community
ASSOCIATIONS INSTITUTE

Preventing Fraud and Embezzlement

Community association boards should consider implementing the following practices and procedures to safeguard association funds.

1. Know the association's federal tax identification number (FTI) and keep separate accounts. Use it to obtain periodic listings of all bank accounts and account numbers, and make sure they are all under the association's name and FTI number. Needed to verify the existence of accounts and open new accounts, the FTI number should not be disseminated to the general membership, but each board member should know it. If, for example, only the treasurer of a self-managed association knows the bank names and account numbers, and something happens to the treasurer, it becomes nearly impossible for other board members to know where the association's money is located. When using professional management, commingled funds make it very difficult to ascertain which funds belong to whom. Even self-managed associations need to ensure funds are not commingled. All too often, a volunteer treasurer will provide his or her social security number instead of the association's FTI number, which makes it easier for the treasurer to transfer money to personal accounts.

2. Use a lock box system for deposits and require dual signatures for all withdrawals. While it may seem obvious, *never* sign blank checks. If your association is professionally managed, require dual signatures on all checks or a monthly report showing check numbers, payees and amounts. As proof, require the bank to return canceled checks or provide electronic images of the canceled checks along with the monthly statements. A lock box system allows owners' payments to be mailed or transferred directly to the association's bank accounts. This reduces the chance that the association's money will be deposited into the wrong account.

3. Segregate and safeguard your association's reserves. As the association builds its reserve funds, make sure you are segregating and safeguarding them. Similar to checking accounts, the reserve account(s) should be under the control (ability to make withdrawals and transfers) of at least two people. If your association uses professional management or another person, such as an office manager or bookkeeper, to handle the finances, any transfers or withdrawals should also require the name and signature of a board member. Do not give one board member or bookkeeper total control over reserve accounts. It is also important to lock long-term savings into non-liquid accounts such as certificates of deposit.

4. Require that duplicate monthly statements of operating and reserve accounts be sent every month. One statement should be sent to the management company (or, if self-managed, to the treasurer or bookkeeper) and the duplicate to a board member, who does *not* have authority to sign the checks or make any type of transfer or withdrawal. Alternatively, many banks offer statements by e-mail, which could be sent to more, if not all, of the board members. Another option would be to give the board members read-only access to view the account(s) online. While this recommendation requires boards to update the information—and, if necessary, change passwords—whenever a change on the board occurs, it is a small chore considering that this step alone could prevent someone from falsifying bank statements, or otherwise covering their tracks, to conceal withdrawals from association accounts.

5. Check invoices against checks paid and the original receipts for credit card accounts, if any. If the association has professional management or a bookkeeper, the board treasurer should conduct this review. If self-managed, a board member without access to the bank accounts or credit card privileges should check for any unauthorized use.

6. Shop around for bank services. Several of these steps require the cooperation of the bank to be effective. Unfortunately, some banks do not enforce dual-signature requirements or prohibit electronic transfers among accounts, despite their being under different FTI numbers. It is not enough to choose a bank that pays the highest interest rate. If the bank wants your business, demand that it demonstrate the safeguards it has in place to minimize the threat of theft, especially through electronic transfers.

7. Know the association's insurance company and consult with the agent. Every board member should keep copies of the association's insurance policies or, at a minimum, the declaration(s) page. At least once a year, the board should have the agent attend a board meeting to discuss the association's policies and whether additional or increased coverage is recommended.

8. Insure the association's money. Obtain fidelity coverage on the board members and the management company/bookkeeper, if any, in an amount that equals or exceeds the association's reserve and several months of operating funds. It is just as important as carrying adequate property and liability insurance and should be part of every association's common expenses. When you purchase directors and officers insurance, a part of that provides fidelity insurance bonding on the board members, but it may not be sufficient. Similarly, fidelity coverage for the management company is not included in the base policy and requires the purchase of a managing agent rider. Even with coverage through the association's insurance carrier, the board should require evidence that the management company carries its own fidelity coverage, which would provide the first line of recovery in the event of a theft by one of its employees.

9. If your association is professionally managed, make sure that the management agreement includes specific terms to require these safeguards. The association should have its legal counsel review the original agreement and any renewal prior to execution, so the agreements are not riddled with lopsided terms that are detrimental to the association.

10. Regularly engage an independent Certified Public Accountant to conduct an audit. While it may be too costly to conduct an audit every year, the board should commit to having one performed at least every few years. In the interim, the association should have an annual review performed, with the stipulation that the bank balances be independently verified.

While no single suggestion is fail-proof, these safeguards used in combination should help to create a system of checks and balances to keep your association and homeowners from being victimized.

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This is a modified excerpt from "Whodunit," published in Common Ground*, the flagship magazine of Community Associations Institute. The article was written by Darcy Mehling Good, Esq., a partner with Kaman & Cusimano, LLC, which represents community associations throughout Ohio, with offices in Cleveland and Columbus.*

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