



Embezzlement: Don't Let it Happen to Your Association!

By David C. Swedelson, Esq.

“He is the last person I would have expected this from.”

“He was like family to me.”

This is often what board members say when they discover that their association has been the victim of embezzlement.

Sometimes it is a board member; often it is the longtime, trusted manager who embezzles cash over a period of years. I hear these stories all too often. It happens at associations of all sizes. Embezzlement knows no gender bias, and it has been reported that in the majority of cases, the embezzlers had no prior criminal record. It usually starts off in small amounts and grows with increasing fearlessness. By the time the embezzler is caught, thousands (sometimes hundreds of thousands, and even millions) of dollars have been lost.

This is a serious problem that is not going away. In fact, during economic downturns, the problem only gets worse. Many association board directors think, “Not my manager,” but this type of blind trust mixed with a lack of internal control can lead to trouble. Your manager or a board member could be doing it right now.

The number one reason that managers (or board members) embezzle from their association is because they can. It is often too easy. A well designed, functioning internal control system is the number one defense against both errors and fraud. It is not difficult; it starts with compliance with the Civil Code, which, among other things, mandates board member review of financials, quarterly reconciliations of the bank accounts, etc. (see Civil Code Section 1365.5).

Over the years I have assisted a number of associations that were victims of embezzlement. Perhaps this article can help your association(s) avoid this type of loss.

Recently, I assisted an association in recovering \$500,000 that had been lost to embezzlement. This is an interesting story and example of embezzlement because of the various means by which their former manager took the money. Their manager fit the profile. He became the board members' trusted friend. All the while, he was

stealing the association blind. First, he added his signature to the signature card for the bank. It was not difficult. There was an extra space, and he just added his name. This can be easily avoided by having the board strike out the extra spaces that are left open. Next, he forged the president's signature on a credit card application with the association's bank. He then began to spend lavishly, approximately \$10,000 a month. He paid the credit card bills by writing five checks per month for \$2,500 each. The assumption was that he thought this would fall under the "radar." It worked, at least for a while. Eventually, he started writing checks to himself, depositing the laundry lease monies to his own account, and continued to liberally use the credit card. His downfall occurred when a homeowner, who happened to be an IRS auditor, requested copies of the association's financial records. He refused to comply.

Undaunted, the IRS auditor/homeowner ran and was elected to the board of directors. Then, as a board member, she insisted upon seeing the financial reports. The manager resigned two weeks later. The IRS auditor/homeowner discovered that all of the association's financial and banking records had been destroyed (purportedly lost to a flood, according to the embezzler). By this time, the board realized that there was a problem, and many of the board members were new (and were not responsible for what had occurred). They went to the bank and got copies of all their bank records, and then went to the credit card company (it was their credit card), and painstakingly put together a record of all of the expenses. It was clear that the association's accountant/auditor should have seen that there was a problem. The accountant had various excuses, including "the treasurer contacted me to say she had the records regarding the expenditures." It turned out that the embezzling manager had manufactured a number of receipts and invoices and enlisted the help of a friend (who impersonated the treasurer in a phone call with the accountant).

When the dust cleared, it was determined that the manager/embezzler had taken approximately \$500,000 from the association over a period of five (5) years. The former board members met with the current board, and we discussed the problem. They acknowledged that they had trusted this manager implicitly. He was like everyone's best friend, son, grandson, etc. When they told him they did not know how to operate the association, he told them not to worry, and they did not. They did not ask for financial reports, and he did not provide any reports to them. They never even asked to see bank records or cancelled checks and did not inquire as to how much they had in reserves. They trusted him implicitly. It turned out that he had taken all of their reserves. I asked if he seemed to be living too grand a lifestyle based on his salary. They said they were surprised by his BMW, big screen TV and many trips, but he had told them he was a trust fund baby and worked to stay busy. They bought it – hook, line and sinker.

When the association made a claim to their insurance carrier under their fidelity policy, they were told that the insurance company could not cover the loss, because the employee (embezzling manager) had been excluded. It turned out that the insurance company had twice sent letters to the board excluding this employee from coverage. The problem is, they sent the letters to the embezzling manager, who then forged the president's signature and sent the acknowledgement back. That is when I came into the picture. After interviewing the former board members and reviewing all of the data, it became clear to me that the former board of directors had allowed this to happen by failing to carry out their responsibilities pursuant to the Civil Code. I presented all of the facts and circumstances to the carrier, in a Directors and Officers Insurance liability claim, and although it took some negotiations and development of additional facts, the carrier agreed to pay 100% of the association's loss.

I was surprised to learn that after the manager/embezzler had left the association he had stolen the money from, he went to work for a high rise luxury building. I was more shocked to learn that that association had not bothered to contact his former employer of over five years for a reference!

With a lot of persistence, especially by the IRS auditor/board member/owner, the former manager and embezzler was indicted, and I was advised that, as part of a plea bargain, he plead guilty to one count of forgery, made some restitution and was sentenced to only one year in jail.

This embezzler is still around. After he got out of jail, he applied for a job with a portfolio management company in the San Fernando Valley. By sheer coincidence and luck, I received an e-mail (forwarded to me by one of our staff people) from this individual. I contacted the owner of the management company who hired him before the criminal background report had been received (and he failed to disclose his status as a convicted felon). As a reference, he had given her the name of a person who was representing himself to be the former president of the association he embezzled from. When confronted, the embezzler resigned.

Recently, I was advised that he had gotten a job with a high-rise association in Long Beach who had contacted the same reference person impersonating a former president of the association he had embezzled from. He left that job (and they have since discovered he had embezzled from them) and made a workers compensation claim. I received a call from a fraud investigator for that insurance company who is investigating whether the worker's comp claim is fraudulent. This manager is a serial embezzler who preys on associations and management companies.

Embezzlement is not limited to managers. There are many associations that are self-managed. At one association, the board trusted one of the board members to pay expenses for a major repair. She decided to put some of the money into her pocket. At another association I represented, the board had, for many years, trusted a retired bookkeeper/board member/owner to keep the association's books. She decided that she needed some extra spending money, so she manufactured some invoices for her husband's pool supply business, and wrote herself some checks.

These fraud schemes are uncovered in various ways, and can be avoided by developing internal control systems (like complying with the Civil Code requirements under CC §1365.5). Generally, the signs are all there; but someone must be paying attention. Strong indications of possible embezzlement or fraud should be investigated until resolution, including the following signs: bank reconciliations not being done on a timely basis or at all, extremely late financial reports (or none), consistent errors in financial reporting, the manager who will not take a vacation, the board member or employee living beyond their means, and the list goes on.

As you can see, embezzlement is not an unusual circumstance. Community associations are easier targets than other businesses because of the usually "thin" administrative structure and the "trust" element. The fact is that most board members trust their manager, and do not really pay much attention to their financial affairs. Do not fool yourself by having a "that won't happen to us" mentality. Do something now to minimize your risk before it is too late. Ensure that you have healthy skepticism, that you are conscious of your manager or board member's situation.

Have a strong control environment, effective policies and procedures in place. It is not difficult; review the Civil Code and comply with what it requires. You may not be able to eliminate the risk that someone will embezzle from your association, but by performing these tasks, you should be able to rest easy, knowing that you are doing something to prevent your association from being one of the statistics.

For more information on dealing with and/or preventing embezzlement at your association, contact David C. Swedelson, Esq. at dcs@sghoalaw.com.