

AN OPEN LETTER TO THE TRUSTEES
OF THE RADBURN ASSOCIATION
REGARDING OVERSIGHT OF
THE RADBURN ASSOCIATION'S FINANCIAL AFFAIRS

By:
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Credentials

I am a certified public accountant licensed by the States of New York and New Jersey. I have over 25 years experience in the field of public accounting. Part of my experience in the field of public accounting includes providing litigation support services in a wide variety of cases including: a \$1 billion lawsuit involving a large US city and a major public authority, estate disputes and accountings, chapters 7 and 11 bankruptcies, and tax fraud.

I am the author of articles concerning professional issues and taxation that have been published in *Computers In Accounting* and the *Lambda Philatelic Journal*. I write a financial planning column for the *Challenge* newsletter. Letters of mine concerning various professional issues have been published in *The CPA Journal*, *The New Jersey CPA*, and *Accounting Today*.

I am a member of the American Institute of Certified Public Accountants (AICPA), the New Jersey Society of Certified Public Accountants (NJSCPA), the NJSCPA Help Center, and the NJSCPA Professional Conduct Committee.

Executive Summary

The Radburn Association is engaged in massive deficit spending, massive over budget spending, deficit spending year after year, and apparently lacks Trustee oversight of management and significant expenditures. These are indications of material weakness in the Radburn Association's internal control. Material weakness in internal control is a matter of such importance that the AICPA Professional Standards classify material weakness as a reportable condition.

Fraud risk factors, as defined in the AIPCA Professional Standards, appear to be present in the operations of the Radburn Association.

I am extremely concerned about these issues. I am so concerned that I felt the need to alert you, the Trustees, and the homeowners of Radburn to this situation. If this situation is allowed to continue, it may adversely affect home values in this community.

As Trustees, you are responsible for addressing the material weakness in the Radburn Association's internal control and the resultant fraud risk factors.

I recommend in the strongest possible terms that you immediately engage the services of a CPA firm to audit the Radburn Association's 2005 financial statements. Furthermore, I call upon you to provide the audited 2005 financial statements of the Radburn Association to all the homeowners and residents of Radburn in a timely matter.

Additionally, I call upon you to immediately have a CPA firm do a comprehensive study of the Radburn Association's internal control and to make that report public.

The letter to The Radburn Association Trustees
starts on the next page

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January 3, 2006

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Mark Berman, Trustee
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David Bostock, Trustee
1 Burlington Place
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Don Morris, Trustee
1 Addison Place
Fair Lawn, NJ 07410

June Meyerson, Trustee
15 Ballard Place
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Scott Bray, Trustee
2 Ballard Place
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Sue Mecky, Trustee
12 Berkeley Place
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5 Burlington Place
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Dear Trustees:

Introduction and the Concept of Internal Control

The single largest investment, the single largest asset most people will ever own, will be their own homes. One of the conditions of the purchase of a home in Radburn is the payment of dues to the Radburn Association. Therefore, the people of this community have a significant stake in the financial affairs of the Radburn Association. It is your duty as Trustees to oversee the financial affairs of the Radburn Association and to protect the interests of the homeowners in Radburn.

On December 13, 2005, I attended the annual budget hearing of the Radburn Association. I am deeply concerned about what I observed at that hearing.

Before I proceed to discuss the budget hearing, and the issues that were discussed at the hearing that concern me, it is necessary to define the term internal control. The CPA profession is governed by professional standards issued by the American Institute of Certified Public Accountants (AICPA). AICPA Professional Standards AU Section 319,

Consideration of Internal Control in a Financial Statement Audit, defines internal control as follows:

“*Internal control* is a process---effected by an entity’s board of directors, management, and other personnel---designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations.

Internal control consists of five interrelated components:

a. *Control environment* sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.”

The other components of internal control are risk assessment, control activities, information and communication, and monitoring.

Internal control is the tool used to insure accurate accounting and financial records, efficient operations, and compliance with laws and regulations. Internal control is the responsibility of the Radburn Association management and the responsibility of the Trustees. Not only are the Trustees responsible for the internal control, but in the case of the Radburn Association, the Trustees are solely responsible for the control environment, the foundation of an effective system of internal control.

The importance of the control environment, and other components of internal control, can best be illustrated by what happens when the internal control is not effective: Enron.

The Control Environment

I now come to my observations of the Radburn Association budget hearing. These observations bear directly on the issue of the Radburn Association’s control environment.

It appeared the Trustees were unprepared for the hearing. When asked questions directly, the Trustees seemed unable or unwilling to respond to most questions.

The Radburn Association Manager dominated the meeting. Her answers sometimes seemed evasive, obfuscatory, and misleading. When asked for documents, the Radburn Association Manager brushed off every request. The excuses the Manager used to not provide any of the requested documents were; “I do not have them with me” (when those very documents were in the very building that we were in), or “the matter is confidential,” or “it is a corporate matter.” In the case of a question involving the pre-school, the Manager told residents that she did not know where the documents were.

I am concerned about the apparent lack of advance authorization for the expenditure of significant sums of Radburn Association funds. When questioned, it seemed the Trustees did not know their law firm’s hourly rate for the PREDFA matter and certain other legal services is up to \$475 per hour, and not the \$200 per hour that had been widely believed. When someone in the audience did a simple calculation and

computed that the legal bills for the PREDFA matter involve over three 40-hour work weeks of attorney time (if all the legal fees were billed at \$475 per hour), the Radburn Association Manager disputed this. The Manager did not say why the calculation was wrong. The calculation is \$62,000 (approximate PREDFA expenditures per the *Radburn Bulletin* dated December 2, 2005) divided by \$475 per hour equals a little more than 130 hours. At 40 hours per week, that is over three solid weeks of attorney time that the Radburn Association has paid for.

Additionally, none of the Trustees present seemed at all concerned about the issue raised by the Radburn resident that the attorney's bills and time spent on this matter seemed excessive. When asked, neither the Trustees nor the Manager could provide an estimate of how much the PREDFA matter was going to cost after spending approximately \$62,000 in 2005. When most of us buy things, we look at the price. When we have a contractor come to fix something in our homes, we ask for an estimate. Yet, when PREDFA came up, money was spent and neither the Manager nor the Trustees can or are willing to estimate what the PREDFA matter is going to ultimately cost. I fear this is an example in an ongoing series of Trustee failures to oversee the finances of the Radburn Association.

This fear is not based just on the high costs of legal fees over the PREDFA matter. According to the Radburn Association's federal tax returns, legal fees for the years 2003 and 2004 totaled over \$462,000, less than \$38,000 shy of half a million dollars. Nearly half a million dollars was spent on legal fees in just two years. Not only do the legal fees appear large in dollar terms, but also they appear to be disproportionately large in terms of the Radburn Association's total expenses. Why is so much money being spent on legal fees year after year after year? What matter(s) require almost one in four dollars spent by the Radburn Association to be spent on legal fees?

When asked why it takes 11 months to get incomplete financial information to the residents, and why it takes over 10 months to prepare the Radburn Association's tax return (a tax return that is due in seven and a half months), the Radburn Association Manager replied the accountant is busy and that's the way we have always done it. The reply does not answer the question. However, it raises another question: are the Radburn Association's records in such disarray that financial information cannot be assembled in less than 10 months?

When I asked to see the Radburn Association's financial statements, my request was refused. The purpose of all financial statements prepared in accordance with generally accepted accounting principles (GAAP) is to provide the user with complete information so that the user of the financial statement is able to make an informed decision about the entity whose financial statements he or she is reading. Nothing in a financial statement is confidential. In fact, the entire purpose of financial statements prepared in accordance with GAAP is disclosure. Financial statements prepared in accordance with GAAP are routinely provided to stakeholders, which in this case would include the dues paying residents of Radburn. Financial statements prepared in accordance with GAAP are routinely distributed to and used by management, directors, trustees, investors, banks, financial institutions, foundations, not for profit organizations, charities, government agencies, regulatory agencies and so on. Yet, when I requested the financial statements, the Radburn Association Manager told me it is a corporate matter. In effect, I was told it is none of my business, and none of the business of any of the homeowners in Radburn. As many of the Trustees were present when the Radburn

Association Manager rejected my request to see the financial statements, I ask you, the Trustees, what is in the financial statements that you and the Manager are keeping secret and why?

The Radburn Association is projecting a 2005 deficit of over \$121,000. 2005 is not the only year to show a deficit. According to the Radburn Association's recently prepared 2004 federal tax return, the Radburn Association had a deficit in 2004; despite receiving a "nonrefundable deposit on real estate contract," one time non-budgeted revenue of \$125,000 from Landmark for the sale of Daly Field. According to the Radburn Association's 2003 federal tax return, the Radburn Association also ran a deficit in 2003.

Deficit spending year after year has bankrupted many businesses, homeowners associations, and not for profit organizations. Deficit spending year after year is a clear sign of an organization whose finances are out of control.

When asked about the history of unusually large expenditures for professional services, including projected 2005 professional service expenditures of \$202,000, neither the Trustees nor the Manager were able to provide or were willing to provide an explanation. The Radburn Association Treasurer opened the meeting stating that he knew legal fees were a concern to many people present and that he wanted to discuss them as the last item in the budget hearing. Yet, when the subject came up, it was painfully apparent that neither the Trustees nor the Manager had bothered to acquaint themselves with the large expenditures concerning legal matters. This was evidenced by answers that were vague and unresponsive to homeowners' questions.

When a resident asked the Manager about the cafeteria plan, the Manager explained that the plan was funded by the employees and that it "did not cost the Radburn Association anything." The *Radburn Bulletin* of December 2, 2005, shows a projected 2005 cost of \$12,930 and a 2006 budgeted amount of \$13,000.

All of these observations, taken together, appear to indicate a weak control environment and material weakness in the Radburn Association's internal control.

Reportable Conditions and Material Weakness

AICPA Professional Standards AU Section 325, *Communication of Internal Control Related Matters Noted in an Audit*, states:

"This section provides guidance in identifying and reporting conditions that relate to an entity's internal control observed during an audit of financial statements. It is contemplated that the communication would generally be to the audit committee or to individuals with a level of authority and responsibility equivalent to an audit committee in organizations that do not have one, such as the board of directors, the board of trustees..."

"During the course of an audit, the auditor may become aware of matters relating to internal control that may be of interest to the audit committee. The matters that this section requires for reporting to the audit committee are referred to as *reportable conditions*. Specifically, these are matters coming to the auditor's attention that, in his judgment, should be

communicated to the audit committee because they represent significant deficiencies in the design or operation of internal control...”

“A reportable condition may be of such magnitude as to be considered a material weakness. A *material weakness* in internal control is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud ... may occur and not be detected within a timely period...”

The Radburn Association is engaged in massive deficit spending, massive over budget spending, deficit spending year after year, and apparently lacks Trustee oversight of management and Trustee oversight of significant expenditures. These are indications of a weak control environment, which is a material weakness in the Radburn Association’s internal control.

Material weakness is a reportable condition because a correlation exists between weak internal controls and entities experiencing financial difficulties. Weak internal control leaves an organization vulnerable to mismanagement and fraud. I refer to my previous example, Enron.

Fraud Risk Factors

In addition to my concerns regarding material weakness in internal control, I am concerned about fraud risk factors. AICPA Professional Standards AU Section 316, *Consideration of Fraud in a Financial Statement Audit*, states:

“...’The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of misstatement, whether caused by error or fraud. [footnote omitted]’ This section establishes standards and provides guidance to auditors in fulfilling that responsibility, as it relates to fraud...”(footnotes omitted).

“Fraud is a broad legal concept and auditors do not make legal determinations of whether fraud has occurred. Rather, the auditor’s interest specifically relates to acts that result in a material misstatement...”

“Management has a unique ability to perpetrate fraud because it frequently is in a position to directly or indirectly manipulate the accounting records and present fraudulent information...”

“Because fraud is usually concealed, material misstatements due to fraud are difficult to detect. Nonetheless, the auditor may identify events or conditions...Such events or conditions are referred to as ‘fraud risk factors.’ Fraud risk factors do not necessarily indicate the existence of fraud; however, they are often present in circumstances where fraud exists.”

Among the fraud risk factors discussed in AU Section 316 are:

- “Missing documents...”
- Inconsistent, vague, or implausible responses from management or employees arising from inquiries or analytical procedures...
- Denial of access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence might be sought...

- Unusual delays by the entity in providing requested information.”

AU Section 316 further discusses fraud risk factors, including the following:
“There is ineffective monitoring of management as a result of the following:

- Domination of management by a single person or small group (in a nonowner managed business) without compensating controls
- Ineffective board of directors or audit committee oversight over the financial reporting process and internal control.”

Based upon what I observed at the budget hearing, it appears these fraud risk factors are present in the operations of the Radburn Association.

Conclusion and Recommendations

An independent auditor would be obligated under AIPCA Professional Standards AU Section 325 to report these concerns to the Board of Trustees of the Radburn Association. I am not the independent auditor of the Radburn Association, and therefore I am under no obligation to say or do anything about these concerns.

However, I am a resident of Radburn, and I am a Certified Public Accountant. As both a Radburn resident, and as a CPA, I am so concerned about this situation, that I felt the need to alert you, the Trustees, and the homeowners of Radburn to this situation (without being asked and without the expectation of payment). In addition, I am sending a copy of this letter to the Radburn Association’s accountant, as a professional courtesy.

If this situation is allowed to continue, it may adversely affect home values in this community. As Trustees, you are responsible for addressing the material weakness in the Radburn Association’s internal control and the resultant fraud risk factors.

The 2005 fiscal year of the Radburn Association just ended. I therefore recommend in the strongest possible terms that you immediately engage the services of a CPA firm to audit the Radburn Association’s 2005 financial statements. Furthermore, I call upon you to provide the Radburn Association’s 2005 audited financial statements to all the homeowners and residents of Radburn in a timely matter.

Additionally, I call upon you to immediately have a CPA firm do a comprehensive study of the Radburn Association’s internal controls and to make that report public.

If you have any questions concerning anything discussed in this letter, I would be happy to meet with you (pro-bono) and to discuss this situation with you.

I look forward to your prompt response to this letter.

Respectfully submitted,

Gary Konecky, CPA