

How We Beat a New Jersey Ponzi Scheme

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NJ AFFORDABLE HOMES Corp. (NJAH) was an entity established in 1992 for the stated purpose of investing, rehabilitating and selling homes in various communities in New Jersey. In 1995, after receiving complaints and determining that NJAH was not fulfilling its required reporting obligations to investors, the Securities and Exchange Commission was granted a Temporary Restraining Order and a receiver was appointed to investigate the affairs of NJAH. Shortly after his appointment, the receiver retained us as his accountants and financial advisors.

We immediately went to NJAH's office and began our investigation. Within two weeks, we had confirmed that the numerous related entities involved in this matter were commingling funds. We made two other initial determinations: (1) many of the related entities were formed immediately after the Internal Revenue Service filed a levy on NJAH's bank accounts, with apparently no valid business purpose; (2) investor funds and property sale closings were deposited into different accounts with no apparent business purpose for the differentiation. Additional evidence of commingling included rent checks payable to one entity being deposited in bank accounts in the name of separate related entities. Funds were transferred back and forth between the different entities with no record of the purpose for the transfers, even into entities established (per NJAH's personnel) for specific purposes unrelated to the transfer of funds.

Evidence of the lack of proper accounting procedures included the lack of agreement among the various entities as to the inter-company balances. For example, the internal records indicated Entity A owed Entity B \$780,000 as of a particular date, whereas entity B showed it was owed \$910,000 by entity A as of the same date. One former employee indicated to us that the inter-company accounts had never been reconciled. We also discovered that bank accounts in the name of certain entities were included in the internal accounting records of different entities.

NJAH's handling of internal operations further demonstrated the commingling of funds in that expenses of various entities were sometimes paid by the entity incurring the expenses and at other times paid by other related entities.

Perhaps most compelling was our determination that of the more than 200 various purported investments held by NJAH and related entities, funds used to pay the mortgages were paid by the various related entities with no attempt to match the source of the payments to the mortgages being paid. Even more extreme, the entity paying the mortgages would in many cases have received funds from yet a different related entity in order to make the payment. Although investors were led to believe they were owners of certain properties, our tracing of the funds revealed that—in many cases—their invested funds could not in any way be traced to the properties they were told they owned.

There was no attempt to account for invested funds, property management funds (i.e. rent and expenses related to a particular property) or closing proceeds on a property-by-property basis. In fact, in most cases, when investors deposited funds with NJAH, the money was simply commingled with other funds and transferred across the various entities for no apparent business purpose, but rather was used to prop up the business and pay out other investors in a classic Ponzi model.

With six years worth of tax returns showing an accumulated loss of \$60 million together with all our documentation and evidence that the operation had not been self-sustaining, we issued a report to the receiver, ultimately resulting in his determination to put the entity into a Chapter 7 proceeding.

Using our investigation as well as information developed by the FBI and the SEC, the U.S. Attorney was able to achieve convictions of the defendants without the necessity of lengthy trials. ■

Bederson & Company Partner Matthew Schwartz, CPA/CFE, CIRA, CFE, MBA, and Manager Shari Hartstein, CIRA, received medals and recognition from the FBI for their role in unraveling a New Jersey Ponzi scheme. For more information, visit www.bederson.com.

