

Fraud Happens – a True Story

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Have you ever heard a Board member or Manager say:? “Fraud can’t happen in our Association. We have good controls and people we can trust.”

In the Community Association industry, fraud can happen anywhere, anytime – from the management company, to the on-site employee, to the volunteer treasurer or other board member. The typical embezzler is someone that is personable and well-liked by everyone around them. In our experience, in this industry, the following are other common attributes:

- Active in CAI
- Well educated in the industry
- Highly regarded by their board members or others
- Considered to be friends or “like family” to those around them
- No extreme outward increase in financial status

The intent of this article is not to cast a negative light on everyone around you; but rather to increase your awareness and skepticism of circumstances that can give rise to fraudulent activity, and controls you can put in place to help prevent it.

First: A “real-life” story from southern California that will hopefully cause you to keep reading this article:

Kristin Davis, the owner and CEO of Paradigm Management Group, (Thousand Oaks) and her Chief Financial Officer, Melissa Hoff, were arrested in September, 2013 for allegedly embezzling approximately \$900,000 from the Big Sky HOA in Simi Valley. Big Sky is a master-planned community of about 800 homes. The Ventura County District Attorney’s office filed 12 felony counts against Davis, including grand theft, forgery, and insurance fraud. Hoff was charged with grand theft and criminal conspiracy. They are out on bail and proceedings are on-going.

While Paradigm was in operation, it managed about 50 communities, both in Ventura County and Orange County. Other HOAs have reported losses that occurred during this time. Detectives are investigating these additional allegations which may result in additional charges being sought. In late fall, 2013, Kristin was charged with another \$700,000 embezzlement from the Oak Park Calabas HOA.

These embezzlements took some time to uncover, investigate, and charge. The Big Sky HOA contracted with Paradigm in February, 2008. The Board discovered the thefts in October, 2009. After this, Davis closed down Paradigm and opened a new company called MK Management. The Sheriff’s office conducted the investigation which resulted in the September, 2013 arrests. One CA law firm in the area,

writing about the Big Sky HOA case, stated that prosecutors are reluctant to prosecute these types of cases due to the enormous amount of paperwork to organize and sift through, and because jurors may become “bored” by all the financial documents presented as evidence.

Following are some of the “schemes” used by Davis:

- **She inflated the amount of fixed management fees and falsified the management contract.** She charged (fixed fees) more than the amount in the official management contract. As new board members came on the board, she altered certain pages in the contract, and had the new member sign the falsified alterations. The management company was in control of the operating cash account and she had various board members approve disbursements, based on the altered contracts. Related to this, she added in numerous ancillary services that were never provided, such as escrow fees, legal fees.
- **She created invoices made payable to her management company,** printed checks, and signed them, for items such as “20 hours billable time” that didn’t occur.
- **Her management company had access/ control of ALL cash accounts; including reserve cash accounts and CDs.** She was able to access accounts on the internet and direct transfer funds into her Management Company account. Bank statements (including scans of checks) were NOT provided to the board.
- **She gave them excessive delinquency information to focus on, instead of the financial statements and bank reconciliations.** The Board was more focused on the income and less focused on the expenses. Due to high delinquencies, they didn’t question the lack of cash as quickly.
- **How was this activity uncovered?** In the Big Sky case, after several months, a new board member reviewed the monthly financial packet and started asking questions because several things were not making sense. The other board members focused on the information and agreed, and this led to the discovery and investigation that resulted in the charges.

One final note on the Kristin Davis case: At one point in her career, Kristin served as the Executive Director for CAI- Channel Islands, CA.

Now that (hopefully) I have your attention, the rest of this article will discuss three areas:

- **WHY** does fraud occur?
- **HOW** is it perpetrated (most often) in the CA industry?
- **WHAT** are some prevention techniques?

WHY does fraud occur?

- **Opportunity:** A lack of strong financial controls will provide the opening needed.
- **Motivation:** The fraudster may be incurring significant family financial challenges, including health care issues.
- **Attitude:** An honest person who feels they are underpaid and underappreciated may rationalize the need for fraud.

HOW is fraud perpetrated (most often) in this industry?

- **Kickbacks:** Vendors pay off the manager or board members “under the table” by including the kick-back amount in over-inflated contracts and “kicking back” the difference in cash or equivalent, such as a car.
- **Corporate Credit Cards:** The on-site manager or other employee uses the card for non-association purchases.
- **Bank Signature cards:** Obtaining signature cards from the board and then adding in the manager signature
- **Work not performed:** Paying for either work not performed, or for the same work, multiple times
- **Non-existent employees:** Paying a person not on the payroll
- **Expenses:** False expense reports and vouchers

WHAT are some prevention techniques? Following are some industry standards. They are the responsibility of the entire board, not just the Treasurer:

- **Read the monthly financial statements!** Compare the budgeted to actual expenses and ask questions regarding the variances.
- **Review the monthly or quarterly bank statements and bank reconciliations.** They should be performed in a timely manner, and reviewed consistently by the board. The bank statements should have the scans of the checks. This includes ALL cash accounts, including CDs. Ask your bank to generate at least quarterly CD statements; and if they can’t provide that; consider changing banks. The bookkeeping department for the management company is not the internal control.
- **Understand who has signing authority for all bank accounts.** The board should ensure they have control over the reserve cash accounts, including two board member authorizations for all disbursements/transfers. If the management company signs on the operating account; ensure the invoices are being reviewed and compared to the disbursements, by someone other than the check signer.
- **Document all material and unusual transactions in the board minutes;** including the descriptions (and operating or reserve) and dollar amounts of reserve expenses.
- **Review contracts carefully,** and when hourly and ancillary charges exist, be very specific about the nature of the expenses and appropriate limits. Have contract signatures notarized; ensure all board members understand and have the appropriate notarized contracts.
- **Consider an annual CPA audit,** if required by the RCW, or otherwise appropriate. Although the audit is not an internal control, it can be a fraud deterrent.

Fraud Happens! Following these basic controls can help prevent it.

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