

*Fraud ~
It Can't
Happen in
MY
Company!*



Who....

Is the “typical” fraudster?

Why...

Does fraud occur?

How...

Is fraud perpetuated?

What...

Are some fraud prevention techniques?

Who . . . ♦ is the typical fraudster?

I have seen fraud at every level – from the management company receptionist to the general manager who reports to the CEO of the management company; from the Association’s volunteer treasurer to the onsite employee. There are opportunities for fraud with absolutely every position within your organization and within the Association’s sphere of influence.

One study on white-collar criminals found out the following about the fraudsters:

- ✓ Likely to be married
- ✓ Probably not tattooed
- ✓ Educated beyond high school
- ✓ Range in age from teens to over 60
- ✓ Employed 1-20 years, or more, at the same job
- ✓ Member of a church
- ✓ No arrests
- ✓ Socially conforming
- ✓ Usually acts alone

Think about it...if the person looks and acts like a criminal are you going to trust your money and assets to them???? I don’t think so!

With every embezzler that I have met over the last 20 years (and it is probably close to 25 or so), with very few exceptions, they have been personable and well liked by those around them. In addition to above list, those fraudsters in the community association industry that I have met most have the following additional qualities:

- ✓ Active in CAI
- ✓ Well educated with regards to community associations
- ✓ Highly regarded by their board members or others
- ✓ Considered to be friends or “like family” to those around them
- ✓ Not even their spouses suspect them
- ✓ No extreme outward increase in financial status

Why . . . ♦ does fraud occur?

- **Opportunity**
- **Motivation**
- **Attitude**

An honest person with high integrity may commit fraud if there is enough motivation and high opportunity.

A person of low integrity may not commit fraud if there are strong controls and little opportunity for fraud.

An honest person who feels that they are underpaid and underappreciated may have the right attitude to rationalize fraud.

Keep in mind that everyone probably has a motivational point in which they could commit fraud – even if they termed it “borrowing”.

How . . . ♦ is fraud perpetuated?

This is the most difficult part of this presentation, but generally the one of most interest to the audience. I have a dilemma, however, because to teach you how to stop fraud, I have to teach you how to commit fraud!

This is by no means the totality of how fraud can happen. These are real life community association examples, which show a variety of ways that fraud can or might occur. In some examples, the issues were settled confidentially or the victim did not pursue the matter, so there is no record of the actual event. Thus, we will present most of the cases as possible or potential ways fraud can occur, but the basis of each one comes from an actual example.

Check Fraud

This occurred twice in the last year that I know about (see article attached).

FACTS:

Somehow the thieves got the bank encryption on the bottom of the Association checks. Note: any vendor that receives a check from the Association has this information.

They duplicated the information in a check writing program. Note: even the simplest of accounting programs can do so.

They wrote checks out that appeared to be payroll checks. These checks were then cashed at a local cash check store.

PREVENTION:

Very little can be done to prevent this. You can secure the bank information in house, but it is very easy to obtain check stock these days and copy a legitimate check.

DISCOVERY:

It is vital that bank reconciliations be performed in a timely manner. This was discovered when the bank reconciliation was performed a couple of days after receipt. One banker told me that one Association did not perform bank reconciliations for almost a year, so when it was discovered, there was no recourse back to the bank.

Signature Card Fraud

This occurred many years ago in Southern California and the manager was prosecuted and sent to jail.

FACTS:

The manager took signature cards to the board meetings to have the board members sign. The Board only wanted officers to sign on the account. After signing the cards, the Board handed the cards back to the manager to take to the bank. The manager added her name to the signature card before turning in.

She then began to “borrow” monies when she needed them. She would repay them each time, but the repayment period got longer and longer. Finally, she got so that she could not repay the monies.

PREVENTION:

The Board members should mail or take the signature cards to the bank, or at least verify with the bank the signers on the account. (Side note: Important to change signature cards at the time of change of board members) The Board members should review all bank statements at least quarterly.

DISCOVERY:

The manager did not provide financial statements with copies of checks, and the Board got suspicious.

“Additional” Amounts Paid to Vendors

This occurred several years ago in a very prominent management company. It was perpetuated by one of their managers.

FACTS:

The Board approved X dollars to be paid on a large project. Each invoice was approved for a specific dollar amount. When it came time to make the payment, the manager made the voucher out for slightly more than the amount, cashed the check (he actually had set up a bank account with the Association’s name), and then sent the vendor the lower amount.

PREVENTION:

Have the board meeting minutes reflect approval of all unusual expenses noting the vendor, the dollar amount and whether it is a reserve or operating expense. The Board should closely review all financial statements.

DISCOVERY:

The CEO found it. When she did find it, she was extremely above board and open and honest about the whole situation. She advised her boards, the accountants, and those in the industry. It is my understanding that the manager agreed to repay the monies.

Use of Association Credit for Personal Reasons

I have had numerous examples of this over the years. I will combine the events into one example. Note: one onsite manager went to jail over this (well..this was one of the tactics she used!)

FACTS:

The person (manager, board member or employee) has a credit card or authorization to charge on an open account (such as at Home Depot). In one instance, the manager bought everything from coloring books for his grandchild to a TV. In another instance, the employee purchased expensive cable, then returned it later for cash credit. In another, the Association was replacing doors in the complex, but the employee purchased 20 extra doors and sold them to friends.

PREVENTION:

All purchases should be approved in advance, where possible. When it is not possible, then the board should approve each line item on the charge requiring back up of the actual purchase.

DISCOVERY:

In a couple of cases, we found them during the audit process. In another, the manager found out what the employee was doing. In one instance, a new treasurer questioned a part number on the bill and wondered what it was. In most all of these situations it had been going on for quite awhile.

Payments for Work not Performed

I can't even begin to tell you how many of these I've seen over the years. A large one that just happened in Southern California involved the person running the management company for an owner. She has been in this industry for 20+ years. Again, I've combined the facts into one example.

FACTS:

The Association pays for services that were not rendered.

PREVENTION:

If the Board would be more diligent in reviewing the financial statements, if the accounting department (in some cases) would question why there are numerous payments "per board" or to the same vendor, same amount, but to different account codings, if the auditor would have checked closer – the larger amounts would have been

discovered sooner. If the fraudster does not get greedy, it is possible for a low level fraud to continue for quite awhile.

DISCOVERY:

Change in management companies, new board member, new auditor – various reasons for the discovery.

Stolen Cash

Three instances of stolen cash stand out to me, so I will outline them separately in the Facts section.

FACTS:

The receptionist was in charge of getting documents to escrow and title companies when there were sales of units or refinancing by owners. She told each title company that the management company would only accept cash.

The Association charged per use fees for clubhouse use, RV parking and storage containers. The on-site manager did not require checks, but said cash was acceptable.

The Association owned the laundry machines and only one person collected the coins on a weekly basis.

PREVENTION:

With cash there are a few prevention tools:

1. Don't accept any cash. I know that sounds harsh, but one management company I know has a flyer at its front desk with the locations of the closest places to get money orders or cashiers checks.
2. Make sure that if cash is accepted that there are at least 2 people involved at the time of the transactions.
3. Come up with some reconciling form/feature. E.g. for each document package that is checked out for an escrow, the person must sign for the package noting the amount received from escrow company. This then is forwarded to the accounting department to verify against the deposit.

DISCOVERY:

The receptionist was discovered when she was out ill one day and the title company brought in cash. The person taking her place thought they did not accept cash.

The clubhouse fee cash scandal was discovered after the manager left and someone wanted their deposit back.

The laundry money was tested by utility usage once a new management company came on board.

Payment of Personal Items by the Association

Similar to a couple of examples above, but with a little “twist”.

FACTS:

The accounting person put her own utility and vendor bills in with the Associations. Thus, instead of paying for 24 electric meters, there were 25 paid that month. When the Association made a payment to a local office supply house, she included her bill.

PREVENTION:

The person signing the check should review all supporting documentation and ensure that it agrees with the payment.

DETECTION:

Another employee of the company “stumbled” upon it when looking for something else.

Fraud Perpetuated by “Serial” Offenders...

I have seen several instances where when fraud is discovered, it is found that this was not the first offense.

FACTS:

The management company was desperate for a manager, so either did not call the former employer or ignored “warning bells” when getting answers to questions.

PREVENTION:

Make sure that you thoroughly check all references and ask as leading of questions as legally possible. If a former employer is evasive or is not willing to hire the person back, don’t always assume that the employee was “wronged”. Keep involved in a network of peers in the CA industry.

DETECTION:

In all but one case, it was discovered AFTER the frauds occurred. In one case, the manager was talking to another manager and brought up her new employee’s name, and learned the facts behind the change in employment.

What... ♦ are the best fraud prevention techniques?

Establish a corporate culture of integrity....

The most important thing that you, as CEO, can do in and for your company is to establish a “corporate culture” of integrity. Such items as:

- Insist on total honesty with each other, vendors, clients and all persons with whom you deal with on a daily basis.
- Reward integrity and honesty.
- Protect “whistleblowers”
- Consider adopting an “ethics” policy, similar to that used in the PCAM program of CAI (copy attached)
- Train all levels of employees regarding the corporate ethics.
- Have a zero tolerance policy with regards to certain items.
 - Kickbacks from vendors.
 - Getting “favors” from vendors.
 - Taking cash personally when it belongs to the Association.

Segregate duties when possible....

Whenever fraud requires collusion – that is, two or more people to be involved, the less likely that it will occur. Except when those two people are closely related in some manner, most fraud is a singular act.

Examples:

Different people should issue checks and perform bank reconciliation.

Different people should make bank deposit and post payments to A/R.

Different people should open the bank statement (and review quickly) and perform the bank reconciliation.

Random/Surprise Review of Desk and Work Area or Product....

This is a difficult one for some CEOs and most employees to accept. However, if is discussed up front and is unilaterally done on all employees, it can be an amazing deterrent to fraud.

Most frauds are “stumbled upon”. Randomly do some of the following:

- Open the employee’s mail before it gets to them (company mail, not personal).
- Check voice mail or e-mail (check with your attorneys re: privacy and needed wording to be able to do so).
- Ask clients and vendors about your employee.

In this same vein, insist on vacations and insist that someone else takes over that desk during the vacation time.

Reconcile bank statements promptly, and make sure that the board reviews all bank reconciliations....

An addition to this, is to have a copy of all bank statements sent directly to the treasurer. Most banks will do this for a minimum fee.

Have strict controls on cash....

This was discussed under the “How” section.

Have audits of your financial statements....

It's not that audits will always catch fraud, because they won't if the fraud is well planned. However, just knowing that the books will be audited is a deterrent to many fraudsters.

Keep an attitude of skepticism....

I know, who wants to be the skeptic?!?! But, remember, you have a fiduciary duty to your clients and you owe it to yourself and your employees to protect your business and its reputation.

NEVER think-

- ❖ **It can't happen here.**
- ❖ **That person could never be a fraudster.**

COMMUNITY ASSOCIATIONS INSTITUTE -PROFESSIONAL MANAGER CODE OF ETHICS

The Manager Shall:

1. Comply with current bylaws, standards and practices as may be established from time to time by CAI subject to all federal, state and local laws, ordinances, and regulations in effect where the Manager practices.
2. Participate in continuing professional education through CAI and other industry related organizations.
3. Act in the best interests of the client; refrain from making inaccurate or misleading representations or statements; not knowingly misrepresent facts to benefit the Manager.
4. Undertake only those engagements that they can reasonably expect to perform with professional competence.
5. Exercise due care and perform planning and supervision as specified in the written management agreement, job description or duly adopted Board policies.
6. Disclose all relationships in writing to the client regarding any actual, potential or perceived conflict of interest between the Manager and other vendors. The Manager shall take all necessary steps to avoid any perception of favoritism or impropriety during the vendor selection process and negotiation of any contracts.
7. Provide written disclosure of any compensation, gratuity or other form of remuneration from individuals or companies who act or may act on behalf of the client.
8. Insure that homeowners receive timely notice as required by state statutes or legal documents and protect their right of appeal.
9. Disclose to the client the extent of fidelity or other contractually required insurance carried on behalf of the Manager and/or client and any subsequent changes in coverage, which occur during the Manager's engagement if the amount is lower than the contract amount requires.
10. See that the funds held for the client by the Manager are in separate accounts, are not misappropriated, and are returned to the client at the end of the Manager's engagement; Prepare and furnish to the client accurate and timely financial reports in accordance with the terms of the management agreement, job description or duly adopted Board policies.
11. Recognize the original records, files and books held by the Manager are the property of the client to be returned to the client at the end of the Manager's engagement; maintain the duty of confidentiality to all current and former clients.
12. Refrain from criticizing competitors or their business practices; Act in the best interests of their Employers; Maintain a professional relationship with our peers and industry related professionals.

13. Conduct themselves in a professional manner at all times when acting in the scope of their employment.
14. Not engage in any form of price fixing, anti-trust, or anti-competition.
15. Not use the work products of colleagues or competing management firms that are considered proprietary without the expressed written permission of the author or the management firm.

Last revised September 2006

CODE CLARIFICATION DOCUMENT

Last revised 09/2006

A. Authority

The Code derives its authority from the Community Associations Institute (CAI). CAI's Board of Trustees has established a minimum standard of professional ethical performance for those individuals who receive recognition or designations from CAI.

Those individuals or entities that have received professional designations from CAI are subject to this Code. Those designations include: PCAM®, AMS®, LSM™, and AAMC.

B. Definitions

The Code shall apply in any manager-client relationship where the Manager receives some form of compensation for professional services offered or provided to the client.

1. Manager - a singular term which shall apply to all of the following persons or entities providing or offering some form of property or financial or administrative or consulting services to one or more clients:
 - a. A single practitioner functioning as a client employee, or
 - b. A single practitioner employed by a firm contracted by one or more clients, or
 - c. A principal or supervisory staff member for a firm which is contracted by one or more clients, or
 - d. A firm, which is contracted by one or more clients, whether it is organized as a corporation, partnership, or other entity.

Because the Code is designed to establish a standard of conduct for the practice of managing community associations, it is equally applicable to individuals and firms. An individual who agrees to abide by this Code shall also be responsible to see that any other person or firm under his/her supervision shall comply with the Code.

2. Client - a singular term applying to one or more community association properties (condominium, homeowner association, cooperative, PUD, PRD, etc.) and their governing body. The client may employ the Manager directly or be under some form of independent contract with the Manager.

C. Amplification

CAI to further explain and define the Code of Ethics provides the following information.

**The following explanations correspond to the numbered paragraphs in the
Professional Manager Code of Ethics**

1. Current standards or practices are those numbered one through fifteen in the Code. Managers who practice in states with legislative requirements must comply with those laws. Managers shall not discriminate in any relationship, with any individual or firm, based upon race, color, religion, sex, national origin, familial status, or handicap and shall comply with all federal, state and local laws concerning discrimination. Managers shall not engage in any form of price fixing, anti-trust, or anti-competition with other Managers or Vendors.
2. Continuing professional education requirements are consistent with that Manager's designation. While CAI membership is not mandatory, the Manager must satisfy the designation requirement in order to use said designation. Additionally the Manager has a duty to remain informed on relevant matters affecting the industry.
3. Act in the best interests of the client; Not make any inaccurate or misleading representations or statements to a prospective client; Not knowingly misrepresent facts to benefit the Manager; the manager has a fiduciary duty/responsibility to the client and should at all times act in the best interests of the client. Managers should avoid exaggeration, misrepresentation, concealment, and knowingly distributing misinformation.
4. Undertake only those engagements that they can reasonably expect to perform with professional competence; the Manager shall provide accurate information within his area of expertise and refrain from the unauthorized practice of other professions. No manager should provide any service or advice that is outside his or her field of competence which includes dispensing of professional advice that falls under the auspices of other disciplines such as legal representatives, engineers and contractors.
5. Exercise due care and exhibit planning and supervision as specified in the written management agreement, job description, or duly adopted Board policies. The intent of this statement is for the Manager to make a good faith effort to operate within the framework of the applicable employment/agent relationship and to abide by the terms of said agreement. Any failure of the Manager to fully comply with this requirement shall not be considered relevant unless the failure is material and/or willful.
6. Disclosure of any possible conflict of interest is the key here. An example may be of assistance. A Manager (individually or through a company) may have financial interest in a service contractor, supplier, or professional firm that is being considered by that Manager's client. Disclosure must be in writing and sufficiently in advance of the selection process to allow full consideration of the possible conflicts and any alternatives. The fact that the client may still choose the Manager's related entity is not a violation of the Code, provided ample disclosure was given.

7. Provide written disclosure to the client of any compensation, gratuity or other from of remuneration from individuals or companies who act or may act on behalf of the client. Written disclosure shall be made to the client by the Manager, confirming receipt of all commissions, rebates, discounts, payments, or other benefits received in excess of \$200.00 annually by the Manager from any vendor or vendor related client.
8. CAI recognizes that insuring that homeowners have timely notice or that their appeal rights are protected is limited by the extent that the Manager can influence his or her client. Thus, a Manager who makes reasonable efforts to properly advise the client has complied with this standard, even if the client chooses to reject the Manager's advice.
9. Disclose to the client the extent of fidelity or other contractually required insurance carried on behalf of the Manager and/or client and any subsequent changes in coverage, which occur during the Manager's engagement if the amount is lower than the contract amount requires. This standard does not require the Manager to carry fidelity insurance unless an AAMC company or required by the contract. The change is based upon any decrease in contractually disclosed/required coverage and/or fidelity bond coverage.
10. If the Manager is responsible for handling funds for a client, that client must have at least one, independent cash account. This standard does not preclude a Manager from initially depositing payments into a central account with funds promptly distributed to individual client accounts, nor does it prohibit a central disbursement or payroll account that is promptly reimbursed by each client's individual cash account. When a Manager's engagement has ended for a client, all funds must be returned to the client the earlier of:
 - the time limit under state statute, or
 - the time limit in the existing management agreement, or
 - within 30 days of the end of the Manager's engagement (see also #12)

INTERNAL CONTROLS CHECKLIST

(These are the *minimum* standards we recommend for associations)

- Board meeting minutes approval will consist of:
 - ⇒ Opening/closing of bank accounts
 - ⇒ All reserve expenditures
 - ⇒ Major contracts

- Board receives financial statements, at least quarterly, consisting of:
 - ⇒ Balance sheet
 - ⇒ Income statement comparison to budget

- Board reviews **all** bank statements **and** reconciliations at least quarterly (including certificates of deposit):
 - ⇒ Operating accounts
 - ⇒ All reserve accounts

- The Board has a signatory policy on cash accounts in compliance with their governing documents and State law. If the Board does not sign checks, other controls are in place to ensure approval and proper payment of expenses.

- The Board must approve all bad debt write offs or adjustments to A/R balances over \$_____ (depends on Association.)

- All related party transactions/conflicts of interest are disclosed to the Board and, where appropriate, to the membership.

- The Board has a policy to determine what contracts need to go out to bid.

- The Association accepts no cash, or has very specific controls with regards to cash acceptance.

Approved by Board of Directors

_____ Association

Date _____

By _____

Title _____

The Ten Commandments of Internal Control for Your Association

1. Thou shalt not sign blank checks, nor leave blank check stock unsecured.
2. Thou shalt deposit all checks in a timely manner (preferably daily). If a deposit is not made daily, then the undeposited funds should be adequately secured.
3. Thou shalt not accept cash. If absolutely necessary to accept cash, then do so only with 2 witnesses, then generate a receipt for the files.
4. Thou shalt not make checks payable to "Cash".
5. Thou shalt require invoices, or other type of verification of the expense, on all paid bills. That invoice should be "canceled" in some manner after payment to avoid duplicate payment.
6. Thou shall have two board signers on reserve withdrawals. Thou shalt not allow telephone withdrawals of reserve funds.
7. Thou shalt update signature cards in a timely manner whenever there is a change in board members or change in management personnel. The board may want to consider having a board member deliver/mail the signature cards to the bank.
8. Thou shalt require approval of write-offs of A/R balances by a person other than the person making the deposits and reconciling the banks. The board shall approve all write-offs over a certain amount.
9. Thou shalt review all bank statements and reconciliations at least quarterly for ALL bank accounts - including certificates of deposit.
10. Thou shalt receive financial statements at least quarterly (monthly, is even better).

Check Fraud – It Could Happen to You

You are preparing the bank reconciliation for an association you manage and there is a check that has cleared the bank for an amount that is not included in your check register. You look at the copy of the check attached to the bank statement and the check looks very similar to ones you issue out of your office, but wait...it is slightly different. In fact, there are several differences, including an incorrect signer on the account. What has happened? How could this happen?

What was just described happened very recently. The bank terms this a form of “identity theft”. Someone with a little knowledge of computers, some blank check stock and the coding information for an association’s bank account taken from a properly issued check, has prepared a completely forged check.

In this particular instance, the perpetrators got away with approximately \$3,000. The bank covered the loss as the signer was not valid. The good news is that it was caught quickly, the account closed and the issue resolved fairly painlessly.

A few details of the case that are specific to this instance, but may be of interest to the readers of this article:

- Some of the checks were written to appear to be payroll type of checks, e.g. X hours at \$X.XX, and they were written for “odd” amounts.
- Most were cashed at check-cashing places.
- The checks were very similar to the actual checks, but they went a step further and even included the bank’s address, which was not included on the association’s true checks. (In my opinion, this may have been required by whatever software they were using to write the checks). Also, there was only one signature line on the checks.
- It appears that the criminals got the check information from stealing them.
- There was a debit charge from Sprint also on the statement.

So, what can you do to prevent this type of fraud? Unfortunately, not a whole lot. As soon as you issue any check, the information is out there to be misused. You can ensure that checks are not laid around for everyone to view, mail the checks promptly and hope that the recipient deposits the checks in a timely manner. However, beyond that, if someone can view the check just long enough to get the proper information off it, this type of fraud can occur.

What you CAN do is find the fraud early by timely monthly bank reconciliations. Bank statements should be reconciled on a monthly basis for all bank accounts and you should review the copies of the checks that are attached to the bank statement. That is why it can’t be emphasized enough that bank reconciliations must be performed monthly, soon after the receipt of the bank statement. This management company was very diligent in its accounting practices and saved its association a lot of grief and hassle.