PROTECTING YOUR ASSOCIATION FROM FRAUD: THE BEST RESOLUTION YOU CAN MAKE

By Jonathan H. Katz, Esq.

If you live in an association – whether it is a condominium, homeowners association or cooperative – protecting your community from fraud should be your number one resolution for 2011. Chances are that someone, somewhere, has unfettered access to your association's bank accounts, financial records and, most importantly, your money. Association board members, as well as those hired to manage the association (such as property managers and financial advisors), are in positions of authority and act as fiduciaries in administration and operation of their respective associations. These individuals have a duty to the association and its members to properly supervise the association's activities and to safeguard the association's finances. In a perfect world, these individuals carry out their appointed tasks without incident, and associations are not concerned with the potential for fraud or theft. But this, of course, is not a perfect world...

In March 2010, Lauren Carty pled guilty to defrauding the Wellington Place Condominium association in Aberdeen, New Jersey. Carty, who owned a Property Management company in Little Silver, admitted that, while she managed the Association from January 2005 to September 2006, she and her mother diverted nearly $1 million from the Association for personal expenses, including clothing and trips to Florida. Carty is now serving a 5-year prison term and will have to pay $758,000.00 in restitution to the Association.

Also in March 2010, Anne Marie Kelly, former President of the Lodge Condominium Association in North Wildwood, pled guilty to embezzling over $50,000 from the association from January 2006 through June 2007. Kelly was able to pilfer the funds by writing checks to herself from the Association's bank account. Under a plea agreement, Kelly was admitted to a 36-month pretrial intervention (PTI) program, during which she agreed to pay back the amounts she stole from the Association.

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Unfortunately, these are not isolated incidents. In what seems to be almost a daily occurrence, news of suspected association-related thefts are being reported throughout the country — from New York to Florida to California to Washington — and more and more associations are being plagued by instances of fraud and defalcations, perpetrated by the very individuals charged to protect their associations and their members. For association members and unit-owners, the specter of fraud can undermine their trust in the asso-

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ciation's board and management. For board members and management, fraud can destroy their faith in each other, as well as wreak havoc on the association's bottom line.

So what can community associations do to guard against fraud and to safeguard the association's finances?

The best way to prevent fraud is to stop it before it starts. Fraud investigators say that, far too often, association boards are far too trusting of their employees, contractors and even fellow board members. In order to guard against fraud, association boards must be aware of and look for potentially-fraudulent activity. Some tell-tale signs of fraud include: (1) Vendors not getting paid in a timely fashion; (2) Boards not getting regular and adequate financial reports; and (3) A significant, unexplained rise in expenses.

Association boards must create a "perception of detection" by taking proactive measures to know the signs of fraud, enacting procedural safeguards to protect against the potential for theft, and having natural checks and balances among the board, management and the association's professionals. Some of these procedural safeguards are basic and should be easy to implement. For example:

1. No single individual – either from management or the board – should have exclusive control over all of the association's finances. Confirm that no one has the ability to write checks, move money or commit funds without another person's oversight.
2. Require multiple signatories on expenditures over a certain amount, and always when tapping into a capital reserve account. However, do not rely solely on this requirement of "two signatures" on every check, as this can be manipulated.
3. Bank statements and financial reports should be reviewed by managers and board members alike, and compared with prior month's reports. If management is writing checks and handling the banking, a member of the board should receive a copy of the bank statement directly from the bank. If a board member is writing checks, another board member should be overseeing the process.
4. Make sure financial reports are done on a regular basis and pay specific attention to budget versus actual comparisons.
5. Obtain multiple bids for all major contracts and services, and periodically review invoices and vendor-contracts thoroughly. One common and easily discoverable form of fraud is over-ordering supplies or double-paying vendors.
6. Hire an independent auditor to provide an annual audit of the association's finances.
7. Discuss with management and your association's professionals the need for either a fidelity bond or crime insurance policy. Many associations are required to have such a bond or coverage pursuant to their governing documents, but, in many cases, fail to obtain such coverage that would protect against fraud and theft.

Lastly, if you suspect your association may be the victim of fraud, the first step is to bring the issue to the attention of the association's professionals – the board's accountant and attorney. Part of the evaluation process may

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require a forensic audit, which differs from a conventional audit in that it is designed to follow the trail of money to identify fraud. After that, it may be necessary to contact your local police department or county prosecutor's office.

Preventing fraud requires diligent effort on the part of board members and managers alike. While day-to-day involvement in the financial activities of your association is not always consistent with the nature of volunteer boards, it is imperative to be actively involved, in order to stop potential theft before it starts. Moreover, the greater effort an association makes to identify the signs of potentially-fraudulent activity and to enact sufficient procedural safeguards to protect against deception, the more successful the board will be in protecting the community's assets and its members. ■