

MEMO ON INTERNAL CONTROLS

Board Oversight

Homeowner Association boards employ either a community management company or bookkeeper, or it uses the help of an Association officer or volunteer to assist with bookkeeping, paying bills and depositing funds. These services could include accessing funds, writing and signing checks, using electronic banking services such as ACH transactions, issuing electronic checks and transferring funds.

Although these services provide a benefit to the board in managing Association activities, they can represent a significant internal control risk. In a perfect world, the management company/bookkeeping firm would engage an outside qualified firm to opine on the financial and I/T controls within the management company/bookkeeping firm infrastructure and issue a report that boards could use to evaluate the risk of allowing such individuals to have access to Association cash. These reports would need to be updated at least annually to ensure that controls have not changed for the management company or bookkeeping firm. Such reports are generally cost prohibitive and such cost if performed would likely be passed on to the Association. In addition, if volunteers are used to provide such activities, there is generally no practical way to monitor their activities on an ongoing basis.

Insurance products purchased to protect the Association from fraud and I/T losses including outside intrusion to the computer system is advised, but even with this protection, it may take time to be reimbursed for losses. Banks consider Homeowner Associations to be a business and accordingly are required to report unauthorized withdrawals within 24 to 48 hours. There is a risk that such banks will not reimburse Homeowner Associations for losses if not reported in a timely fashion.

Associations continue to build significant amounts of reserve funds, and computer hacking is becoming more commonplace.

Because of these risks, we recommend the following procedures be considered:

- An officer of the Association should consider reviewing account activity via a read only access to all bank accounts on an ongoing basis. This person should have no access to the bookkeeping process and should not be an authorized check signer. Special attention should be given to disbursements to unfamiliar vendors, electronic payments, unusual charges and electronic transfers. Paper copies of month-end bank statements should be compared to online statements. Any unusual activity should be investigated and reported to the board. We understand this procedure may place an undue burden on the board.

And/Or

- Fidelity and computer fraud insurance policies should be reviewed annually to ensure that policy limits include all cash in operating and reserve bank accounts. Policies should be in the name of the Association. Associations should meet annually with their insurance agent to clarify provisions in the policies.

No system of internal controls and checks and balances is perfect, but these additional procedures will add a layer of protection that may help minimize risk.