Orten Cavanagh Richmond & Holmes LLC
Attorneys at Law

FRAUD AND EMBEZZLEMENT

HOW TO PROECT OWNER ASSOCIATIONS AND THEIR MEMBERS

A. Context of Fraud and Embezzlement in Owner Associations. Volunteer boards of directors of owner associations perform a number of functions vital to the successful self-governing of the association including: fostering community harmony, maintaining property and establishing and enforcing rules.

The ability of the association to perform these functions depends upon its success as a business. One of the most important business functions of the board is to oversee the association's financial well-being. Here are tips to help protect association finances. Before implementing the suggestions, however, review your governing documents and state statutes and consult with the association's attorney.

B. 5 Steps to Managing Risk. These five steps will help identify potential risk factors and available means of minimizing that risk:

1. Analyze the association's exposure to possible loss
2. Examine alternative risk management techniques
3. Select appropriate risk management techniques for your community
4. Implement the risk management techniques
5. Monitor the results and renew the process as necessary

C. Risk Management Techniques. There are three ways a board can manage risk to the association's financial well-being:

1. Risk control/avoidance
2. Risk financing
3. Risk shifting (by contract)

D. Risk Control/Avoidance – Avoid or Minimize Fraud and Embezzlement Risks – Best Practices**:**

- Engage a professional managing agent – the best the association can afford.
- Insist on appropriate checks and balances by the managing agent.
- Have the person who reconciles bank statements at the management company be someone other than the accounts payable clerk.
- Keep in mind that the time is limited to bring claims against the association's bank for forgeries and altered checks.

- Have bank statements opened and filed by someone other than the accounts payable clerk.
- The association's treasurer should review association financials regularly.
- Learn about "best practices" for owner associations and comply with them.
- Have an independent CPA provide services annually or once every 2-3 years as follows:

    - Audit and/or
    - Review; and/or
    - Compilation

  NOTE: An audit is not designed to detect fraud.

- Ask the association's attorneys and CPA for recommendations and/or a letter regarding management recommendations.
- Require regular (monthly/quarterly) financial statements from the manger/management company.
- Check account balances of the association periodically and independently.
- Require signatures of authorizations from association officers on reserve account transactions.
- Establish and update the association's investment policy
- Require adequate fidelity bonds/insurance.
- Adopt policies/resolutions prohibiting kickbacks.
- Require disclosure of conflicts of interest
- Maintain D&O (director and officer) insurance for the Association, getting the best coverage available.
- Maintain control and access over association documents.
- Develop and adhere to prudent financial procedures.

E. <u>Risk Financing – Purchase and Maintain Adequate Fidelity (Theft) Insurance</u>

- The association should purchase fidelity insurance to cover theft, embezzlement and computer fraud by:

    - Volunteers
    - Directors
    - Manager and management staff

- The association should require the management company to purchase and maintain adequate fidelity (theft) embezzlement and computer fraud insurance.

NOTE: The owner of a management company is not typically insured for theft from the association on the management company's insurance policy.

F. <u>Risk Shifting (By Contract) – Require the Association's Manager to be Responsible for Their Own Negligence and Fraud</u>

1. Review the contract proposed by the managing agent carefully.
2. Have the association's attorney review the proposed contract and provide recommendations.
3. Do not waive claims against the managing agent.