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How to Use Education to Reduce **Conflict of Interest Risk**

Property managers play a crucial role in assisting and educating board members on capital improvement best practices. Unfortunately, the learning curve is steep, becoming even steeper when dealing with board members who are either inexperienced or corrupt. When a property management company is willing to drive accountability, they can successfully steer boards away from unethical conduct they may either knowingly or unknowingly commit.

A lack of education increases the dangers of unethical behaviour and also negatively impacts reserve fund plans. Let's explore how educating board members on ethical behaviour can help avoid misuse of funds and reduce the risk for conflicts of interest.

Risk of Inexperienced or Corrupt Board Members

When inexperienced or corrupt board members head up capital improvement projects, there are two possible risks to funding:

1. Inefficient Assignment of Work

In this scenario, board members become too focused on the budget for capital improvements. Due to inexperience, they tend to hire unqualified vendors and make uninformed decisions that lead to ongoing investment in repairs and replacements.

2. Self-Serving Assignment of Work

Dangers lie where corrupt boards purposefully find ways to extend the scope of projects and bypass the tendering process in order to hire preferred vendors to receive kickbacks.

In both scenarios, the board members' actions can:

a) impact the building's capital and condition

b) lead to removal from the board, or even criminal charges and/or

c) force owners to carry the burden for unethical or inexperienced decisions via fee increases and frequent special assessments.

However, when property managers use their knowledge and experience to educate board members, they can help reduce the risk for unethical behaviour, misuse of funds and conflicts of interest.

Understanding Conflict of Interest

A conflict of interest arises when a board member has a material interest in an agreement or transaction involving the condominium corporation. If the board member themselves owns the company, the company cannot be considered. When a potential conflict of interest exists, board members must tell fellow members they hold interest in the transaction and cannot vote on matters related to it. If the remaining board members knowingly determine the recommended company should be awarded the work, in theory, this would no longer be considered a conflict of interest.

How Conflicts of Interest are Leveraged

When work is awarded based on innocent associations between board members and contractors, board members don't realize this presents a conflict of interest. Property managers can point out the conflict to members and recommend the tendering process instead. However, when the work allows board members to commit fraud or receive kickbacks, the conflicts of interest become more ominous. A perfect example is board members allowing their preferred contractor to perform the diagnosis, assessment, and repairs. This opens a huge opportunity for contractors to recommend unnecessary work and/or generate kickbacks for the board member.

Again, introducing the tendering process makes it more difficult for corrupt board members to receive kickbacks, hire their contractors to perform unnecessary work, and accept overpriced invoices, to name but a few unethical acts.

Many inexperienced board members might not understand what a kickback entails. Kickbacks differ from fraud by virtue of involving a third party in the process. Fraud involves board members, managers or management companies knowingly using corporation funds for their own gain. When managers, board members or even management companies receive money, gifts, or free services from the contractor in question, these benefits are considered kickbacks. In return, contractors expect higher prices for their work, perform unnecessary work, or make recommendations that allow them to make the same repairs repeatedly.

Property managers can educate new board members on the nature and legality of kickbacks to discourage conflicts of interest, including:

- having the contractor perform work on their own unit but include the charges on the corporation's invoice
- creating fake invoices to pay themselves
- listing and paying for work never performed
- forging cheques
- using petty cash to make personal purchases

The list is long, and many the fraudulent act goes unnoticed. However, property managers can introduce secure financial management procedures to reduce the risk of fraud.

Recognizing the Signs of Corrupt Board Members

Property managers can teach boards how to recognize corrupt behaviours, including members who:

- sit on many boards and imply or claim to be managing all of these properties.
- forcefully or subtly recommend or insist on hiring contractors, engineers, and other vendors they know
- always prefer very expensive approaches that constantly extend the scope of work
- criticize other quotes, which come in below the quotes provided by their preferred vendors
- criticize the tendering process or insist on bypassing the tendering process to save time

These actions allow the board member to easily secure work for their preferred contractors.

How Property Managers Can Reduce Risk for Conflicts of Interest

Introducing boards to best practices for capital improvements can reduce the risk of conflicts of interest. Once they understand how conflicts occur, they can see how they impact the property's financial health. Some best practices would include:

- ensuring an independent contractor or engineer performs all diagnostics instead of a regular contractor engaged by the board to perform repairs, replacements, and upgrades
- tendering out all capital improvement projects
- strict adherence to the Condo Act when hiring contractors
- sharing examples of similar projects with comparable budget points and complexity as reference points during the tendering process

Property management companies can ensure the proper use of funds by introducing fair tendering processes. With knowledgeable, detailed technical assessments, they can help decide how and where to spend reserve funds. By considering priorities and the benefits of being more proactive, effective management reduces the risk for misuse of funds by inexperienced or unethical board members. As a result, the property maintains its value, and the board and managers avoid risk for conflicts of interest. ■

Vadim Koyen is the President of CPO Management Inc., a full-service property management company specializing in residential and commercial condominiums in Toronto and the GTA. With over ten years in the industry, CPO offers a broad spectrum of services from strategic and financial planning to accounting, building maintenance and capital improvement.
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