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TO: Dominic A. Nessi, Deputy Assistant Secretary for the Office of Native American Programs, PI

FROM: W. D. Anderson, District Inspector General for Audit, 8AGA

SUBJECT: Indian Housing Authority Cash Probes
Office of Native American Programs

We have completed a report which summarizes the results of twelve limited cash probes performed at Indian Housing Authorities in the Rocky Mountain District. These cash probes were conducted as part of Operation Safe Home. The objective of our cash probes was to determine whether an Indian Housing Authority had adequate controls over its cash assets. The results of our cash probes included cash shortages totaling over \$175,000 and inadequate cash management controls at the majority of the Authorities reviewed. The objective of our summary report is to provide the Office of Native American Programs information and recommendations to help prevent or reduce future cash management problems at Indian Housing Authorities.

We found that Indian Housing Authorities' management over cash assets can be enhanced with the joint efforts of Authority staff and HUD Office of Native American Programs staff. With increased knowledge and focus on cash management controls by both Authorities and HUD, opportunities for diversion, fraud, and abuse can be decreased. HUD can accomplish this by increasing its focus on cash management controls when providing technical assistance and guidance to Indian Housing Authorities.

Within 60 days, please furnish this office, for each recommendation cited in the report, a status report on: (a) the corrective action taken; (b) the proposed corrective action and the date to be completed; or (c) why action is not considered necessary. Also, please furnish us copies of any correspondence or directive issued because of this review.

We appreciate the courtesies extended by the Headquarters and Northern Plains Office of Native American Programs officials and staff during our review. Should you have any questions, please contact Ernest Kite, Assistant District Inspector General for Audit, at (303) 672-5452.

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Executive Summary

As part of Operation Safe Home we conducted limited scope cash reviews at twelve Indian Housing Authorities in the Rocky Mountain District. The objective of these reviews was to determine whether an Authority had adequate controls over its cash assets. Of the twelve limited reviews performed, over \$175,000 worth of cash shortages were discovered at half of the Authorities, and the majority revealed inadequate cash management controls. Specific control weaknesses discovered during our reviews included:

- deposits of cash receipts not made timely and/or intact,
- inadequate separation of duties,
- receipt discrepancies,
- improper control over change/petty cash funds, and
- inadequate safeguarding of cash assets.

Specific recommendations to correct and implement these cash controls were detailed in individual reports and memorandums previously issued.

Proper Controls Over Cash are Required

It is essential that both Indian Housing Authorities and HUD focus on cash management controls to help prevent future cash shortages. The need for this is illustrated by the fact that over \$175,000 was diverted from six Indian Housing Authorities in the Rocky Mountain District.

Indian Housing Authorities, as well as HUD, are responsible for ensuring proper controls exist over cash. Authorities are obligated to set up and manage adequate internal controls, while HUD has the responsibility to evaluate and provide technical assistance and guidance towards those controls.

Enhanced Cash Management Practices Are Needed

Both Authorities and HUD need to enhance their cash management practices to ensure adequate controls are implemented at Indian Housing Authorities. Indian

Housing Authorities need more knowledge concerning cash management controls. This knowledge can be gained through increased awareness training and learning to identify red flag indicators.

HUD can enhance Authority cash management practices by providing what HUD provides best: technical assistance and guidance. If HUD modifies the focus of the technical assistance it provides to include internal controls over cash, then HUD can better identify potential Authority cash management problems or deficiencies. This will enable HUD to provide the necessary direction and guidance to the Authority to alleviate cash control weaknesses.

Enhanced Cash Management Practices Are Beneficial

Increased attention towards cash management controls not only helps prevent or reduce future cash shortages, but improves overall operations of Indian Housing Authorities.

Weak controls attract embezzlement, cash shortages occur, tenant accounts are misstated, less resources are deployed towards maintenance and other necessary expenses, and Authorities continue to lose and waste precious resources correcting the situation.

Strong controls, on the other hand, help prevent or reduce the diversion of funds, pinpoint responsibility to all parties involved, protect innocent victims, safeguard Authority cash assets, make better use of available resources, and ultimately improve overall operations at Authorities.

We Recommend

We are recommending the HUD Office of Native American Programs focus more on cash management controls when providing technical assistance and guidance to Indian Housing Authorities through awareness training and a cash management review plan.

Auditee Comments

The audit results were discussed with HUD officials during our review and at an exit meeting on June 13, 1996. They were in full support of our report and recommendations. HUD's response is shown in Appendix C.

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Indian Housing Authority Cash Probe Summary

As part of Operation Safe Home, the Denver HUD Office of Inspector General conducted limited scope cash probes at 12 of 28 (43%) Indian Housing Authorities in the Rocky Mountain District. The objective of the limited cash probes was to determine whether the Indian Housing Authority had effective controls implemented over their cash assets.

The results of our cash probes were surprising. Cash shortages were discovered at half of the Authorities reviewed. More specifically, six Indian Housing Authorities had a combined total of over \$175,000 in cash shortages while five other Authorities were highly susceptible to cash shortages or diversions because of inadequate controls. Only one Indian Housing Authority had adequate controls implemented over cash. The following chart details the six Housing Authorities with cash shortages and their magnitude.

Selection Criteria

The cash probes were undertaken after an independent public accountant identified a cash shortage at the Turtle Mountain Housing Authority. Besides Turtle Mountain,

nine other Indian Housing Authorities were selected for limited cash reviews. The Authorities selected were identified as having large and continuing deposits in transit each month. These deposits in transit could be indicative of delays in depositing Authority revenues.

The nine Housing Authorities selected were:

- Cheyenne River Housing Authority,
- Crow Creek Housing Authority,
- Lower Brule Housing Authority,
- Northern Cheyenne Housing Authority,
- Oglala Sioux Housing Authority,
- Omaha Tribal Housing Authority,
- Ute Mountain Ute Housing Authority,
- Wind River Housing Authority, and
- Housing Authority of the Village of Winnebago.

Two other Authorities were selected as part of our limited cash probes. Since we were performing unrelated audit work at the Blackfeet Indian Housing Authority, we conducted a cash probe there also. The final and twelfth Authority selected was the Yankton Sioux Housing Authority. Yankton Sioux was brought to our attention by a finance and budget specialist working for the Northern Plains Office of Native American Programs. This HUD employee unveiled a check forgery scheme. We performed a cash probe to identify the exact magnitude and scope of the scheme.

Cash Review Results

The results of our cash probes were surprising. Cash shortages were discovered at half of the Authorities, and the majority revealed inadequate cash controls. Of the 12 cash probes performed,

- Six revealed a combined total of over \$175,000 worth of cash shortages;

- Another five revealed significant cash control weaknesses, leaving each one susceptible to a cash shortage if someone had taken advantage of the weaknesses; and
- Only one, the Blackfeet Indian Housing Authority, had effective cash controls in place.

Effects of Cash Shortages

These cash shortages adversely impacted Authority operations. Authority funds were used improperly for personal non-authorized expenses, making less resources available for maintenance and other vital expenditures. Also, tenant accounts were misstated, causing tenants to lose confidence in the Authority's cash management and accounting system, and giving tenants an alleged legitimate excuse not to make monthly rent payments.

Besides impacting Authority operations and tenants, staff performing the cash handling and accounting functions were affected. Weak controls over cash can tempt an otherwise honest employee to start embezzling. Once an employee begins to embezzle Authority monies and does not get caught, the employee often finds it difficult to avoid the same temptation, leading to larger amounts of embezzlement.

To date, there have been three indictments and convictions against former Authority employees for embezzlement. In all three cases, these Authority employees took advantage of weak controls and embezzled funds. These Authority employees held the positions of Occupancy Specialist, Administrative Assistant, and Comprehensive Grant Assistant. Currently, of these three cases, two are awaiting sentencing while a third former Authority employee received the following sentence:

- Ordered to make \$7,200 restitution,
- Spend 8 months in jail, and

Underlying Causes of
Cash Shortages

- Spend an additional 3 years on probation.

Other cases are currently under investigation.

All of the identified cash shortages stemmed from weak cash controls. The five most common control weaknesses found at Authorities included:

- Deposits of cash receipts not made timely and/or intact,
- Inadequate separation of duties,
- Receipt discrepancies,
- Improper control over change/petty cash funds, and
- Inadequate safeguarding of cash assets.

The number of occurrences of each of these control weaknesses was considered large. Each control weakness was present at 50% or more of the Authorities reviewed as shown by the following chart.

Specific Examples of
Control Weaknesses

These cash control weaknesses and their magnitude can be better understood with the following examples.

Deposits Not Made Timely and/or Intact Of the twelve Authorities reviewed, nine Authorities (75%) made deposits that were not timely and/or intact.

One Authority accumulated cash receipts and made deposits up to 42 days after the money was received, even though a bank was within a block of the Authority office. This Authority's average monthly balance of cash receipts on hand averaged \$62,000.

At another Authority, the bookkeeper would take cash to the bank each evening, and the next morning pick up the cash and return it to the Authority. Instead of depositing the monies each evening, the Authority was only using the bank to safeguard the monies overnight.

Inadequate Separation of Duties Of the twelve Authorities reviewed, seven (58%) had inadequate separation of duties over cash. Primarily, one employee controlled both functions of handling cash and recording cash transactions. As a result, the Authorities had significantly reduced accountability over their cash.

Every Authority with a cash shortage had inadequate separation of duties implemented. Those cash shortages ranged from \$1,937 to over \$81,700.

At one Authority, an employee assumed full control over all aspects of the cash function and the recording of transactions for a program project. This employee carried out a check forgery scheme which resulted in the misappropriation of over \$26,400.

Receipt Discrepancies Another control weakness found at Authorities was the handling of cash receipts. Of the twelve Authorities reviewed, seven (58%) had some type of

receipt discrepancy. Specific receipt discrepancies identified included:

- receipt tickets issued out of numeric order,
- missing receipt tickets,
- no cash receipt tickets issued,
- manipulation of cash receipt tickets,
- un-numbered cash receipt tickets used,
- cash receipts not input into computer, and
- similar numerically ordered batches of receipt tickets being issued.

For example, one Authority had filed a receipt copy showing cash totaling \$71.50 as being collected from a tenant. However, the copy of the receipt sent to the fee accountant was marked "void". Since the original receipt could not be located, a determination could not be made what funds, if any, were actually collected. If monies were collected, the funds were not deposited into the Authority's bank account and the tenant was not given credit for the payment. This Authority has incurred a \$29,100 cash shortage since 1991.

Improper Control Over Change/Petty Cash Funds

Another weakness found at the Authorities was the improper control over change/petty cash funds. Of the twelve Authorities reviewed, seven (58%) had problems relating to change/petty cash funds.

At one Authority, a \$50 petty cash fund had been established on the books, but no monies could be found. None of the staff could explain what had happened to the \$50 petty cash fund.

Inadequate Safeguarding of Cash Assets The last major control weakness found at Authorities was the inadequate safeguarding of cash assets. Of the twelve Authorities reviewed, six (50%) had problems relating to inadequate safeguards over cash assets.

At one Authority, safeguard weaknesses included:

- easy accessibility by several people to the cash bag kept in the Authority safe,
- cash receipt forms stored in a storeroom that had unlimited access by Authority employees, and
- a key to the deposit bag left unsecured.

The weak safeguards at this Authority made it possible for any number of people to have unlimited access to monies in the cash bag or monies received from tenants through the issuance of stolen receipt forms.

Other Audit Districts Identified Similar Deficiencies

Besides the limited cash reviews performed by the Rocky Mountain District Office of Inspector General, other Districts have identified and disclosed similar control weaknesses at Indian Housing Authorities. Specifically, out of four audit reports received from other districts, two of those reports indicated inadequate safeguards over assets, and one of those two reports indicated inadequate separation of duties. These control weaknesses could ultimately lead to future cash shortages.

Specific Reports Were Issued for Each Authority Reviewed

Audit Reports or Audit Related Memorandums have been issued for each of the individual Indian Housing Authorities reviewed. Appendix A lists these reports and memorandums issued by the Rocky Mountain and other Districts of the Office of Inspector General. Specific recommendations to correct and implement cash controls were detailed in these reports and memorandums.

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Cash Management Problems Can Be Prevented Through Enhanced Cash Management Practices

Management of cash assets at Indian Housing Authorities can be enhanced with the joint efforts of Authority staff and Office of Native American Programs (HUD) staff. Enhanced cash management practices are needed to prevent future cash shortages. The need for improved cash management practices is illustrated by the results of the twelve cash probes performed by the Rocky Mountain Office of Inspector General. These cash reviews revealed ineffective controls at half of the twelve Authorities reviewed, resulting in over \$175,000 worth of cash shortages; weak controls at five other Authorities; and effective cash controls in place at only one Authority. The results are clearly illustrated in the following chart:

Proper Controls are Required

Individual Indian Housing Authorities, as well as HUD, are responsible for ensuring that proper controls exist over cash. Specifically, proper management of Authorities' assets is required by the Terms and Conditions of the

Annual Contributions Contracts; Section 85.20, Title 24 of the Code of Federal Regulations; and HUD Handbook 7510.1, Low-Rent Housing Accounting Handbook.

Responsibility of Authorities Under the terms and conditions of the Annual Contributions Contracts, Authorities are to operate their housing programs in an economic and efficient manner and to ensure that housing program funds are used solely for authorized activities. Accordingly, Authorities are obligated for setting up adequate internal controls over cash and for managing them.

Section 85.20, Title 24 of the Code of Federal Regulations details the financial administration standards for program assets that should be put into place by Authorities. Additionally, detailed accounting requirements and procedures are contained in various HUD Handbooks, including Handbook 7510.1, Low-Rent Housing Accounting Handbook. These handbooks provide Authorities with some useful guidance for setting up adequate internal control structures.

Responsibility of HUD HUD has the responsibility towards Authorities to evaluate performance and compliance, and to provide technical assistance and guidance.

Section 950.135, Title 24 of the Code of Federal Regulations, details HUD's administrative duties, and states that HUD will evaluate an Authority's compliance with financial management functions.

Both Authorities and HUD genuinely want to improve Authority operations. However, both have been limited in their efforts.

Indian Housing Authorities need more knowledge concerning cash management controls, while HUD needs to

Enhanced Cash
Management Practices
Are Needed

What Indian Housing Authorities Need

focus on cash management controls when providing technical assistance to Authorities. With increased knowledge and focus on cash management controls, opportunities for diversion, fraud, and abuse can be decreased.

Authorities need more knowledge concerning cash management controls. This knowledge can be gained through increased:

- **awareness training, and**
- **knowledge of red flag indicators.**

Awareness Training Authority management needs the proper training on internal control policies and procedures. If Authority management is not properly trained on internal controls, an Authority's operations are seriously jeopardized. This training should teach management the definition and purpose of internal controls, as well as, how to implement, analyze, and update cash management controls on a continual basis. In addition, Authority staff need sufficient training on internal control procedures in order to better understand the purpose of cash controls, and their responsibility to adhere to control policies and procedures.

Red Flags Authorities need to be aware of common red flag indicators. Red flags identify control weaknesses before those weaknesses cause serious deficiencies. Red flags that Authority personnel should pursue include:

- large, extensive deposits-in-transit,
- receipt tickets missing, or issued out of order,
- cash not properly secured, and
- deposits not made timely nor intact.

A red flag used in our cash probes was to select Authorities whose bank reconciliations included large deposits in transit. Some of the cash shortages we discovered could have been identified sooner if Authority staff were aware of the red flag and took positive corrective action.

How HUD Can Help

HUD can help enhance cash management practices by providing what they provide best: technical assistance and guidance.

If HUD modifies the focus of the technical assistance it provides to include internal controls over cash, then HUD can better identify potential Authority cash management problems or deficiencies. As a result, the necessary direction and guidance can be given to the particular Authorities to alleviate cash control weaknesses. This can make a tremendous positive impact on Authority operations by reducing the possibility of cash shortages and embezzlements. HUD can accomplish this by:

- **providing awareness training to Authorities, and**
- **developing and carrying out a cash management review plan.**

Providing Awareness Training to Authorities HUD needs to provide Authorities training which focuses on cash management controls. This training can be carried out through either a classroom type of instruction or through on-site education and guidance at the individual Housing Authority.

This training could be supplemented with the issuance of various HUD publications and pamphlets that highlight cash management procedures and controls. Some examples of these include the Program Integrity Bulletins and the Fraud Information Bulletins.

The training HUD provides should incorporate basic internal control concepts such as separation of duties, and safeguards over cash assets. Most of the cash shortages discovered during our reviews could have been prevented if the following controls were in place:

- use of prenumbered, sequential ordered cash receipts,
- daily matching of receipts to deposits by independent party,
- daily deposits to bank by independent party,
- accounting for all receipts,
- performing follow up procedures if discrepancies occur, and
- separation of the function of recording cash transactions from the function of handling cash transactions.

These above controls are considered minimal and basic. However, if the Authority is without knowledge of those controls, they can be easily overlooked and/or circumvented.

HUD also needs to provide fraud training to Authorities. Such training needs to provide Authority staff and officials with information explaining the definition of fraud, what fraud entails, responsibilities for preventing fraud, requirements for reporting fraud and related irregularities, and the sanctions and penalties for committing fraud. The training should encourage Authority employees and officials, including fee accountants, to promptly report persons who do not follow control policies and procedures. Employees should know the serious nature of

embezzlement and that they have an obligation to report suspected abuse.

The former Authority employees convicted of embezzlement may have opted not to embezzle if HUD had provided more awareness and fraud training.

Cash Management Review Plan HUD needs to develop a plan to identify control weaknesses or "red flags" in the cash management area of Authorities. While HUD does monitor program activities at Authorities, improvement can be made by increasing the focus on the cash management activities of Indian Housing Authorities.

This plan would not be time nor effort intensive, but would allow an effective review of cash management practices to determine whether effective controls are in place. HUD can incorporate cash management reviews during other regularly scheduled on-site visits.

For example, during on-site visits, HUD could perform a cash count, or review cash receipt procedures (both are red flag procedures). These simple procedures will quickly identify possible control weaknesses, or provide sufficient evidence that effective controls are in place. If control weaknesses are noted, then HUD officials could decide on the appropriate corrective action needed.

Finally, this cash management review plan should be flexible, so it can be revised, modified, and changed as necessary to fit individual Authority and HUD needs.

A HUD Employee's Red Flag Discovery

By identifying and investigating a red flag, one HUD employee uncovered a check forgery scheme which diverted over \$26,400 in Authority funds.

The HUD employee was performing a standard review of cash and disbursements which revealed a \$50,000 draw down in funds containing no supporting documentation.

The HUD employee investigated the red flag further by performing a detailed review of the account. This led to the discovery of a check forgery scheme being perpetrated by an employee.

The red flag in the above case was the lack of supporting documentation for the draw down in funds. Had the HUD employee not investigated the red flag, the forgery scheme could have gone undetected.

This situation illustrates the benefit of HUD developing a review plan that deals specifically with cash management controls, and the identification of similar red flags.

The creation and implementation of this cash management review plan will only enhance HUD's oversight of Authority operations, and make certain that effective cash management controls are in place. In addition, the plan serves as a safety net in case control weaknesses go undetected by Authorities.

Additional detailed information pertaining to red flag indicators is included in Appendix B.

Enhanced Cash
Management Practices
Are Beneficial

Cash management problems can be prevented if Authorities and HUD work together to enhance cash management practices. Some benefits derived if Authorities and HUD accomplish this task include:

- **prevention instead of correction,**
- **protection for everyone within the cash system, and**
- **improved Indian Housing Authority operations.**

Prevention Instead of Correction One benefit of enhanced cash management practices is that problems can be prevented instead of corrected. Precious resources are

wasted each year correcting problems that have gone undetected. If Authority and HUD staff increase their knowledge and attention towards cash management controls, these problems would be detected and corrected accordingly.

Protection For Everyone Within the System Another benefit of enhanced cash management practices is the protection improved controls will provide. By increasing attention towards cash management controls, responsibility can be pinpointed if embezzlement occurs.

For example, if an Authority separates the duties of its employees, it is easy to pinpoint responsibility to specific employees. Thus, strong cash management controls protect innocent victims from undue finger pointing and criticism, and at the same time, pinpoint responsibility to a guilty party.

Improved Operations At Authorities Finally, enhanced cash management practices will improve overall operations at Authorities. Just as weak cash management controls have a negative domino effect, strong cash management controls have a positive domino effect.

Weak controls attract embezzlement, cash shortages occur, tenant accounts are misstated, less resources are deployed towards maintenance and other necessary expenses, and Authorities continue to lose and waste precious resources correcting the situation.

Strong controls, on the other hand, help prevent or reduce the diversion of funds, pinpoint responsibility to all parties involved, protect innocent victims, safeguard Authority cash assets, make better use of available resources, and ultimately improve overall operations at Authorities.

Auditee Comments

The results of our review were discussed with Office of Native American Programs officials during our review and

at an exit meeting on June 6, 1996. They were in full support of our report and recommendations. Their response is shown in Appendix C.

Recommendation

We recommend the Office of Native American Programs:

- 1A Develop a plan to implement a cash management control and fraud awareness training program for Indian Housing Authorities' staff and officials.
- 1B Develop a standard cash management review plan that focuses on cash management activities of Indian Housing Authorities to identify possible cash control weaknesses. This would involve identifying possible red flags. This plan should incorporate the following elements:
- quick reviews of cash transactions, possibly through use of checklists, and performing cash counts during selected site visits,
 - periodic reviews of bank reconciliations for large deposits in transit,
 - obtain necessary description of selected Authority's cash collection and disbursement procedures,
 - direct, appropriate training to those Authorities experiencing high turnover in their finance and/or accounting departments, and
 - provide necessary guidance and technical assistance to Authorities once cash management problems are identified.

Finding

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Internal Controls

We did not review any additional internal controls of the twelve Indian Housing Authorities nor the Office of Native American Programs.

Our reviews of the internal controls of the twelve Indian Housing Authorities were limited to controls over the Authorities' cash assets.

Internal controls are management's adopted plan, methods, and procedures to assure resources are used consistent with the laws, regulations, and policies; that the resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in the reports.

Internal Controls Assessed

Controls to safeguard and assure reliable accounting of Authorities' cash assets were relevant to our objective and were assessed during our reviews. The results of our assessments, the assessment procedures used, and significant control weaknesses identified during our reviews are reported separately in the individual Audit Reports and Memorandums already issued for each Authority. Appendix A contains a complete listing of those Audit Reports and Memorandums for additional information on internal controls.

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Indian Housing Authority Audit Reports and Memorandums

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Red Flag Indicators

Red flag indicators can be used to identify control weaknesses and potential problems.

Some of the more common red flag indicators in the area of cash management are:

- books not maintained on a current basis,
- receipts not recorded in cash receipts ledger,
- unusual quantities of missing or voided cash receipts,
- employee IOU notes or personal checks in the cash receipts,
- large deposits in transit,
- unsupported or insufficient documentation for payments,
- cash receipts not in agreement with deposits,
- erasure marks or white-out on books, receipts, invoices, or subsidiary ledgers,
- altered dates on deposit slips,
- petty cash vouchers which appear to be in excess of cash needs or normal requirements,
- and large write-off of accounts receivable.

The primary methods used to conceal cash shortages are:

- falsifying the cash count or bank reconciliations - Indicators to look for include: personal checks included in the cash fund but never deposited; the depositing of checks written some time ago during or just prior to a review; and bank reconciliations performed using fictitious outstanding checks.
- false entries on the books - Indicators to look for include: entries prepared to show the amount deposited, not the amount collected; and incorrect totals on cash receipts or cash disbursement ledgers.

- the kiting of accounts - Indicators to look for include: cash taken from one project to cover a shortage in another; and checks or funds transferred from one account to another.

Specific procedures that may identify red flags include:

CASH COUNTS

- Add up all cash on hand at the Authority. This includes cash, checks, and coin.
- Compare this amount with undeposited receipts.
- Remember to consider any change/petty cash fund amounts.
- Any difference should be further investigated.

INTERVIEWS

- Through interviews, detail the cash receipts and disbursements process used by Authorities.
- Test these procedures and evaluate the current controls in place.

FEE ACCOUNTANTS

- Require an Authority's fee accountant, as applicable, to notify the Authority Board Chairman, Executive Director, and HUD when certain red flags occur.

Auditee Comments

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