



McGOWAN PROGRAM ADMINISTRATORS



5 Ways Community Associations can Protect Themselves from Theft and Fraud



It's only natural for people to trust their neighbors. You count on them to knock on your door if there's a fire, you know they'll call the cops if they see somebody breaking into your car, and you do the same for them — that's how communities work.

At the same time, we all have secrets and things that we don't usually talk to neighbors about. One neighbor might have a gambling or drug addiction. Another could have a business on the brink of bankruptcy or massive medical bills to pay off. Finances are one of those "off-limit" conversations.

All these factors make community associations and HOAs vulnerable to financial crimes. After all, community association leaders can't imagine anybody they know betraying their neighbors' trust and risking jail time for fraud, theft, or embezzlement.

Community associations are legal entities with all the responsibilities of a business or nonprofit. Their leaders manage hundreds of thousands of dollars, or perhaps millions in larger communities and luxury high-rises. Associations have to be executives, managers, accountants, and cops, despite having little or no training or experience. As volunteers, association boards lack the customary monetary incentive for vigorous oversight.

For most offenders of theft or fraud, an average of 18 months goes by before they get caught. And in many cases, getting away with a crime can be an incentive to do it again.

All these threats persist whether you're dealing with volunteers, professional staff, or your board of directors. The answer is not distrust — it's building controls that manage the risks of financial misdeeds and limit people's opportunities for succumbing to temptation.

Let's look at five ways to do that.



1. Tighten Up Your Hiring Practices

Anybody who has a reason to spend your association's money has an opportunity to abuse the privilege.

Background checks of employees, volunteers, and board members can be helpful —provided you do them properly. Indeed, you could face liability for failing to conduct background checks of people who have access to association funds.

Background checks are fraught with difficulties. They must be:

- **Fair and consistent:** You need a written policy and a process for exposing everybody to the same level of scrutiny. You can't single people out.
- **Legal.** You can't pry into private data, and you can't discriminate against people for their race, gender, age, and so forth. Federal, state, and local laws may govern how you conduct these checks.
- **Thorough.** You need to check references, employee history, and criminal databases. You may be able to pull credit reports, but they have to be relevant to the position (essential for a bookkeeper position, but not so much for a janitorial role).
- **Pattern-oriented.** You're not necessarily looking for somebody who had one misstep. You're looking for a pattern of behavior that suggests a higher risk.

With so many factors at play, it's a good idea to partner with an expert background-checking firm. Find one with experience in homeowner's association work — they'll know the legal issues and have a better idea of what to look for in scrutinizing candidates in a fair manner.



2. Monitor Employee Activity

Background checks go only so far because so many community association financial crimes are first offenses. Indeed, the Association of Certified Fraud Examiners (ACFE) says the average fraud perpetrator has no prior convictions or arrests. ACFE also notes that most frauds happen in areas such as accounting, operations, executive/upper management, and purchasing.

Signs of fraud, theft, or embezzlement may include:

- **Changes in spending patterns.** The person driving a new car or taking a European holiday for the first time may not necessarily be dipping into association funds, but it could be worth taking a mental note of.
- **Reluctance to take time off.** An employee who never takes a vacation or who works 80-hour weeks might be afraid their misdeeds will be noticed when they are away. Again, this is not to say all hardworking employees necessarily have anything to hide.

Signs of increased risk:

- **Reversals in attitude.** The person who becomes sullen and quiet after years of enthusiasm and initiative could be disgruntled about work and tempted to exact financial revenge.
- **Obvious financial setbacks.** The employee enduring extreme financial difficulties may feel compelled to tap association money.
- **Expensive addictions.** Somebody with a gambling or drug problem merits extra scrutiny if they handle association funds.

You're not trying to be Big Brother. You're staying alert for hints that something may be amiss.



3. Create Specific Financial Protocols

Because of their unique vulnerabilities, community associations need to build a financial infrastructure that limits people's opportunities to steal or defraud.

These steps will help:

- **Consult with an accountant.** Find a CPA who has worked with community associations in the past and work out a financial structure to hold people accountable and make it difficult to commit crimes undetected.
- Conduct annual reviews. Scan expenses and revenues for signs of malfeasance. Consider adding surprise audits to your protocols.
- **Reconcile bank statements monthly.** Embezzlers often manipulate bank statements to cover their tracks. The longer you let reconciliation slide, the harder it becomes to spot financial misdeeds.
- **Avoid paying cash.** You want evidence of every expenditure and no opportunities for undocumented spending. You're trying to anticipate crimes, which require evidence to prosecute.
- **Create checks and balances.** Just as our government divides power among judges, legislators, and the president, you need mechanisms requiring multiple people to oversee and approve expenses. For instance, you can require multiple signatures on all checks.



4. Implement Your Checks and Balances

After you create protocols, you need to implement proper checks and balances. Enacting these processes will spread responsibilities around and make it difficult for any single person to skew the books:

- **Divide responsibilities.** The person making bank deposits should not reconcile the accounts. Bank statements should go to multiple people. Rotate people into and out of financial duties so the same person isn't doing everything year after year.
- **Protect your checks.** Store checkbooks in a secure place and issue checks in numerical order.
- **Secure your verification processes.** PINs, access codes, and bank signature cards need to be locked up safely and updated regularly. Don't grant any individual sole access to bank accounts and financial records.
- **Track invoices.** Every expense should include a check request and an original invoice marked "paid."
- **Store dues in a lock box.** Association members' checks should go into a secured box that has limited access among association staff and volunteers.

Be warned that adding financial controls will delay things. If you need to resurface the parking lot, you'll have to budget extra time to ensure that your procurement process is properly documented from bids through invoicing and payments.

Giving someone sole access to your financial resources creates tantalizing temptations. Checks and balances keep them honest.



5. Get the Right Insurance Coverage

The boundless depths of human ingenuity guarantee you'll never stop every financial crime. That's where Community Association Insurance comes in.

McGowan's Community Association Insurance has two components addressing the risks of financial crimes:

- **Fidelity.** This coverage acknowledges the risk of losses caused by your directors, officers, committee members, association employees, board members, and volunteers. Policies protect against money lost to fraud, dishonesty, forgery, theft, larceny, embezzlement, misappropriation, or other criminal acts of people directly involved in your community association.
- **Crime.** This third-party coverage protects associations against a non-employee committing forgery and alteration; causing theft, destruction, and disappearance; or engaging in computer or wire transfer fraud.

Combining fidelity and crime coverage adds a measure of protection where it's needed most. People's innate desire to trust their neighbors and community leaders creates vulnerabilities that require sound risk management and sufficient insurance coverage.

At McGowan Program Administrators, we have a long history of helping community associations address these risks. Let us help you find the right coverage for your community.



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