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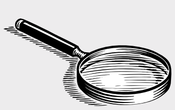
Inside This Issue



Leave It To The Manager

Lake Side Condominium Association (Lake Side) was a complex of 345 units and two common areas. The unit owners elected a Board of Directors to assist in looking over the interests of the association. The elections were staggered to assist in the transition of old to newer members. The Board however, did not fully understand what their overall role was in running the Association.

Lake Side entered into a management agreement with Acme Property Service Management Company (Acme), owned by Peter Johnson. Acme was responsible for all of the financial responsibilities including collection of the monthly maintenance fees, preparing an annual budget, interviewing and hiring contractors and or vendors for certain services related to necessary and emergency repairs, and payment of the association's liabilities. Acme also controlled the association bank account.

Lake Side's board was always pleased with the service provided by Acme as they took care of everything. The contract automatically renewed every year without question. In early 2013 however, things started to change. Acme was not filing the board minutes the way they had in the past, and the financials reports were late and contained less details.

A new Board President was elected in late 2013. While he was becoming familiar with the other Board Members, the Property Manager, and the way things operated, Acme issued the proposed annual budget. It appeared to be excessively high to the President which raised questions. The President brought his questions to the other Board Members.

His informal questioning determined that none of the current or pre-existing board members, during Acme's tenure, had ever had check-signing authority. This meant that Johnson had sole control over the association's funds, enabling him to issue checks to any vendor, including payments to his own company for services he billed to the association without any approval.

The President questioned Johnson about some of the charges, the lack of detail on invoices, and demanded he itemize them. He received vague and insufficient answers to his questions so he continued after Johnson for more answers.

As part of his review, the President wanted a copy of the service contract so that he could compare it to the purported services outlined on their invoices. He found out that none of the current board members ever recalled seeing a copy of the contract dictating the obligations of Acme and the fees they charged for services. Johnson made excuses and delayed in providing a copy to the Board.

Due to the lack of cooperation and response from Johnson, the board terminated the agreement and engaged the services of another property management company. During the interview process, the representative from the new management company detailed the services the company would provide, pointing out the checks and balances that the company insisted on from the association's board. These included, but were not limited to having check signing authority and dual signature requirements for payments over a certain amount for vendor/contractor payments. Someone from the board would approve payment and co-sign the check.

Continued on page 4

We All Practice Due Diligence (And May Not Even Know It)

The term "due diligence" is used extensively in many legal articles and complex business transactions. It sounds complicated but in reality, due diligence is simply the process of "doing your homework" before you make a major commitment, either on a business or personal level. For example, prior to purchasing that new car, what do virtually all of us do these days prior to paying a visit to a car dealer? Of course, we check the internet for the target best price, the dealer cost, and any low interest financing deals so we can be prepared to counter the first three or four "sweet deals" offered by the car salesman. Although we may not really think about what this process involves, we are doing our "due diligence" prior to buying the car to get the best deal possible.

Due diligence can be as simple as just asking the proper questions and making sure that a situation isn't "too good to be true." Probably each of us has, at one time or another, been sold a "lemon" or defective article only to be told the old adage, "let the buyer beware."[1] The term "due diligence" first came into use after enactment of the Securities Act of 1933. It was included in this act as a defense against holding broker-dealers liable for non-disclosure of certain information to investors that was not discovered through an investigation.[2] The term has now been applied to a large number of mostly business and corporate finance related transactions. Typically, in this type of environment, a due diligence investigation would be conducted by a company seeking to acquire another company. In this setting, a due diligence review would likely include audits by licensed professionals in the following areas: Compatibility of business operations; financial operations; legal and regulatory affairs; marketing operations; production facilities; management personnel; information systems operations and security; and financial reconciliation.[3]

Due diligence is simply the process of "doing your homework" before you make a major commitment, either on a business or personal level.

Although due diligence reviews are most often conducted in complex business transactions, this does not mean that we, as individuals, should not practice our own form of due diligence in our financial and personal affairs. Remember Bernie Madoff and his once upon a time overjoyed investors. Bernie was making returns for his investors in the range of seven to ten percent per year when average investment returns were running in the three to five percent range. This "too good to be true" fairy tale ended abruptly on March 12, 2008 when Mr. Madoff pled guilty to running a massive Ponzi scheme that cost his investors more than $50 billion in losses.[4] Many of the investors were wealthy individuals; however, far more of the losses were incurred by corporate investment advisors and mutual funds who failed to conduct a proper due diligence of Mr. Madoff's operations.

This failure to conduct such a review was made even more unforgiving since there were a number of "red flags" that should have alerted individual and certainly institutional investors that there were potential serious problems with Mr. Madoff. For example, the investors allowed Mr. Madoff to provide trade confirmations three to five days after trades were made rather than daily as promised; they allowed Madoff to use weighted averages rather than individual trade prices on trade tickets for securities claimed to have been bought or sold; they did not investigate whether the small auditing firm used by Madoff had the ability to audit a $65 billion fund; and they knew that Madoff's relatives held senior positions in the firm.

Continued on page 3

We All Practice Due Diligence (And May Not Even Know It)

Continued from page 2

These are just a few of the approximately twenty red flags that were detailed in later court cases.[5] Why, you ask, would a professionally operated investment firm fail to conduct a proper due diligence of Mr. Madoff? The answer lies in the fact that those investors that went with Madoff chose faith over evidence. That's what a con man is—a confidence man that engenders a relationship and then subsequently lures somebody into doing something that they shouldn't do.

On a personal level it is important to conduct your "due diligence" whenever you are going to commit your hard earned money or time to an endeavor. Probably the most significant financial outlay any of us will make is the purchase of a home. Proper due diligence in this case is very important due to the long-term financial commitment involved. Typical due diligence areas of review in a home purchase might involve hiring a home inspector to ensure the house is constructed properly and does not have any significant maintenance issues that will be expensive to repair. In addition, you may want to check out the rating of the schools in the area which can impact resale values among other things. How about the property tax rate applicable to your new home? Sometimes this tax can be quite high and pose a significant financial burden. One of my friends actually performed "due diligence" on the neighbors on either side of a home he wanted to buy. He wanted to make sure they were "good folks."

It is important to conduct "due diligence" whenever you are going to commit hard earned money or time to an endeavor.

Another personal area to conduct due diligence involves a new job offer. Before you accept that job offer and move to a new location, you might want to check to see if the new company is financially stable. What about the new industry you will be working in? Does it have a favorable forecast for the future? And then what about any employee benefits that you may have or want to negotiate prior to being hired? All of these areas involve a significant amount of due diligence on your part prior to accepting a new position at a new company.

In closing, make certain you do your own "due diligence" in situations where you are being called upon to trust someone else. Question everyone before you hand your hard earned money to someone to "invest". Always follow up on references provided and go outside of the provided reference pool to make sure you are dealing with a legitimate entity. Make sure you check professional licenses and industry disciplinary actions. Lastly, apply what one of my old law professors called "the smell test." If the "deal" initially smells bad to you, it probably is.

Make certain you do your own "due diligence" in situations where you are being called upon to trust someone else.

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1 IP Due Diligence—A Necessity, Not a Luxury by Ian Cockburn

2 Due Diligence—from Wikipedia.org

3 Due Diligence—From Wikipedia.org

4 The Post-Madoff Emergence of a Fiduciary Duty of Due Diligence by Scott A. Myers and James G. Martignon

5 Ibid

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Leave It To The Manager

Continued from page 1

Once the new company was hired, they conducted an investigation into the association's records. They discovered Acme overpaid itself for basic services rendered under the contract, billed the association for fees that should not have been allowed, made overpayments to legitimate vendors, and made payments to shell companies Johnson set up for services not rendered. The total loss to the association was over $1 million.

The board clearly made a grave mistake by not being more engaged in the association's business. This allowed Johnson to siphon funds from their account. Johnson had control over their funds. He authorized payments to vendors without any oversight from the board.

The board has to be involved in the operation of the association's business. This should include such things as having access to bank accounts, check signing authority, and getting the original bank statements. They should have an audit committee checking on payments, a vendor program whereby vendors are selected after going through a vetting process, and a periodic review of the approved vendor list to make sure they are still viable companies. Just as important is engaging an outside auditor to not only prepare financial statements based on information provided by the management company but test the test the validity of transactions as well. Lake Side learned a hard lesson.

By Tracey A. Archbold, Director, Crime Claims
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ATM Industry Association (ATMIA) U.S. Conference 2014: Reinventing the ATM

ATMIA USA's annual conference and expo is the largest ATM-focused event in the world.

If you manage or operate even a few ATMs – you need to be there. If your company provides products or services to the ATM industry – you need to be there. If you want to see the newest ATM technologies or network with colleagues – you need to be there.

In this time of transformation in the ATM industry, your risk management approach must remain on the cutting edge. Lowers & Associates invites you to stop by Booth #103 and talk to our group of enterprise risk management professionals who truly understand the unique operational risks you face.

Let's discuss your challenges—visit us at ATMIA Booth #103.

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