FIDELITY INSURANCE AND CONDOMINIUM CORPORATIONS

SOME ITEMS TO CONSIDER

If you are a director, officer or any other person of trust in a non-profit organization such as a Condominium Board of Directors' you have a fiduciary duty to protect the assets of that organization.

If your organization has employees, a bookkeeper, volunteers, or employs contractors; if it has a bank account or receives cheques, you are exposed to losses from fraud.

Simply put a fiduciary duty is an obligation you have to act in the best interest of the organization that you serve. You have a duty to act competently, honestly and in good faith. Amongst other things, this means protecting the assets of the organization from theft not only by employees and board members but also by theft from other parties such as contractors and property managers, anyone who might have access to the assets of your corporation. We are going to look at two means of doing so. The first is via financial controls and the second is via the risk transfer medium of insurance.

CONTROLS

Nonprofits typically lend themselves to a culture of trust. Everyone knows each other and we tend to think that others have the same motivation as we do. This may even extend to those firms that the non-profit uses for services. Nonetheless, a little vigilance goes a long way in preventing fraud.

Typical controls that should be in place are

1. Monthly review of accounts by the board
2. Dual signatures on cheques
3. Having a knowledgeable board of directors with at least one accounting expert – a person who has a clear understanding of the account process
4. Having an annual audit done
5. Code of Ethics

While controls are a start in mitigating risk, they are not foolproof. Limitations to internal controls include collusion (two or more persons acting together to commit fraud) and human judgement errors (just this once…). It is important to note that fraud is not just theft of money but it could also manifest in the form of kickbacks or bribes paid by contractors to one or more decision makers (board member or property manager for example). Funds can also be redirected for the benefit of an individual or individuals, instead of being used for the good of the unit owners as a whole. Physical assets such as furniture or building materials purchased for the corporation could be misappropriated.

According to Nagel & Associates[1], forensic and investigative accountants, some examples of fraud schemes are:

- Individuals issuing payments to themselves or to companies that they set up under the guise of legitimacy. These fictitious companies can appear to be above board based on convincing descriptions that may contain the words 'loan', 'salary' or 'reimbursement'
- Purchasing physical assets on behalf of the condominium corporation and then using those assets for their own personal use
- Forging signatures in order to approve disbursements directly, or to manipulate board elections which would afford them the opportunity to control future spending decisions
- Dipping into a 'petty cash' fund, or creating a 'special' fund to redirect funds

Nagel and Associates go on to list some red flags for fraudulent activity are:

- Unit owners of the condominium encounter resistance if they ask for information and disclosure from the board or property manager;
- When board members or property managers are reluctant to answer questions from the unit owners regarding the disbursement of funds;

- The vendors are numbered companies with little or no presence, or have unusual addresses such as a PO Box;
- Purchases of furniture, equipment or materials seem excessive relative to the needs of the condominium or cannot otherwise be accounted for.

In a kickback scheme, benefits are received by a board member or property manager but are at the expense of the condominium unit owners. These schemes often include the involvement of third-party contractors or suppliers.

Red Flags for kickbacks include:

- A strong preference for retaining specific contractors on an ongoing basis – it is important to note here that many property managers have developed relationships with contractors because of the quality of the service provided – the use of a competitive bid process from time to time is a check against such schemes;
- Other issues around the nature of the work such as unnecessary scope, exorbitant price, unqualified contractors.

CRIME INSURANCE

Now that you are sufficiently concerned about losses due to fraud, let's take a look at the types of fraud insurance that can mitigate loss.

A standard fidelity bond provides first party coverage and protects the insured (the condominium corporation, the contractor or the property manager – whatever the case may be) from losses due to an employee's dishonesty. If the condominium corporation has employees, then this form of insurance can be useful. Or, if your broker can get the policy wording amended to cover theft by board members from the corporation (not always easy to do) this type of policy is useful.

However, most corporations do not have employees so the form that we will focus on is referred to a third party bond. Such a crime bond covers theft by the employees of the property manager's or the contractor, acting alone or in collusion with others, from the third party, in this case the condominium corporation.

There is a lot of jargon that essentially refers to the same thing. The 'janitorial extension' or ' third party extension' covers direct loss which any person or organization having engaged the services of the insured (property manager or contractor) shall sustain due to theft of money or property by an employee of the company engaged to do work on behalf of its clients (in this case the condo corporation). In a perfect world you would want any service provider who has access to your assets whether it be property or money to have this type of coverage.

How much insurance should your service provider have?

This is a very tough question. In February of 2020 a former property manager of FirstService Residential was accused of stealing $2 million from the condo corporations she managed in Calgary[2]. A director of one of the defrauded corporations (as reported by CTV news) commented "She was our representative. She was the one who allocated our funds and paid our bills."

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It is important to state that in this case this is an allegation and no criminal activity has been proven. The property management firm, one of the largest property management firms in North America, stated that it has made full reimbursements to the corporations affected. However, one condo corporation believes it is still out over $100,000.

Let's be clear, there are not many such cases that come to light. A quick search of the internet will reveal cases in 2011 and 2016. And, no one is tracking this type of crime to the writer's knowledge. Further, much fraud goes unreported as people are often embarrassed to have been made a victim and some perpetrators when confronted make restitution to avoid their misdeeds becoming known.

So, the question of what is a reasonable limit of insurance for a service contractor to provide has not been answered! Risk tolerance, amount of exposure, assets at risk and even cost of the insurance all come into play here.

At the end of the day, board members need to be aware of the risks that their corporation is exposed and they need to do their due diligence to protect themselves and their community. This involves a mix of controls and insurance. The writer believes it would be prudent to obtain certificates of insurance from all service providers demonstrating proof of liability coverage and third party crime coverage.

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[1] *https://nagel-forensics.com/services/anti-fraud-consulting/*

[2] *https://calgary.ctvnews.ca/calgary-woman-accused-of-stealing-millions-from-condo-corporations-1.4825176*