

Best Practices in Cash Management For Property Managers



AXIS INSURANCE SERVICES, LLC

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What Our Real Estate Clients Have to Say About Our Service

Kimberly Fischer, Controller/Operations Manager

Lee & Associates – North San Diego County, Inc.

"We have done business with Javier and his team at Axis Insurance Services for several years. We appreciate the hands on assistance and guidance and Marianna is always very thorough with processing our paperwork. They are always responsive and take the time to outline any concerns or questions. It's a pleasure working with this team!"

Steve Jehorek, President/Managing Director

Lee & Associates – Newport Beach

"We have worked with Javier Gonzalez and Mike Smith of Axis Insurance Services for many years and looked to them for assistance with our E&O coverage. Recently we added EPLI coverage and they were most helpful in guiding us through the choices and differences in coverages. We had a specific set of coverages for EPLI and Axis was very diligent about making the underwriters understand our particular needs. I would recommend Axis for their expertise and attention to providing a very high level of customer service."

Andie Edmonds, Partner/Principal Broker

NAI Cascade

"As a relatively young but growing firm, NAI Cascade really appreciated Mike Smith's ability to evaluate our current E&O policy and discuss areas where we may be lacking sufficient coverage. As importantly, Mike was incredibly responsive and diligent in helping us meet our deadline to switch coverage. We look forward to a long relationship with Mike and Axis Insurance Services."

Douglas F. Mueller, Chief Financial Officer

NAI Hiffman

"Axis Insurance Services has earned the right to be called a preferred provider for NAI Hiffman. For the past twelve years, NAI Hiffman has turned to Mike Smith and his staff for our Errors & Omissions coverage. Mike has shopped our premiums, explained our coverage and discussed our options. Mike has shared his knowledge on claims he has observed against brokerage and property management firms and that knowledge has helped us establish procedures and determine coverage. On occasion, we have asked Mike to review contract insurance language as his expertise is not limited to just Errors and Omissions. Mike and the other people at Axis make you feel as if you are their only client. Twelve years; I don't recall how we found Axis Insurance Services but I am glad that we did as their service goes well beyond just placing insurance coverage."

Ira Krumholz, President

NAI Daus Property Management

"I have worked with Mike Smith and Axis Insurance Services, LLC for over 10 years. We appreciate his knowledge of the commercial real estate industry and the service he is able to provide to our company. In addition to our insurance broker, he has been a frequent speaker and exhibitor for the Property Management Council and we highly recommend his services."

Victor Segrest, Co-President/Chief Financial Officer

Lee & Associates Valuation and Consulting Services, LLC

"For the past four years, Axis Insurance Services has provided us with national appraisal E&O insurance. The right coverage can be a challenge since we appraise all property types. We appreciate the wealth of knowledge Javier and Mike bring to the table to help us find and evaluate the different carriers to determine the right solution. They take the time to make sure we fully understand the pros and cons of each choice. Javier has always been quick to respond whenever a question arises. Axis is an important strategic partner for us and I would highly recommend them."

Robert Chaffin, Manager

Green County Abstract & Title

"The service we received from Axis Insurance Services, LLC was exceptional! We could not have asked for a better broker to guide us through the process. Mr. Culkin's experience and patience has served us well."

Lori Jensen, VP/Chief Operating Officer

Lee & Associates – Riverside

"Since 2005 we have had the great benefit of having Axis Insurance Services as our E&O insurance agent. When looking for a new agent and coverage, we wanted to make sure that our new agent was looking out for our best interest, and could educate us on what was important to have in our coverage. Mike Smith has been available to us whenever a problem arises, or just for a minor question. He is a wealth of knowledge and makes us feel that his company is small and we are his biggest client. His expertise in guiding us through challenging situations has been invaluable. Every year the application process becomes easier with Axis, mainly due to their well-trained, helpful staff. Because of our excellent relationship and trust with Axis, we have added DO/ELP coverage with them."

Contact our experts today to find out how you can protect your business.

Cash and Other Funds Received

Property Management companies are at an increased risk of employee theft. Many controls that are common in large businesses relating to cash receipts are simply not implemented between onsite managers and home office accounting departments. Implementation of some basic internal controls can help reduce or eliminate the risk of fraud.

Highlighted below are some basic controls that should be implemented by every property management company and could help reduce loss from occupational theft.

Risk

1. Cash collected on-site at the managed properties can be diverted before reaching the main office accounting department or the property owners.
2. Funds received by on-site managers for CAM or other charges can be diverted.
3. Onsite managers collecting checks can whitewash checks or even endorse checks to themselves.
4. Bookkeepers and accounting personnel may have access to multiple bank accounts and can divert funds from one account to another in a Ponzi scheme.



Recommended Controls

1. A specific written procedure for the collection of rents and other funds, including a procedure for actual cash receipts, should be established.
2. A separate bank account should be used for each property.
3. Payments should be made to the home office accounting department or a lock box.
4. A policy that does not permit cash payments is preferable. If cash payments must be accepted, then a log book with pre-numbered receipts, completed in ink, should be maintained. An audit should be done of these log books periodically.
5. A sign should hang in the office where cash is accepted stating that all cash transactions will be issued a receipt.
6. If a property manager collects cash payments, a 'Deposit Only' account should be used for that property.
7. All employees who handle cash or accounting functions should be required to take a minimum of one full, continuous vacation week each year, to allow for a review of their daily work and compliance with company procedures.
8. You should have a separation of duties between the person receiving funds and the person doing the bank reconciliations. The person who reconciles bank accounts should not be the same person who writes checks.
9. You should perform background checks on all employees that handle funds or work in accounting or bookkeeping.

Claim Examples

Cash Accepted with No Procedural Controls - \$200,000

At one multifamily property, tenants frequently paid their rent in cash. No procedures for accepting cash payments had been established when the onsite manager was hired years earlier. Receipts were not issued when cash was accepted. Over the course of several years, the onsite manager diverted over \$200,000 in rental income from the property, by skimming a small amount from these frequent cash payments.

Ponzi Scheme Diverts over \$1,000,000

One property manager set up multiple bank accounts for each property, but was the lone signatory to each account and also responsible for bank deposits. Each month, he endorsed several rent checks over to himself and then deposited them into one of his own accounts. To conceal the theft, he repeatedly moved funds between the bank accounts of the properties he controlled. His theft led to an extravagant lifestyle, which went unnoticed by the property management firm. When a motorcycle accident kept him away from the office for two weeks, his Ponzi scheme was revealed. The property management firm then brought in a team of forensic accountants. Their audit revealed that over the course of several years, he was able to divert \$1.4 million from the property owners.

The above procedures are recommendations of best practices and should be reviewed in conjunction with your company's accountant.



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Mike is the founder and owner of Axis Insurance Services, LLC and PL Risk Advisors, Inc. both nationally recognized Professional Liability insurance brokerages.

Mike has become a valuable market resource and has been requested to be a frequent speaker, panelist and writer on professional liability risk and insurance. Having over 20 years of experience in the industry, he brings a wealth of knowledge and a unique ability to create innovative coverage solutions.

Check Payments and Funds Dispersed

The payment process for Property Managers is often less controlled than ideal. Property Managers have multiple vendors and the approvals and payments to vendors are often made outside of the home office. Highlighted below are some procedures that can help reduce your exposure.

Risk

1. Payment can be made to phony vendors.
2. Payment can be made on inflated invoices from contractors in collusion with employees.
3. Inappropriate, fictitious charges can be booked as CAM expenses, which might not get the scrutiny typically given to budgeted line items.



Recommended Controls

1. Maintain a prescreened list of approved vendors for all services needed for the property, including vendors for after hours and emergency services.
2. An established requisition process which includes the use of purchase orders that are approved in advance by the main office. In circumstances where such prior approval is not possible, the onsite manager should prepare a purchase order and submit it to the main office the following business day.
3. Vendors should be paid from the main office, if possible, and all vendor payments should require a corresponding, preapproved purchase order. If the onsite manager is to have any authority to pay a vendor, that authority should be limited to circumstances where such payments are permitted such as an emergency, and a specific limited dollar amount of their authority should be established for such payments.
4. Ideally, the person responsible for vendor payments should not be the same person who is authorized to sign checks or conduct bank reconciliations.
5. The company should have a policy that all home office and on-site employees who handle financial transactions, including the receipt of cash, vendor payments and bank reconciliations, have no less than one full, continuous vacation week each year, to allow for a review of their daily work and compliance with company procedures.
6. You should have a separation of duties between the person receiving funds and the person doing the bank reconciliations. The person who reconciles bank accounts should not be the same person who writes checks.
7. You should perform background checks on all employees that handle funds or work in accounting or bookkeeping.

Claim Examples

Onsite Manager Uses Phony Invoices to Divert Cash

A large industrial property was sold to a group of doctors who undertook extensive renovations of the older buildings. The property management firm they hired did not have specific procedures in place for vendor payments. The onsite manager, who oversaw the renovations, had the authority to hire vendors for the projects. In collusion with a few people, he submitted fictitious invoices for work that was never performed on the property. Since the property was large, and needed a lot of updating, the phony invoices were not discovered for over a year. When the costs of the renovations far exceeded the projected costs, the doctors hired a forensic accounting firm to conduct an audit. In just a little over one year, the onsite manager had diverted over \$350,000 using these phony invoices.

Padded Invoices Used to Divert over \$2,000,000

The property management firm's procedures allowed the onsite manager to approve vendor invoices that were then charged back to the tenants in the form of CAM charges or renovations. This allowed the onsite manager to easily get the padded invoices paid. At a multi-tenant property in Nevada, an onsite manager struck a deal with a vendor for a ten percent kickback on his invoices. Over a three year period, over \$2,000,000 in unnecessary expenses were charged to the unsuspecting tenants. The occupancy rate dropped steadily over the three year period, partially due to the unreasonable allocated costs that were shifted to the tenants. This prompted the property management firm to conduct a thorough audit, which revealed the theft. Fortunately, most of the stolen funds were later recovered.

The above procedures are recommendations of best practices and should be reviewed in conjunction with your company's accountant.



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Wire Transfers

The use of wire transfers and ACH payments increases the risk of significant financial loss for property managers and real estate professionals. A property manager should have strict wire transfer instructions and guidelines.

Risk

1. Wire transfers can be approved based on fraudulent invoices.
2. Employees can be duped into wiring money to a known vendor, but with fraudulent banking information.
3. Funds can be wired to fictitious vendors.

Recommended Controls

Some recommended policies that can help reduce exposure are as follows:

1. All wire transfers should be conducted by the main office.
2. Limit the number of persons who are authorized to initiate a wire transfer.
3. Wire transfer requests over an established dollar amount should be approved by more than one person, including someone in a supervisory role to the person who will be initiating the wire transfer.
4. Establish the same payment controls for wire transfers and check payments, such as the use of approved purchase orders and an approved vendor list.
5. A list of approved vendors with their verified bank account information should be maintained. Any changes to vendor information, such as address, corporate name or account numbers must be verbally confirmed. Wire transfers should not be initiated to a vendor who does not appear on this list or to a bank account that has not been previously verified by the main office.
6. All wire transfers should be verified verbally with the vendor prior to initiating the wire. Your policy should permit no exceptions to this rule.
7. Consider implementing a call-back and medallion method of approval.
8. Consider implementing a positive pay procedure with your bank.



Claim Examples

Accounting Department Duped

The accounting department for a property management firm received an email and invoice from an existing and pre-approved vendor. By all measures, both the email and the invoice looked like every other email and invoice they had received in the past from this vendor, except for the new bank account information. The accounting department was instructed to remit payment to the vendor's new bank. Without verbally verifying the new bank information with the established vendor, the accounting department wired \$225,000 to the new account. When the actual invoice arrived a week later, the fraud was revealed. In this case, the accounting department's email had been hacked, and the fraudulent email and invoice was sent in place of the true invoice. By the time the theft was discovered, the funds had been wired to an account outside the United States, and were not recoverable.

Vice President's Email Turns Out to be a Fraud

At a property management firm the accounting clerk responsible for wire transfer payments received an email with instructions to pay several vendor invoices by wire transfer. The email appeared to be from a vice president of the company. Because everything looked to be in order, she wired over \$90,000 as instructed. The fraud was revealed the following week, when she mentioned the wire transfer to the vice president, who had no knowledge of the email. This Property Management firm had inadequate procedures in place for wire transfer payments. The firm did not maintain a list of established vendors with their bank account information and did not verbally verify wire transfer instructions. The funds were transferred to an account in China, and were not recoverable.

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