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plus:

CONDO FRAUD

THE BEST DEFENCE IS AWARENESS



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FRAUD: Eyes Wide Open

Awareness and the concepts of fraud should be continually evaluated



Looking at fraudsters directly in the eyes is a difficult thing to do; accusing them of such is even more difficult. With condo reserves increasing well into the millions and the industry booming, there is a heightened attraction to take advantage of condominiums. The best defence on fraud is to understand it both from the perspective of risk exposure as well as from experience. Furthermore, setting proper controls as well as tone from the top as a proactive measure adds that second line of defence.

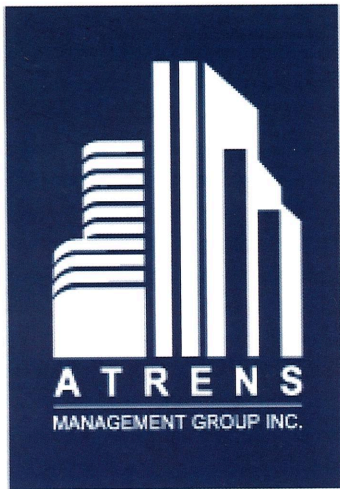
Fraudsters have become more sophisticated in their dealings and in many cases they take advantage with related party transactions. These transactions come about when two or more parties have a common interest where there is common control, family relations and as well when two parties do not act independently of each other. To be clear, not all related party transac-

tions are fraudulent, as there are certainly economical benefits in terms of efficiency as well as reduced fees in working closely with those you can trust. However, where things go wrong is when the related parties work against the best interests of the condominium. It is not illegal to conduct related party transactions; however, if management and the board wish to do so then the rules must be clear and must be well managed. The tone from the top should convey the message that any related party transactions that are not clearly disclosed should result in negative consequences. A good control is that when engaging a related party, the relationship should be disclosed in the proposal. To provide further accountability, competing proposals should be provided in contractual arrangements and evaluated by those who are not part of the related party.

Those who commit fraud either have been

doing it all their lives or there may have been some form of financial trauma which caused them to turn to illegal activities. Both profiles are difficult for those in our industry to filter out; however, there are signs. Habitual fraudsters will have some form of track record which may have left a trail in the past. Therefore, it is always a good control to perform the necessary background checks before engaging any service provider to the condominium. The power of search engines on the internet can come up with considerable background on those who will be engaged with a high level of trust. Certainly where there are areas of high level of trust, referrals are very useful as well as background checks relevant to the degree of authority and should be investigated and documented. The other form of fraudsters arise from financial trauma such as a result of poor or failing business ventures, gambling addictions or a change in personal lifestyle.

ILLUSTRATION BY JASON SCHNIDER



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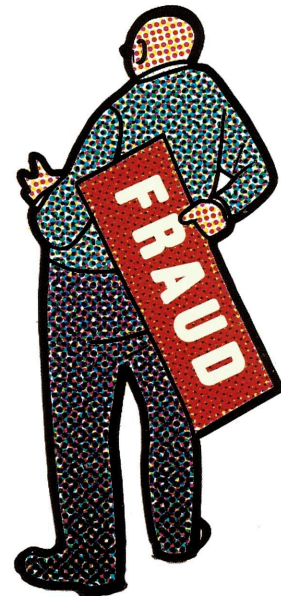


If you personally had several million dollars in a bank account or in your investment portfolio, it would be wise that you focus most of your energies to nurture that investment as well as to ensure it is safeguarded.

The signs are not necessarily conclusive and certainly care must be exercised in making accusations. The best approach is where there is known financial trauma there should be heightened awareness by the condo board members and to increase the scrutiny of such transactions. Care should always be exercised when calling out fraud as I have seen too many times false accusations that will damage long term relationships and create a general sense of distrust. However, where fraud exists, documentation of such activity is essential to build up the case. It is the condominium board's responsibility to provide oversight and investigate fraud if they suspect it has occurred. However, it is not in their best interest to act as prosecutor. After obtaining the necessary facts, the board should seek legal guidance as well as communicating the suspected fraud to their auditor.

Auditors use risk assessment to evaluate where a potential misstatement would be likely to occur. Often the risk areas exist where there is a strong level of bias and where there are large material transactions. It is also most efficient for condominium boards to focus in on the evaluation of risk as a preventative measure against fraud. Risk differs industry by industry; however, with respect to condominiums, the high risk areas occur where one party exerts a high level of control and also in the reserve fund where the majority of the condominium's assets are held. If the board is entrusting the condominium to those who are in control of it, it is essential that there is regular communication

and reporting of significant decisions as well as regular monthly financial reporting. If you personally had a several million dollars in the bank account or in your investment portfolio, it would be wise that you focus most of your energies to nurture that investment as well as to ensure it is safeguarded. This should not differ in condominium governance as regular inspection of the investments is a good control against fraud. A condo board has the right to communicate directly with their bank as well as with their investment advisors to ensure that the investments have proper access controls to such funds. Gaining online access to view the activity of such funds is a simple way to manage your risk. Looking for control weak spots should also be a regular activity that the board discusses and reviews on a regular basis. Given there is flux in the board members themselves, management companies as well as suppliers, the board has even a tougher task to deal with these moving targets. Where change does occur then a



new evaluation process should take place to assess the risks, perform due diligence and evaluate what controls have been put in place to safeguard this new situation. A good example of a control weakness is where bank accounts have recently been changed; however, setting up the signing authority was just "looked after". Every board and management company exercises different protocols; however, in the end it is up to the board to ensure that safeguards are in place.

Many condominiums invest substantially in preventative maintenance measures such as fire safety, elevator inspections and the list goes on. However, it is puzzling when owners in condominium corporations under 25 units elect to not have an audit. The Condominium Act has a provision to allow for smaller condominiums to exempt themselves from the audit as long as there is unanimous consent from all owners. Many believe the intention of the Act was to provide safeguards in place to protect condominium homeowners by mandating annual audit requirements. Just because there is an exemption, it does not alleviate the smaller condos from fraud or financial

misstatement risk. Having an annual audit for condominium of all sizes ensures that all parties to the condominium know that there will be a third party who acts on behalf of the owners and who is independent to alert the board of areas for material misstatement and fraud if so encountered. To be clear, the auditors' role is not intended to actively seek situations where fraud may have occurred. It is, however, their role to be skeptical that it may exist and to investigate and disclose fraud when it has occurred. With this role, auditors can act as a deterrent against fraud and it is in many ways the auditors' presence that acts as a preventative measure. If fraud does occur, the au-

ditor can independently bring this to the attention to management and the board and limit the exposure by suggesting improved internal controls.

Maintaining a highly trusted and respected condominium industry requires the responsibility for all those involved to set the tone for a low tolerance of fraud. Certain rules must be put in place with respect to proper conduct and to set appropriate disciplinary action for those who wish to test our waters. The awareness and the concepts of fraud should be continually evaluated in order to safeguard owners' investments and the confidence in the condominium industry. **CV**

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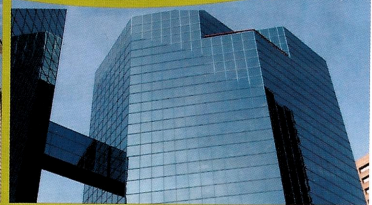
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