

# Open Letter to R. Miller Treasurer, GRF Mutual

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December 2, 2009

To: Robert Miller, Treasurer, GRF Board

From: Conrad Grundke, Residents Voice

Subject: \$40.00 per hour charge for gardeners/KPMG & IRC Designation of 501(c)(4)

Bob,

You mentioned that you would clarify the misstatements on page 3 of the November, 2009 issue of "The Voice" newsletter referencing the 2010 budgeted labor charge of \$40.00 per hour that PCM charges the mutuals for a gardener. I am looking forward to that in the Directors Corner.

The following is an excerpt from the article in question:

"If you take our infamous '**Red Book**' (which is the 'ultimate financial yearly budget document') and calculate what PCM charges us for one hour of a PCM gardener's time .... It comes to \$40 per hour. Don't ask a Board Member to justify this cost because most of them haven't a clue. It might not be their fault, in a few instances, because when it comes to wages and salaries, PCM takes on the **"Don't ask! Don't tell!"** approach."

Before I respond I would like to ask the Directors, who are copied on this correspondence, to inwardly answer if they can justify this \$40.00 an hour, as stated in the newsletter above. This is an "open book" test and please use any information that you have in your possession. Just don't cheat and go to PCM for the answer.

If you respond "yes", as the GRF Treasurer at the Board Meeting on December 1, then you should be able to provide the residents with answers to the following questions (please note that I did not ask PCM to provide the answer, I am asking if the Directors can provide the answers):

1. What is the hourly take-home pay for the gardener?
2. What are the hourly benefits?
3. What are the benefits that are included in the benefit package?
4. List the other incremental additions to the "Base pay" ( sum of Salary & Benefits).
5. What are the costs for each of the incremental additions?
6. What is the total of each of the incremental additions?
7. Does it reach \$40.00 per hour?
8. Lastly, are each of the incremental costs (including the base) justified and correct?
  - a. The real issue of course, is, **are you providing "oversight" on PCM's costs?**

When I was a Director, I could not answer these questions without going to PCM and I feel confident in assuming that the current Directors would also be unable to do so. Does this imply

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that the Directors are ignorant? Not necessarily! Some Directors will never have been given the data that would shed light on answering these questions and they could be “justifiably ignorant.” The problem arises when questions are asked of the Directors and they take no action to inform themselves. These individuals are “willingly ignorant.” To those Directors, the residents have every right to feel that they are betrayed in performing their fiduciary duty.

The intent of the article in “The Voice” was to get an “Operational Audit” via the back door. If the Directors would accept the fact that they cannot provide those answers, then it was hoped that they would attempt to get the answers through an outside auditor who could provide that information. One of the purposes of an operational audit is to evaluate the incremental costs in the wages to see if we are charged correctly. One of the major culprits that are identified in this type of audit are the levels of management that a corporation has. Many times these audits recommend removing a level and thereby reducing the labor cost.

It would also allow a bit of “forensic auditing” to be accomplished from this data. By having to delve into the incremental costs, verification of these costs via the general ledger will identify unjustified costs and if the Directors cannot provide this, it might be worthwhile looking for a third party to provide this service.

At the conclusion of the referenced GRF Board meeting, Director Hatch asked Director McNulty if he could provide some comments on a “Forensic Audit.” Director McNulty said that he had been in contact with a top level KPMG employee last year and had discussed this subject with him. The KPMG employee suggested that it would be very costly and we would not benefit from such an audit.

Now let’s try to anticipate **KPMG’s** answer! Do you believe that the following companies should have asked for a “forensic audit”?

1. General Electric
2. New Century Financial
3. Countrywide
4. Bernie Maddof
5. PCAOB
6. PWC/Satyam
7. Fannie Mae, etc.

**KPMG was their auditor** and currently is being sued in excess of 1 billion dollars for their failure to bring to light inconsistencies in their financial books. If you had asked **KPMG** to do a forensic audit on **their clients books by KPMG**, would you have expected **KPMG** to answer; *“Yes! Do an audit and find our errors,”* or, *“NO! Don’t do an audit because, It would cost too much.”*

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As stated in the Aug/Sept 2009 “The Voice” newsletter there are four major audit companies, KPMG being one of them. In reviewing the lawsuits being filed against these companies, it would be a major oversight to not consider the possibility of finding an alternative “small” company. Obviously, the size of the auditing company does not assure quality of service.

Many of the lawsuits originate from illegal suggestions on means of tax evasion. Others for not providing the depth of the audit that is expected of an auditing firm, whether or not it is specified in the “Agreement Letter” that the Finance Director writes yearly to the auditor.

In an effort to not put the Directors on the carpet in the future (don’t want any “willingly ignorant” Directors) it might behoove at least one of you to verify that the suggestion by KPMG to file the GRF taxes as a 501(c)(4) designation (which we did a few years ago) is legal.

For your reference, the following is taken from the website, and pertains to Home Owners Associations:

<http://www.irs.gov/pub/irs-tege/eotopici03.pdf>

“Of the three routes to tax exempt status, IRC 501(c)(4) imposes the strictest standard. To be described in 501(c)(4), a Home Owner’s Association must primarily serve the community rather than the private interests of its members. Therefore the principal obstacle to exemption is the degree of private benefit involved in the operation of the homeowners’ association.”

Do we truly serve Laguna Woods (a community), or, do we serve Laguna Woods Village (private members)? An answer that Directors should be able to respond to without hesitation.

Maybe to conform to the IRC requirements, we should open our clubs to all Laguna Woods residents?

Conrad Grundke