

Thinking on the Unthinkable: Good Association Financial Practices

By: Kelly G. Richardson

In 1994, many associations were devastated by earthquake, and in 2007 some were destroyed by fire. However, annually a number of associations suffer an event in many ways just as jarring — discovery that a director or agent trusted with finances abused that trust.

Unlike earthquakes, this can largely be prevented. Boards and managers should calmly address the unthinkable — that some future employee or board member might betray the association's trust. Of course, the vast majority of directors and managers are trustworthy, and breaches of that trust are quite rare. However, accusations of financial mismanagement or even dishonesty often too quickly arise in HOAs. Healthy financial practices can quickly prove the integrity of a board or manager.

This is not written for homeowners who distrust their managers or boards. If there is distrust, the relationship may need changing — hire a new manager, or elect a new board. Rather, this provides some important guidelines to consider in preserving the healthy relationship. As with any guidelines, these should be considered in the context of each particular association's circumstances.

The law already places specific auditing responsibilities on association directors. Under Civil Code § 1365.5(a) and (b), directors must at least quarterly:

1. Review current reconciliations and income/expense statements for all accounts;
2. Compare the current reserve revenues and expenses with the budget; and
3. Review the latest bank statements for all accounts. Reserve accounts must require at least two signatures for any withdrawal.

Ten practical measures can reduce the risk of disaster:

1. Association operating accounts can be amended so that two signatures are required on checks or withdrawals.
2. Reserve accounts can be amended so that three signatures are required for any withdrawal.
3. Have a Certified Common Interest Development Manager in place. A good manager is trained in record keeping and financial reporting.
4. Separate check writing from check signing. Have the manager cut the checks and not the board, and have directors sign the checks and not the manager. This means you will have to work with your manager and make yourself available to sign checks that cannot wait for the next board meeting.
5. Insist on reviewing bank statements, to make sure they match the financial reports from your manager or treasurer.
6. Prior to signing any check, review the invoice documenting the expense.
7. Periodically request a monthly check register report from the manager or treasurer, showing all activity in each account.
8. A classic technique of wrongdoing is the use of phantom vendors or phony invoices, so know your vendors and what they do.
9. Ask questions. Have a solid understanding of how the association's funds are handled. There should be no information which a treasurer, president or manager cannot readily provide. A pattern of secrecy,

exclusive control or other method of keeping all information with one person is an unhealthy sign, and builds mistrust. Many embezzlement victims find in hindsight that they allowed financial control to be concentrated too narrowly in one person, and many honest directors have appeared questionable for the same reason.

10. The last line of defense is insurance. Associations should have fidelity coverage, which protects against dishonesty — ask your insurance agent about it. One insurance broker recommends fidelity coverage equal to the reserve account balance, plus three months operating income. The association also can and

should inquire as to whether its management firm has fidelity bond coverage.

Reasonable financial standards and practices will reduce risk of mismanagement, and result in a greater level of confidence and trust in the board, and strengthen the relationship among the board, membership and manager. Greater confidence and trust benefits everyone, and is the rational response to proper handling of association business.

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