

Community Association Vulnerability

If you ask any person who lives in a community association if fraud or embezzlement would ever occur in his or her association, it is more likely that you will be assured that it would never happen. However, no association is immune from the risk of fraud. In fact, community associations are inherently vulnerable.

Community Associations, whether a condominium, cooperative, homeowner's association or property owner's association, are legal entities, like any other business entity. The people governing that entity are responsible for maintaining the association's interests pursuant to its governing documents, including maintaining banking accounts, supervising collections and all fiduciary obligations for all other common assets and investments.

The difference, however, between community associations and business enterprises is that associations are governed by volunteers, some with no experience in running a business or management, and others with too little time to devote to the task. Association and their boards are often ready even willing to let others handle the responsibilities. Accordingly, they may be too quick to trust—leading to potential dishonesty and/or theft.

If All Else Fails, Make Sure There is Insurance

Fidelity coverage indemnifies for loss of money, securities, or any property because of acts of fraud, dishonesty, forgery, theft, larceny, embezzlement, misappropriation, or any criminal act on the part of directors, officers, committee members, association employees, board members, and volunteers.

As a general rule, the fidelity coverage should cover the greater of either (1) the maximum funds that will be in the custody of the association or its management agent at any time, or (2) any amount required by the association's bylaws or (3) three months of assessments plus current reserve funds. Unwary community associations often assume that their policy provides coverage for any exposure. But this is often not the case when a package policy is sold with set limits that bear no relations to the formulas set above. This is why associations should turn to professionals who are versed in the needs of the community association industry.

Third-party crime coverage protects associations from the effects of a non-employee committing one of the following crimes: (1) forgery and alteration; (2) theft, destruction, and disappearance (premises and transit); or (3) computer fraud and wire transfer. The coverage can be sold as part of fidelity coverage or as a separate package.



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McGowan Program Administrators

Home Office
Old Forge Centre
20595 Lorain Road
Fairview Park, OH 44126

phone (800) 545-1538
fax (440) 333-3214

www.mcgowanins.com

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COMMUNITY ASSOCIATION FRAUD

How to identify it and how to avoid it

Community Association Fraud

Most often, if someone is engaging in fraud or embezzlement, there are clear indicators that something is amiss. Fraud is most often perpetuated by employees who pay personal bills out of petty cash, waive the dues or assessments of various community members, or give association repair and maintenance contracts to friends, relatives, or certain vendors in return for kickbacks. As with any organization, if the opportunity is there and there are no controls, temptation can get the best of some people.

Sloppy Hiring Practices

Every association should conduct background checks on prospective employees. Background checks are inexpensive procedures, and it is prudent to check not only employees, but board members as well. Associations should also check references and contact the former employers or prospective managers.

Changes in Lifestyle

Stay alert to significant changes in employees' spending habits or financial circumstances. Invading employees' privacy is illegal, but if an association puts checks and balances in place, the temptation for employees to stray would be avoided in the first place.

Poor Check-Signing Practices

Associations should avoid requiring only one signature on each check. Very often this practice is the result of trying to reduce or avoid the inconvenience of having to collect more than one signature on a check. But associations should view this simple control as part of the cost of living in an association. Be equally wary of using a rubber stamp. Make sure signature cards are properly updated when officers or management companies change.

Control of Bank Records

Who receives bank statements? Is it the same person who handles all bank transactions and business? This is very often the case in a small association. It is prudent to separate these tasks, so one person is charged with writing checks and conducting association business, and another person receives bank statements and balances accounts.

No Vacations

Always be wary of employees who never take time off. An employee who earns \$22,000 a year and never takes time away from the office should prompt a hard look. If an employee is refusing to take time off, it may be because he or she doesn't want irregularities to be revealed during his or her absence. Banks require their employees to take time off, and any other entity that handles fund should make the same requirement.

Fraud Avoidance

- Background check on employees
- Hire CPA to institute procedures
- Supervise employees
- Monitor managers
- Require managers to have fidelity coverage
- Divide tasks
- Rotate tasks
- Dues & assessments deposited daily
- Dues & assessments directly deposited
- Do not allow cash payments
- Divide deposit and reconciliation responsibilities
- Multiple signatories where practicable
- Review financial statements monthly
- Reconcile bank statement monthly or at least quarterly
- Keep blank check in a secure place
- Require "original" invoices and mark paid
- Have duplicate bank statements sent to different people
- Issue checks in numerical order
- Regularly update signature cards, PIN and authorization codes
- Require that employees take vacations
- Demand full disclosure of potential conflicts with vendors