

programs and operations to assist the Department in meeting its mission. HUD's OIG is charged specifically with combating waste, fraud, and abuse in the administration of HUD programs and operations.

Consistent with this charge, Section II of this notice presents OIG's recently issued bulletin on detecting and preventing counterfeiting of local housing authority (HA) checks.

II. Fraud Information Bulletin: Detecting and Preventing Counterfeiting of HA Checks Purpose

This Bulletin highlights a recurring problem in the production of counterfeit Housing Authority checks across the country.

Background

OIG's mission is to provide policy direction for HUD and to conduct, supervise, and coordinate audits, investigations, and other activities for the purpose of promoting economy and efficiency in the administration of the programs and operations of HUD and preventing and detecting fraud and abuse in such programs. HUD administers Federal aid to local housing agencies (HAs) that own and operate housing for low-income residents at rents they can afford. During the course of audits and investigations of, and relating to, HAs, OIG has detected numerous bank fraud schemes victimizing HAs across the country. Examples of these schemes follow.

Examples

In Cleveland, OH, fourteen individuals were indicted for conspiracy to defraud local banks, merchants, businesses, and the Cuyahoga Metropolitan Housing Authority (CMHA). These individuals allegedly comprised a loosely connected ring formed to counterfeit payroll and business checks. The ring was led by a felon with a prior uttering conviction. He used "recruiters" who, in turn, would seek out individuals who were willing to provide their identification, and in some cases, their own bank accounts, to deposit counterfeit checks which he made on a personal computer. The felon, the recruiters, and check utterers would then split the proceeds. Counterfeit check amounts ranged from as little as \$300 to more than \$16,000. Six of the defendants were indicted for passing counterfeit checks that displayed either the payroll or Section 8 account numbers of the CMHA. CMHA's loss estimates exceed \$49,500.

In St. Louis, MO, an individual was indicted on two counts of bank fraud for allegedly manufacturing counterfeit

checks drawn on accounts of the City of St. Louis and St. Louis County Housing Authority (SLCHA). The individual engaged in his scheme beginning in October 2002 and continuing until April 2003, and over \$80,000 in fraudulent SLCHA checks were created and uttered in the St. Louis metropolitan area. SLCHA lost over \$28,000 from its Section 8 account.

What Happens

As part of a counterfeiting scheme, bank routing and account numbers of HAs are used to create counterfeit checks. Among other means, counterfeiters obtain the routing and account numbers from: (1) HA employees and vendors who receive payroll checks or other checks from an HA; and (2) HA residents who receive utility or other checks from an HA. Counterfeiters then employ personal computers, commercially available software, and check stock to manufacture bogus checks using the legitimate routing and account numbers. In some cases investigated by OIG, the counterfeit checks were used to buy computer equipment, which in turn was used to manufacture more fictitious checks.

The Problem

Federal funds are at risk, and from an HA's standpoint avoiding victimization can be difficult. First, even tiny HAs have numerous employees and vendors who regularly receive HA checks, and it only takes one such employee or vendor to open an HA to fraud. Second, many HAs issue utility checks directly to residents via the U.S. mail. These residents may participate in a scheme against the HA, or their utility checks could be intercepted from the mail by a third party. Third, check stock and business check software is readily available at local office supplies stores. Fourth, counterfeit checks are usually cashed at local mom/pop stores that don't have check authentication equipment or protocols. Fifth, numerous false identities accompany the counterfeit checks, and local merchants don't necessarily have the will or ability to detect false identifications.

Red Flags

An accounting discrepancy detected by monthly bank reconciliation performed by the HA. A discrepancy in the check stock (e.g., color, design) ordinarily used by the HA. Suspicious endorsements on cancelled checks. Unusual disbursements.

HA Responsibility. What Can Be Done?

Internal Controls

The first step in preventing this type of scheme is for HAs to enhance procedures for preventing and detecting fraud and mismanagement (*i.e.*, to improve internal controls). The most effective internal control concept is separation of duties. An ideal system of internal controls will separate three functions: (1) Authorizing transactions; (2) keeping books; and (3) handling funds. When staff size is too small to permit separation of duties, closer supervision is needed to occasionally check for problems. Other steps that can be taken to improve internal controls include HAs paying for all disbursements by sequentially pre-numbered checks, reconciling accounts receivables to the general ledger on a monthly or more frequent basis, reviewing cancelled checks for suspicious endorsements and unusual disbursements, and requiring timely audits.

External Controls

Positive Pay Agreements. The most effective external control concept is Positive Pay Agreements (a/k/a Check Registries). This form of external control protects the HA from absorbing the loss involved with counterfeit checks if a bank fails to identify a counterfeit check and makes payment. Many banks will enter into a security contract (Positive Pay Agreements) with HAs, whereby the HAs are responsible for submitting electronic registries to the bank indicating checks that have been legitimately drawn of the HA's operating account. Upon receipt of the registry, the bank compares all checks received for payment against the registry. Any check that is not listed on the registry is rejected for payment. The bank makes a copy of the unverified check and forwards it to the HA for appropriate investigation. The bank returns the unpaid check to the original depositor and the HA will not incur a loss on the unverified check. In the event the bank pays a counterfeit check, the HA is not responsible for the amount paid out by the bank. While the registry does not prevent the production of counterfeit HA checks, it does reduce the financial loss to the HA and the Federal Government. Positive Pay Agreements have been an effective tool in the detection and prevention of check fraud. At least one bank fraud scheme that is currently under OIG investigation is the result of a Positive Pay Agreement detection.

Electronic Payment Systems. HAs may also consider converting to an