

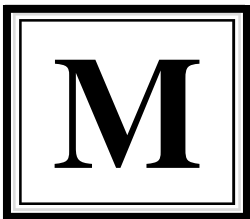
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Did You Know?



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How to Prevent Theft and Fraud of Association Funds

by Beth Mulcahy, Esq.

Theft of association funds is unfortunately becoming quite common. Just recently, an Arizona newspaper reported that a small management company in Arizona closed unexpectedly and may have absconded out of the country with several associations' funds. If you have not heard about someone stealing money from community associations, do an internet search. Fraud in community associations is rampant.

In the 2008 case of *Davis v. Dyson*, a property manager embezzled more than \$550,000 from a condominium association by allegedly forging one of the board member's signatures on over 100 association checks. An unhappy owner (plaintiff) alleged that the board failed to take proper precautions to protect the association funds, such as failing to review any of the monthly bank statements, failing to conduct a proper audit or annual review and failing to secure sufficient fidelity bond insurance as required by law. In this lawsuit, the Court stated that the board members "may not close their eyes to what is going on about them in corporate business, and must in appropriate circumstances make such reasonable inquiry as an ordinarily prudent person under similar circumstances". There is a fiduciary duty that is owed by board members and therefore, the board of directors must act in the best interests of the association, show good faith AND act diligently.

A well-known criminologist, Donald R. Cressey, created a model called the Fraud Triangle to help explain the different components that leads a white collar criminal to commit fraud. The three sides of the triangle are rationalization; perceived opportunities; and social pressure. Two legs of the triangle, rationalization and social pressure are difficult for an association to manage. However, perceived opportunities can be managed quite effectively by the association. Practicing good risk management and being aware can mean the difference between maintaining healthy accounts and being another victim.

What might misappropriation of funds look like?

1. Outright taking of cash; 2. Faked expenses; 3. Non-existent employees or former employees included on the payroll; 4. Transferring association funds to another community or the management company; 5. Use of association funds as collateral on personal loans; and 6. Showing investments on the financial statements as certificates of deposit when they are actually non-existent.

Accounting checks and balances are vital steps toward protecting the association's assets, but, vigilance and awareness are also needed. The board of directors should set aside time for a full discussion of all financial matters and above all they must maintain a level of skepticism.

Internal Controls

The entire board must select both a team of advisors and/or a management company to best serve the association. Depending on the size of the association, advisors may include some or all of the following: 1. Attorney; 2. Insurance agent; 3. CPA; 4. Investment consultant; and/or 5. Reserve specialist.

The board should do its due diligence and research any and all advisors that they may want to employ. Select advisors who are knowledgeable, experienced and dedicated to community associations. Additionally, there must be excellent communication between the association's treasurer and the advisors and also among the advisors themselves. A major board decision is the selection of a management company to perform financial services. Working together, the board and advisors can make a good selection by considering: 1. The company's reputation for integrity; 2. Experience of the managers and the company; and 3. The qualifications of, and processes followed by the financial department.

continued

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How to Prevent Theft and Fraud of Association Funds continued

by Beth Mulcahy, Esq.

In your selection process, ask questions of other community associations who have a successful working relationship with their management company.

It is perfectly acceptable and indeed *necessary* to investigate the association's management company. One or more key board members, including the treasurer, should take the time to visit the management company, tour their offices, and meet with key personnel. The company should know members of the board personally and know of the association's concern and diligence to protect the association funds from theft. Ask if the management company has conducted criminal background checks regarding persons in their company who handle association funds, and ask to see the results. A report of the visiting board members findings should be presented to the board of directors and possibly the advisors at the following board meeting.

Insurance

A board of director's primary responsibility is to preserve and maintain the association's assets. Most lenders now require all associations with 20 units or more to have their own employee dishonesty/crime (Fidelity Bond) insurance coverage in addition to any coverage the managing agent might carry. This policy should cover anyone who has access to the association's monies. Review the coverage offered by the insurance company and meet with your insurance agent to be assured that it meets the needs of the association: 1. Employee dishonesty; 2. Forgery or alteration of records; 3. Protection while on association premises; 4. Protection while In transit regarding association business; 5. Money orders and counterfeit currency; and 6. Computer fraud.

Be aware and Vigilant

Warning signs for potential fraud include the following: missing bank statements and reconciliations, general ledgers that do not balance, missing and altered documents, photocopies rather than originals, unexplained cash shortages, unauthorized credits to receivable accounts, increased past due accounts, duplicate payments to vendors, unauthorized purchase transactions and payments for unspecified services.

Answers

Take Control

Our law firm suggests that boards have the following accounting and financial controls in place to prevent embezzlement and fraud in their association:

1. Keep association records up to date;
2. Assign control of all reserve funds to the entire board;
3. Monthly financial reports should be prepared and made available for board review (include in the monthly report, a balance sheet, a statement of revenues and expenses and a comparison of actual revenues and expenditures to budgeted amounts);
4. Require two signatures (including at least one board member) on all checks or transfers greater than a pre-designated amount;
5. Prior to signing checks, authorized check signers must review invoices and supporting documentation;
6. Review bank statements and reconciliations on a monthly basis;
7. Keep only a small amount of petty cash on hand and in a secure place;
8. Regularly review delinquent receivable balances;
9. Purchase adequate fidelity insurance to cover the volunteers and employees who handle funds. In addition, arrange for directors and officers coverage (D&O insurance) in the event the board is accused of financial mismanagement; and
10. Hire a CPA to conduct an independent annual review or audit.
11. If your board discovers that funds are missing from your association, remove the suspected fraud perpetrator from a position of control, put a stop on all bank account activity and check with your association attorney for advice on how to proceed.

Is a Registered Sex Offender Living in Your Neighborhood?

by Beth Mulcahy, Esq.

The recent arrest of a San Diego registered sex offender, brings to the forefront, the angst of a sex offender living in your neighborhood. On June 1, 1996, the Arizona legislature adopted the Arizona Sex Offenders Community Notification Statutes (A.R.S. Sections 13-3821 to 13-3828). Under this law, once a convicted sex offender is released from jail and intends to enter and remain in Arizona, the sex offender must register with the sheriff of the county in which they intend to reside. Prior to release, the agency that had custody of the individual completes a risk assessment which determines the offender's risk level. The level of risk is used to predict whether an offender will commit another similar offense.

Associations typically receive written notice when a registered sex offender moves into the community. Community Notification is carried out by law enforcement, which has discretion regarding the type of notification. Community notification is discretionary for Level 1 (Low Risk) offenders. State law requires mandatory community notification on all sex offenders assessed as a Level 2 (Intermediate Risk) and Level 3 (High Risk) offender. According to the Arizona Department of Public Safety website, notification of the registered sex offender's presence is sent to "surrounding neighborhood, area schools, appropriate

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continued

community groups and prospective employers.

The notification shall include a flyer with a photograph and exact address of the offender as well as a summary of the offender's status and criminal background. A press release and a level two or three flyer shall be given to the local electronic and print media to enable information to be placed in a local publication."

Successful community notification is dependent on three factors: communication of the sex offender's presence in the community; citizen education regarding what can and cannot be done concerning the individuals' presence; and a zero tolerance approach to harassment or vigilantism against the offender. Neither the association nor residents may harass or otherwise intrude upon the offender's privacy. Such acts would create criminal liability for the resident. As such, community associations cannot discriminate or otherwise harass a

known sex offender in an effort to prevent the offender from residing within the community association or neighboring areas. However, a community association has the right and, in my opinion, the obligation, to notify its residents of any registered sex offenders residing within the association or in the neighboring areas.

Information regarding Arizona's Sex Offender Community Notification Statute may be found on the State of Arizona Department of Public Safety web page <http://www.azsexoffender.org>. This site allows users to enter a specific residential address or a zip code to locate registered sex offenders residing in the specified area. Some associations print the information obtained from this website and post it in common areas or distribute to the residents. Full reports are available for a fee. Please contact our office if you have any questions regarding this law.

Answers

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A Reminder:

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9 - 10 a.m.**

on the first Friday of the month to receive your **free** consultation regarding community association law.

**May 7, 2010
June 4, 2010
July 2, 2010**

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Our March 16, 2010 Legal Seminar

for Community Associations will be available on DVD.

Please call our office at 602.241.1093 to order your copy.

Be in the Know!

A summary of community association bills pending in the

Arizona Legislature is updated weekly and available every Monday on our website:

www.mulcahylawfirm.net.

On the Publications Tab scroll to and click on:

Mulcahy Law Firm, P.C. Legislative Update of Pending Bills for the 49th Legislature, 2nd Regular Session

Beth Mulcahy is the founding attorney and partner of the Mulcahy Law Firm, P.C. Beth's legal practice focuses exclusively on the representation of over one thousand (1000) community associations throughout the State of Arizona.

After receiving a Bachelor of Arts degree in Political Science from Marquette University in Milwaukee, Wisconsin, Beth earned her *Juris Doctor* degree from Marquette University Law School where she was on the Dean's List and a member of the Marquette University Law Review. A native of Wisconsin, Beth is licensed to practice law in the State of Wisconsin and the State of Arizona.

As the former editor/author of a weekly question and answer column in *The Arizona Republic*, Beth addressed hundreds of questions on association governance. In her three years with the paper, she became known for providing information and answers that communicate a clear understanding of the subject matter. Beth's *Answers* publication and periodic legal seminars on community associations continue to provide education and information for the industry. She has also published articles in *Managers Report* magazine, Community Association Institute's (CAI) *Journal of Community Association Law*, *Strictly Legal* newsletter, *Common Ground* magazine and *Arizona Community Association Journal*. Beth is a member of the National and the Central Arizona Chapters of CAI, CAI's prestigious College of Community Association Lawyers and the Arizona Association of Community Managers.

Beth regularly speaks on the topic of community associations for seminars, conferences and workshops at state and national levels.

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Kristen L. Rosenbeck graduated from Valparaiso University with a Bachelor of Arts degree in Biology where she actively supported her school as the Student Body President. Kristen graduated in the top third of her law class receiving her *Juris Doctor* degree from Marquette University in Milwaukee, Wisconsin in 2001. She maintains licenses to practice law in both the State of Wisconsin and the State of Arizona.

Kristen's legal practice focuses on the interpretation and enforcement of association documents and guidance on state and federal laws. She represents associations in general counsel matters, bankruptcy, collection of delinquent assessments and enforcement actions. Kristen also provides representation to office condominiums. Kristen is experienced in litigation and transactional law.

Kristen is a member of the National and the Central Arizona Chapters of CAI, a nonprofit organization supporting the interests of community associations, and the Arizona Association of Community Managers.

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Laura is an associate attorney with Mulcahy Law Firm, P.C. and her practice focuses on the representation of community associations with an emphasis on litigation, enforcement of restrictive covenants and collection of delinquent assessments. Laura is experienced in arbitrations, litigation and transactional law.

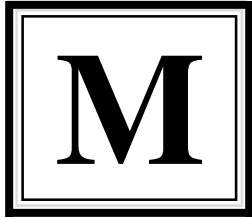
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Answers is not intended to offer specific legal advice or responses to individual circumstances or problems. If legal advice is required, please consult individually with the Mulcahy Law Firm, P.C.

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A Reminder:

Associations Must Conduct an Audit, Review or Compilation Each Year

Pursuant to Arizona law (A.R.S. Sections 33-1810 and 33-1243), a board of directors is required to conduct a financial audit, review or compilation of the association annually. The annual audit, review or compilation shall be completed no later than 180 days (6 months) after the end of *each* fiscal year and shall be made available upon request to the members within 30 days of its completion. Most associations have a fiscal year end date of December 31 so their audit review or compilation must be completed by June 30, 2010. It is important to note that if the association's documents require an annual audit by a certified public accountant, then the association must hire a certified public accountant to conduct the audit.

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