Six Tips for Preventing Embezzlement

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Community associations share many of the characteristics of both government entities and business corporations. But since they are really just groups of unpaid volunteers who often know each other well and are simply trying to make their neighborhoods better, they operate in a more relaxed and trusting atmosphere. Unfortunately, a few bad apples may take advantage of this, and end up stealing the shared money which is entrusted to their care. It's called embezzlement, and it's a serious combination of theft and betrayal.

Often, these people are in financial distress or feel undervalued. It typically starts out small, and they even delude themselves into believing they will pay back the money soon. But then they need to lie to conceal their actions, followed by more lies to conceal the original lies. Local news reports over the last few years show what can happen when managers and board members think no one will be able to detect what is happening to the association's funds and records – and often they're correct for years at a time. According to Stephen Pedneault, a forensic accountant and CPA specializing in fraud and embezzlement, "in many cases involving embezzlement from an association, board members had little to no access to critical financial information, or their access was limited to summarized reports prepared by the very individual who diverted the funds." Fortunately, your association can take a number of lessons from the internal controls which governments and businesses use to reduce the likelihood and severity of embezzlement.

First, develop the right culture. An executive board which is sloppy, fractured, and permissive makes itself an attractive target, while a board which goes out of its way to prove that it is highly organized, attentive, and thorough will help keep its members honest. A board which fairly allocates its workload and enthusiastically recognizes every members' contributions will come to perceive itself as a team, while a board which coordinates poorly and communicates negatively will encourage its members to only think about their own individual interests.

Second, develop written policies to avoid conflicts of interest. Anyone who has a professional relationship with the association, such as paid maintenance work or professional services, should not only recuse themselves from votes related to that relationship but also be required to have other board members closely supervise all contracts, payments, work, and other related interactions. When the treasurer is marking his own common charges as paid, he should be expected to give simultaneous proof of that to another officer. Board members who have maintenance requests, disputes with board decisions, or other matters of personal interest should follow all of the same procedures as any other unit owner, which the rest of the board should handle openly and fairly. "The board's underlying theme should be 'transparency.' both in appearance and in their actions," explains Pedneault.

Third, insist on divided responsibilities. Different people should write, sign, and reconcile outgoing checks against the invoices and bank statements. Different people should also open, deposit, and log incoming payments. Require two signatures on all association checks and contracts over a certain dollar amount. Everyone with access to the association's bank accounts and petty cash should be forbidden from using them at any time without another person being present or notified, along with documenting it in the books at that time. If your community is professionally managed, make sure your management agreement requires advance board approval of all payments, contracts, and fund transfers over a specific dollar amount. (This provision is specifically mandatory under state law, and yet often omitted). "Segregating responsibilities and implementing checks and balances among Board members, or between the management company and the Board," says Pedneault, "will make it harder for one individual to gain too much control, and thus divert Association funds with little risk of being detected."

Fourth, all financial records should be easily accessible and diligently reviewed. Treasurers and managers should circulate original bank statements to the board, not just summaries, along with a standard set of financial reports generated directly from the accounting system used (rather than Excel-based reports). They should be scrutinized at least monthly by other board members and, ideally, also someone who is not directly involved in the association's day-to-day finances. Independent and objective quarterly examinations and an annual audit by an accountant are also advisable. Ask your bank whether there is an easy way to allow the association's accounts to be viewed online by designated persons without giving all of them the ability to conduct transactions. According to Pedneault, this can be accomplished by having your bank add authorized on-line users with "read only" access to the association's accounts. And of course, always promptly honor unit owners' requests to inspect the books.

Fifth, independently verify all invoices, vendors, reimbursements, and payees. Fictitious companies and employees can be discovered with phone calls and online research, while imaginary transactions buried in "miscellaneous" line items can be detected by insisting on itemization and backup. Pedneault says that among the reports every board should receive monthly is the detailed general ledger report, which identifies every transaction posted to each account during the month. If a check is made payable to one name but endorsed in another, the former might not really exist. Never tolerate checks made payable to "cash." Insist on competitive bidding, references, written change orders, and documentation of cost overruns for every significant repair or capital project. Search for any transaction on a bank statement that is atypical, unexplained, from or to an unknown account or payee, or omitted from an officer's or manager's report.

Finally, always be on the lookout for signs of heightened risk or opportunity for embezzlement. People who have occupied the same position for many years, refuse to delegate or share responsibilities, refuse to give detailed answers or original documents, and are experiencing drug, alcohol, or personal financial problems may be displaying classic red flags – perhaps long before improprieties have begun. Establishing term limits, or at least rotating duties, as well as directly involving multiple people in every financial transaction can help respond to these risks. And although fidelity insurance coverage for the association and bonds for financial officers may not prevent embezzlement, they certainly come in handy after it's been discovered.

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