

J. Armand Musey
425 E. 86th Street, PH-A
New York, NY 10028

August 17, 2015

Mssrs. Jeffrey Shavelson and Steven Neuman
Shavelson, Neuman & Company, LLP
30 Jerico Executive Plaza, Suite 200E
Jerico, New York 11753

Re: 425 East 86th Street financials

Mssrs. Shavelson & Neuman,

Thank you for your prompt response to the concerns outlined in my July 18th letter. I appreciate the challenges Mr. Shavelson faced, especially after his recent hospitalization.

After reviewing the changes and the building minutes, however, I am concerned about both the accuracy and completeness of the additional disclosure to the 2014 financials.

The additional disclosure indicates:

12: RELATED PARTY TRANSACTION

One of the board members is a relative of the principal owner of the facade rehabilitation company that performed capital improvement work on the building. The board member has no financial interest in the company performing this work. The facade company provided the lowest bid amongst the five submitted bids. The bidding process was conducted according to normal business practices, including the submission of sealed bids. The relationship between the board member and the facade rehabilitation company was disclosed to the board and noted in the minutes of the relevant board meeting.

I. Issues of accuracy

After reviewing the Co-Op's board meeting minutes, I found the following chronology:

1. July 2010 – Galicia bid for waterproofing project approved. *Note: Galicia had been building's long-time waterproofing contractor.*
2. June 2011 Annual Shareholder Meeting. Mr. Chaney elected to the board and became president.
3. August 16, 2011 meeting – Standard Waterproofing hired to do work including work on F-line. *Note: Little detail provided on this award and no evidence of competitive bidding. No disclosure from Mr. Chaney of*

- relationship to Standard or indication he did not participated in vote or deliberations. (See Exhibit 1 attached)
4. September 20, 2011 Meeting. Standard Waterproofing hired to do work related to 9th floor and courtyard. Note: Little detail provided on this award and no evidence of competitive bidding. No disclosure from Mr. Chaney of relationship to Standard or indication he did not participated in the deliberations. Unanimous vote suggest he voted in favor of using his brother-in-law's firm. (See Exhibit 2 attached)
 5. December 16, 2011. Standard Waterproofing hired to do Local Law 11 inspections. Note: Little detail provided on this award and no evidence of competitive bidding, No disclosure from Mr. Chaney of relationship to Standard or indication he did not participated in vote or deliberations. (See Exhibit 3 attached)
 6. January 17, 2012 meeting. Proposals requested from five contractors for waterproofing work. Mr. Chaney was heavily involved in settlement terminating Galicia Waterproofing that created opening for new contractor. No explanation offered for termination of contract with Galicia or the price difference. Note: It seems there was settlement related to Galicia's termination, but that may have been for previous work they completed, the minutes are unclear as is the net savings/cost of changing contractors. No indication in prior minutes of concerns about Galicia's work (See Exhibit 4 attached)
 7. April 11, 2012 meeting. Board considered revised proposals from two waterproofing companies, Standard and United. No explanation about the down-selection process from five to two, or what the revisions to the prior bids entailed. The Board considered a number of subjective factors and the minutes indicate the bids were not identical. Board unanimously voted to award a \$510k contract to Standard Waterproofing without indication it was the lowest price. Since the bids were not identical, the lowest price might not be indicative of best value. Minutes indicate Mr. Chaney gave statement that his brother-in-law was owner of Standard Waterproofing, but that Mr. Chaney himself had no financial interest. This disclosure appears to have occurred AFTER the down-selection process from five to two bidders. Note: No indication Mr. Chaney excused himself from discussion related to decision. Because vote was unanimous, presumably Mr. Chaney voted (as opposed to excusing himself). No indication that he excused himself from discussions surrounding later supervision of Standard's work, approval of their work, change orders etc. (See Exhibit 5 attached). Financials indicate \$331,000 was spent on façade work in 2012, \$610,861 in 2013, and \$13,801 in 2014. This is almost double the \$510,000 in the April 2012 contract award. How much of this was paid to Standard? Were these changes negotiated on an arms-length basis? Later minutes strongly suggest Mr. Chaney was involved in many of the details of the project. (See Exhibit 6 attached)

Summary

The board meeting minutes suggest a process is quite different from what the new Footnote 12 implies - that selection was done on a sealed bid basis from five bids and that Standard was picked because they were the lowest price. Moreover the implication that Mr. Chaney disclosed his relationship to the board before Standard

was given any work from the building is inconsistent with the board's meeting minutes.

II. Issues of Completeness

AICPA rules require this disclosure (FASB ASC 850) as well as a discussion of the adequacy of controls around the transaction and the risks. According to the AICPA, the following disclosures are required:¹

- The nature of the relationships involved. <INADEQUATE – ONLY IDENTIFIED AS “A BOARD MEMBER” AND “RELATIVE,” NOT THE THEN “BOARD PRESIDENT” AND “IMMEDIATE FAMILY MEMBER” AS MY JULY 18, 2015 LETTER SHOWS ANDREW WIST TO BE>
- A description of the transactions, including transactions where no amounts or nominal amounts are involved, for each of the reporting periods where income statements are presented; additionally, other information deemed necessary to gain an understanding of the effects of the transactions on the financial statements should be disclosed. <INADEQUATE - ONLY SINGLE DISCLOSURE FOR 2014 AS A “CAPITAL PROJECT” AND DOES NOT DISCUSS THE 2011 AWARDS THAT WERE NOT CAPITAL PROJECTS, OR MENTION OF 2012, or 2013 WORK>
- The dollar amounts of the transactions for each of the reporting periods where income statements are presented along with the effects of any change in the method of establishing the terms of the transactions when compared to the method used in the preceding reporting period. <MISSING – NO DOLLAR AMOUNTS PROVIDED FOR ANY PERIODS – 2011, 2012, 2013, or 2014>
- Amounts due to or from related parties as of each financial statement date and, if not otherwise apparent, the terms and manner of settlement related to those amounts. <MISSING – NO DOLLAR AMOUNTS PROVIDED FOR ANY PERIODS – 2011, 2012, 2013, or 2014>
- No discussion of the cost impact of changing waterproofing contractors (including termination costs) from Galicia Waterproofing to Standard Waterproofing.

Additionally, the AICPA practice note indicates: *“In circumstances where they are made, representations about related party transactions are precluded from implying that the transactions were consummated on terms equivalent to those that prevail in arm’s-length transactions unless the representations can be substantiated.”*² Given the context, I’d expect greater substantiation around the implication that the awards to Standard were arm’s-length, especially issues surrounding later supervision and approval of their work, change order approval and holding them accountable for the quality of their work as building leaks have so quickly reappeared (See Exhibit 7)

¹ See: FASB ASC 850: Related party Transactions & Disclosures, <http://www.aicpa.org/interestareas/centerforplainenglishaccounting/resources/2012/pages/fasb-asc-850-related-party-transactions.aspx>

² See: FASB ASC 850: Related party Transactions & Disclosures, <http://www.aicpa.org/interestareas/centerforplainenglishaccounting/resources/2012/pages/fasb-asc-850-related-party-transactions.aspx>

The building is apparently now spending additional money from the Co-Op's reserve fund on Standard Waterproofing (See Exhibit 7) despite assurances during the June annual meeting that the reserve fund increase would be used for plumbing issues.

Fiduciary obligations generally require a board member with an actual or perceived conflict of interest to 1) disclose the conflict to other board members at the earliest practical time; 2) excuse themselves from deliberations and voting on the issue(s); 3) otherwise insulated themselves from involvement in the project; and 4) ensure the (potential) conflict is noted in the financials for that period and/or otherwise disclosed to shareholders generally. Based on the Board Minutes, each of these basic governance expectations appears to have been significantly breached.

Summary

As the Co-Op's auditor, you may have access to additional information that explains the need for omitting information and the discrepancies I found. But as a shareholder for whom these financials are intended, I find the missing information described above to severely limit my understanding of the situation and the newly added Footnote 12 to be materially misleading. In fact, it is impossible to even determine the amount of money ultimately paid to Standard Waterproofing. The context around which this happened – the largest contract in the building's history - is even more troubling. It also appears to be inconsistent with both the letter and spirit of GAAP.

As you are aware, each of the Co-Op's shareholders made large investments in the building. We rely on the vigilance and objectivity of the auditor to provide complete and accurate information about its financial condition based on information available. Certainly the auditor would have access to the minutes of the board meetings. These should have resulted in additional follow-up questions. I trust you will work to promptly resolve or explain the situation.

Regards,



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cc: Mr. Stuart Sugarman - Hinman, Howard & Kattell, LLP