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AVOIDING EMBEZZLEMENT OF PUBLIC HOUSING FUNDS

If your Authority were robbed at gunpoint, you would take positive steps to prevent it from happening again. You would buy locks and safes, install alarms, and hire guards.

But what about theft from within? Do you have the same concern? Have you thought about ways to prevent or reduce the risk of embezzlement? Most people think the possibility is remote because they have long trusted employees who would never steal. However, it's this very attitude that makes it possible for embezzlement to occur. Trust is the one component that differentiates embezzlement from stealing.

If you don't believe embezzlement is a problem, read on. Your public housing agency (PHA) is more susceptible to being robbed from within by employees than by strangers from the outside. This bulletin will answer some of the basic questions about embezzlement and things you can do to prevent it.

- You are committing fraud if you sign a form knowing that you provided false or misleading information.
- The information you provide on housing assistance application and recertification forms will be verified.
- The local housing agency, HUD, or the Office of Inspector General will check the income and asset information you provide with other Federal, State, or local governments and with private agencies.
- **Certifying false information is fraud**

WHAT IS EMBEZZLEMENT?

Embezzlement is a form of white-collar crime in which a person misappropriates the assets entrusted to him or her. In this type of fraud the assets of the PHA are switched from their intended purpose to the personal use of the embezzler. Embezzlement is a breach of the fiduciary responsibilities placed upon a person. Next to tenant fraud, embezzlement and theft are the next leading types of cases investigated by the Office of Inspector General (OIG).

OIG has seen repeated situations in which people who have been caught embezzling have left one PHA only to be hired by another. A Bureau of Justice Statistics study showed that 66 percent of fraud offenders were rearrested within 3 years so the rate for repeat offenses by embezzlers is high. PHAs only hurt each other when, for the sake of avoiding embarrassment, they keep quiet about detected cases.

Instead of reporting the case to OIG, some have entered into non-disclosure agreements with embezzlers in exchange for their leaving the PHA quietly. PHAs should protect themselves at the front end by conducting background checks and other due diligence on employees before hiring them. Effective tips for doing this will be covered in a future bulletin.

VARIOUS TYPES OF EMBEZZLEMENT SCHEMES TO WATCH OUT FOR

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

WHAT ARE SOME EXAMPLES OF PHA EMBEZZLEMENT?

Based on OIG experience, embezzlements are often committed by persons who have been with the organization a long time. They have worked their way into positions of trust and are key persons on the board, in management or in accounting. For the most part, these are ordinary people who give in to the pressures or temptations on the job. 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."

A great number of schemes have been used to embezzle PHA funds. Some are described in the following investigative cases:

Stealing Cash-Unauthorized Checks:

The former executive director for the Steele Housing Authority was sentenced in U.S. District Court, Cape Girardeau, MO, to 1 year and 1 day incarceration; and 3 years supervised release and ordered to pay \$119,184 in restitution for her guilty plea to committing embezzlement and forgery. **The executive director stole approximately \$224,000 in cash and forged checks from the Authority.**

Credit Card Misuse:

Over a 7 month period, a former executive director of the Jacksonville Housing Authority devised and executed a scheme to steal Authority funds by using the Authority's **credit cards, fuel, computer, and rental cars for her own personal use.** She also increased her salary without authorization from her board of commissioners. She was sentenced to 5 years of probation and 6 months of home confinement and ordered to pay \$37,475 in restitution to the U.S. Department of Housing and Urban Development (HUD) for her earlier guilty plea to theft of government funds.

Falsifying Accounting Records:

The former executive director of the Chelsea Housing Authority pled guilty to falsifying a record in a Federal agency matter after failing to accurately report his true salary in annual budget reports as required by HUD and the Massachusetts Department of Housing and Community Development. From 2008-2011, the executive director **inflated his salary by more than \$100,000 annually without the Authority's board of director's knowledge.** The executive director was sentenced to 36 months in jail.

Unauthorized Forged Checks:

The former assistant executive director of the Alamosa Housing Authority was sentenced in U.S. District Court, Denver, CO, to 1 year home confinement and 5 years of probation and ordered to pay the Internal Revenue Service restitution for her guilty plea to filing a false Federal income tax return. From April 1998 to October 2007, other Authority staff members embezzled more than \$1.3 million in Authority funds when they generated or negotiated unauthorized Authority checks. The former assistant executive **director wrote 96 checks to her former husband for clean-up work that was not performed.**

Six former employees of the Homer Housing Authority were sentenced in U.S. District Court for stealing hundreds of thousands of dollars in public money. The harshest penalty was for the former executive director who was sentenced to 37 months in prison and ordered to pay \$430,000 in restitution to HUD. The former executive director **caused checks to be issued to friends and relatives for work allegedly performed for the Authority.** The defendants admitted they did no work for the Authority and that they usually cashed the checks and returned much of the proceeds to the executive director.

Fraudulent Billings:

Two brothers colluded in a scheme against the Housing Authority of the City of Los Angeles. One brother worked for an organization that received HUD funds for public housing construction projects. Over a 4 year period, he steered contracts to shell companies operated by his brother. The two brothers **double-billed** the Authority for construction work that was actually performed by an in-house construction company. They pled guilty and were sentenced to 21 months incarceration, and ordered to pay \$526,727 jointly to the Authority for stealing government money.

A former contract chief financial officer of the New Orleans Housing Authority **submitted false billings for accounting services** and fraudulently obtained \$900,927 in Authority funds. He was sentenced to 46 months incarceration and 36 months' probation, ordered to pay \$225,889 in restitution, and fined \$75,000.

Payroll Scheme:

The former finance director of the Coeur d' Alene Tribal Housing Authority was sentenced to 5 years Federal probation and ordered to pay \$28,275 in restitution. The defendant **issued unauthorized paychecks and payroll advances** and authorized bank transfers from the Authority's account to herself for unapproved personal expenses.

Misappropriations of Property:

The former materials coordinator for the Philadelphia Housing Authority pled guilty to theft of government funds and conspiracy. The **defendant purchased materials through Authority vendors and then sold the materials for a profit that was split with a co-conspirator**. The value of the materials was more than \$431,000. An attempt was made to cover up the scheme by submitting fraudulent invoices to the Authority for payment .

Misappropriation of Services:

The former executive director of the Cuyahoga Metropolitan Housing Authority was found guilty after a jury trial and sentenced to 10 months incarceration and 1 year supervised release for making false statements to Federal agents. The defendant received free airline tickets, lodging, and meals to attend golfing events **and had air conditioning work done on his personal residence at no cost to him**. The work was done by contractors who were bidding on a \$30 million energy grant at the Authority.

WHAT CAUSES EMBEZZLEMENT?

A famed criminologist, Donald Cressey, developed the concept of the fraud triangle in which he maintains that there are three variables leading people to commit frauds such as embezzlement:

1. **Situational pressures.** Employees are pressured by events such as divorce, drug dependency, etc., or are lured into the crime by expensive habits such as: gambling, high standards of living, etc., or simply greed.

What Can Be Done About Situational Pressures?

Commissioners and directors with oversight responsibility should be alert for any employees or other commissioners displaying signs of giving in to situational pressures. Be alert to indications of unusual money or marital problems, the failure of outside business or stock market involvement; and unusual affluence such as extravagant lifestyles, expensive vacations, gambling habits, or big homes and cars. People who steal to support these pressures often display personality changes and have sudden mood swings.

2. **Opportunity.** When employees know that taking funds can be done easily and there is little likelihood of being caught, it is easier to give in to situational pressures.

What Can Be Done To Reduce Opportunity?

Mitigate the potential for embezzlement by reducing opportunities by implementing strong internal controls. The most effective internal control concept is separation of duties. When two or more of functions are in the control of one person, the potential for fraud is greatly increased. When staff size is too small to permit separation of duties, closer supervision is needed to occasionally check for problems. Some schemes are as simple as individuals making checks out to themselves or not depositing all cash received.

3. **Personal Integrity.** According to risk surveys, sponsored by the Chubb Group of Insurance Companies, as many as 60 percent of an organization's employees might steal (30 percent "definitely" - 30 percent "maybe") given the right combination of the two other factors. Reasons for this risk include employees not receiving sufficient messages to remain honest in their duties. Others ignore integrity when they are angered by perceived injustices and want to "get back" at the PHA. Finally there are some individuals who believe they can outsmart the rules, and seek the thrill of committing the crime.

What Can Be Done To Assure High Integrity?

While you cannot change a person's character, you can establish expectations for honesty and integrity. Issuing a fraud policy as well as "tone at the top" memorandum will help employees understand what is expected of them.



WHAT ELSE CAN YOU DO?

- Look for common tangible signs that an employee may be stealing including missing records (such as receipts, and cancelled checks), checks that bounce, hefty payments made for "miscellaneous" purposes in employee expense claims, and managers who insist on performing clerical duties.
- Rotate your certified public accountant firm at least every 3 years, and ensure that audit findings are resolved. If you use a fee accountant, he or she should not be doing your audits.
- Background checks on new employees including executive directors, are important. Dig beyond the names the applicant provides. These checks can reveal undisclosed criminal records and prior instances of fraud, allowing you to avoid a bad hire.
- To ensure high integrity, have PHAs employees attend ethics training regularly, and review and sign a code of professional conduct document.
- Institute programs that emphasize good behavior such as ethics classes, Issue memorandums to staff promoting honesty and citing nationwide examples in which bad apples were caught and punished.
- Adopt a risk management policy to include specific penalties such as termination and law enforcement notification for dishonest behavior. Ensure that all employees receive a copy of the policy and require them to sign, verifying that they received, reviewed, and understand it.
- Finally, all employees should be made aware of the serious nature of embezzlement and that they have an obligation to report suspected abuse. It is critical to have a process through which people can report suspected fraud. This process may be as simple as appointing a contact person for allegations or more comprehensive such as hiring an investigator to examine tenant frauds.

Due to the size of some PHAs, it may not be possible to institute all of these controls (particularly the ones dealing with separation of significant duties). In situations in which a lot of authority is vested in a few individuals, the role of commissioner/ board member becomes even more important as an independent check on those key positions of trust.

Learn more about Fraud Prevention on our web site.
www.hudoig.gov