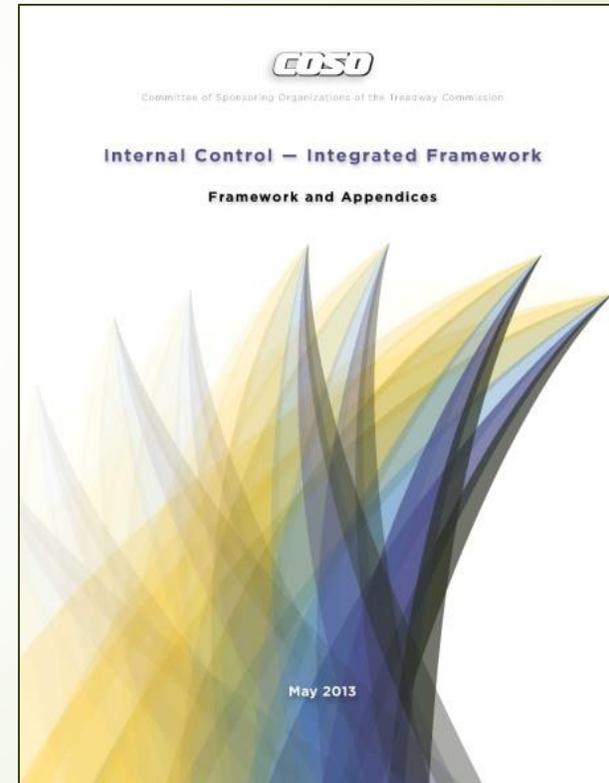
2009



2013

# COSO Publication

1. Consists of three volumes:
  - ▶ Executive Summary
  - ▶ Framework and Appendices
  - ▶ Illustrative Tools for Assessing Effectiveness of a System of Internal Control
2. Sets out:
  - ▶ Definition of internal control
  - ▶ Categories of objectives
  - ▶ Components and principles of internal control
  - ▶ Requirements for effectiveness



# COSO Changed in 2013

## *Environments changes...*

Expectations for governance oversight

Globalization of markets and operations

Changes and greater complexity in business

Demands and complexities in laws, rules, regulations, and standards

Expectations for competencies and accountabilities

Use of, and reliance on, evolving technologies

Expectations relating to preventing and detecting fraud

## *...have driven Framework updates*



COSO Cube (2013 Edition)



# Update articulates principles of effective internal control

## Control Environment

1. Demonstrates commitment to integrity and ethical values
2. Exercises oversight responsibility
3. Establishes structure, authority and responsibility
4. Demonstrates commitment to competence
5. Enforces accountability

## Risk Assessment

6. Specifies suitable objectives
7. Identifies and analyzes risk
8. Assesses fraud risk
9. Identifies and analyzes significant change

## Control Activities

10. Selects and develops control activities
11. Selects and develops general controls over technology
12. Deploys through policies and procedures

## Information & Communication

13. Uses relevant information
14. Communicates internally
15. Communicates externally

## Monitoring Activities

16. Conducts ongoing and/or separate evaluations
17. Evaluates and communicates deficiencies



# Control Environment

1. The organization demonstrates a commitment to integrity and ethical values.
2. The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control.
3. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.
4. The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
5. The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.



# Risk Assessment



6. The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.
7. The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.
8. The organization considers the potential for fraud in assessing risks to the achievement of objectives.
9. The organization identifies and assesses changes that could significantly impact the system of internal control.



# Control Activities



10. The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
11. The organization selects and develops general control activities over technology to support the achievement of objectives.
12. The organization deploys control activities through policies that establish what is expected and procedures that put policies into place.



# Information & Communication

13. The organization obtains or generates and uses relevant, quality information to support the functioning of internal control.
14. The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.
15. The organization communicates with external parties regarding matters affecting the functioning of internal control.



# Monitoring Activities



16. The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.
17. The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.