

[CORRECTED VERSION ALSO REFLECTS BOARD ACTIONS ON
JUNE 30, 2011]

June 28, 2011

THE VAUX CONDOMINIUMS OWNERS' ASSOCIATION
FINANCIAL COMMITTEE MID-YEAR REVIEW REPORT TO THE
BOARD OF DIRECTORS

(Prepared by Larry Emery)

Introduction

The purpose of this review was to assess the financial reports prepared by CMI as of May 31, 2011 and to arrive at recommendations considered appropriate for Board Action.

Note:

- This report is organized by the order in which the financial reports are presented by CMI except that work sheets and reference materials are discussed the first time they come up in the related report documents.
- The Community Manager, Nancy LaVoie, advises that CMI agrees with all recommendations.
- All Buildings and Grounds and Finance Committee members concur.

Balance Sheet For The Period Ended May 31, 2011

This discussion is intended to clarify terms and relationships between selected elements of the Balance Sheet. It also includes recommendations for title or label convention changes to clarify the Balance Sheet content for owners.

Association financial resources are classified for accounting and reporting purposes in the following funds established according to their nature and purpose:

1790 Operating Fund - This fund is used to account for the financial resources available for Common Expenses of the Association, and includes the sum of current accounts receivable, checking account balances, and savings account balances. (Bylaws Sections 5.1 and 5.3)

1950 Working Capital Fund - Under current policy established by the Board of Directors, this fund is used to accumulate a working capital reserve to meet cash flow requirements beyond funds currently available in the Operating Fund and is adjusted on an annual basis to maintain a reserve level equal to two months average of the current year operating budget of the Association. The working capital fund is used to meet contingencies and replacements not covered by the Replacement Fund. The working capital fund may be used to cover extraordinary expenditures not originally included in the annual estimate that may become necessary during the year. (Bylaws Sections 5.5.2 and 5.5.3)

1908 Replacement Fund - This fund is used only to accumulate financial resources for replacing Common Elements that will normally require replacement in more than three and fewer than thirty years as required by the Maintenance Plan and exterior painting of Common Elements. The Board of Directors may borrow amounts from the reserve fund to meet high seasonal demands on funds obtained from regular assessments or to meet other unexpected increases in expenses that will later be paid from special or regular assessments, if the Board of Directors has adopted a resolution, which may be an annual continuing resolution, authorizing the borrowing of funds. (Bylaws Section 5.2)

As one tries to understand the statements, it is important to note that the amounts reflected in the **ASSETS** section for accounts are different than the amounts in the **MEMBERS' EQUITY** section for like named entries. Confusing? Yes! One reason is that the equity section reflects the impact of accrual accounting adjustments. Another reason is that the labels are misleading.

Let's try to sort this out.

ASSETS

Current Assets (NOTE FOR FORMAT CONSISTENCY LABEL SHOULD BE ALL CAPS)

1000 Cash in Bank – Checking \$ 3,285.31

This amount is net of outstanding checks written but not cleared or cashed. The USBank Statement for Checking reflects a balance of \$7,680.87.

The difference is explained by the bookkeeper's accompanying worksheet: The Vaux Condominiums (178) US Bank OPERATING Account Reconciliation For The Month Ended May 31, 2011, which deducts \$4,395.56 for un-cleared checks outstanding.

This reconciliation presentation would be clearer if:

- The term OPERATING in the title were changed to CHECKING ACCOUNT, as the checking account balance is only one component of total operating funds.
- The side head label, Beginning Balance Per BANK STATEMENT is really the Ending Balance Per BANK Statement and should be changed accordingly.

1140 Accounts Receivable – \$ 27,523.85

The Accounts Receivable Aging Report attached to the financial statements combines the HOA Assessments due from owners (positive entries -- \$27,523.85 for May) and Advanced Payments of HOA Assessments by owners (negative entries -- \$13,788.64) that are carried on the books as current liabilities until earned. In theory these are current liabilities because if owners sell their units such advance payments must be refunded.

In the future, it would be clearer to present the two buckets separately in the Accounts Receivable Aging Report with subtotals that track to the Balance Sheet entries.

1142 Doubtful Accounts Receivable – (\$5,004.37)

According to the 2010 Draft Audit report, the Association has provided for an allowance for doubtful accounts as of December 31, 2010, based on discussion with the Association's community manager regarding the collectability of assessments receivable. The Association considers assessments receivable collectible until the unit has been foreclosed or the unit owner has filed for bankruptcy.

The amount included on the May 31, 2011 Balance Sheet is the same as the amount included as of December 31, 2010 in the draft audit report.

While the details of foreclosures and bankruptcies are confidential, the total amounts and trends are of interest to owners and should be disclosed monthly by adjusting the Doubtful Accounts Receivable amount each month. It is important to note that as of May 31, 2010, we have an additional total of (\$5,106.30) identified as in the foreclosure process.

CMI should encourage owners who are chronically late payers to consider automatic payments. It would also be helpful to note in the report the trends for late payments, collection actions, and foreclosures (perhaps as a graphic).

In addition, we have been carrying an account payable in the amount of \$4070.44 related to an old foreclosure in which the owner had prepaid their assessments, but the person cannot be located. CMI should consult with the auditor as to when this amount should be written off the books.

1265 Prepaid Insurance -- \$3,363.16

This asset liquidates, as the time period advances, and is a consequence of accrued accounting practices that recognize premiums prepaid for future periods as an asset because, if the policy were canceled the excess premiums would be refunded.

DESIGNATED CAPITAL AND UNDESIGNATED OPERATING FUNDS

The terms Designated Capital and Undesignated Operating Funds are not defined, but apparently:

- Account 1908 Replacement Fund and account 1950 Working Capital Fund are considered as designated meaning restricted as to use.
- Account 1790 Operating Fund – considered as undesignated meaning unrestricted as to use.

Notes:

- See definitions of these funds above as reflected in the annual audit report and previously approved by the Board of Directors.
- The amounts reflected for these accounts track to the balances contained in the US Bank Statement entitled COMMUNITY ASSOCIATION MONEY MARKET SAVINGS, and also track to the amounts reflected in separate work sheet prepared by CMI entitled, THE VAUX CONDOMINIUM (178) INVESTMENTS
- In the bank statement the funds are comingled, but separated in the CMI bookkeeping report, it is not clear how the interest earnings are attributed in the balances.
- The terms designated and undesignated are not particularly useful and should be discontinued.
- This section title should be changed to **INVESTED BALANCES**

FIXED (LONG TERM) ASSETS

The VAUX does not own such. Obviously the site and common area facilities are assets, but are not for sale so are not scored as financial assets. An example of a fixed (long term) asset would be a residential unit if owned by the association and rented out to owners for short-term guest accommodations.

LIABILITIES AND EQUITY

CURRENT LIABILITIES

2100 Accounts Payable \$ 10,447.62

Reflects invoices received but not paid, ties to the included Accounts Payable Aging Report listing.

2101 Accrued Accounts payable \$ 12,534.31

Reflects, as identified by CMI, services received, but for which no invoice has been received from vendors.

CMI should provide a report each month listing each item.

2140 Prepaid A/R \$13,788.64

Reflects HOA fees collected, but not accrued. These details are included in the accounts receivable aging report as negative entries, which are reduced as time passes to reflect accrual of the revenue each month.

LONG TERM LIABILITIES

None is a good thing, an example of such would be if the Board chose to finance a capital replacement or investment requirement by borrowing funds from a bank or other financial institution.

MEMBERS' EQUITY

3100 Designated Replacement Fund \$625,487.83

Note this label is a misnomer as we have no such fund, per se, but rather this is the sum of the balances in the 1950 Working Capital Fund account and the 1908 Replacement Fund account.

CMI should change the name of 3100 to Capital Reserve Investment Balances Start of Year.

Current Year Addition \$ 67,246.54

Note this amount is a net increase to members' equity and is a combination of the planned contributions to the:

- Replacement fund \$11,444.42 per month X 5 months = \$57,222.10; plus
- Working Capital Fund from unit sales \$3,104.02; plus
- Interest earnings on total money market account YTD \$439.40;
- PLUS a Miscellaneous deposit of \$6,525.00.

Note the interest earnings reported in the **Members' Equity** balances and included in the **Actual to Budget Revenue and Expense Variances for the Month Ended May 31, 2011** total \$395.42, even though the money market bank statement reflects Interest Paid This Year as \$439.40. This is because CMI prorates a portion of the interest earned to operations.

Note there is a minor discrepancy in the summation that CMI will sort out.

Total Reserves (Designated) \$692,734.37

This amount equals the sum of the amounts for account 1908 Replacement Fund -- \$605,688.37 and 1950 Working Capital Fund \$87,046.00 in the asset section of the balance sheet. Perhaps there are no accruals impacting these accounts.

CMI should change the subtotal label to **Total Capital Reserves Invested.**

3145 Undesignated Operating Fund \$61,371.64

Presumably this is the bookkeeping record amount at the start of the year reflecting the annual audit results for 2010.

CMI should change the name of 3100 to **Operating Reserve Investment Balance Start of Year.**

Current Year Addition (\$3,491.89)

This amount is the mathematical differences between YTD actual operating income of \$194,741.48 and YTD actual operating expenses of \$198,233.37 (see **Actual to Budget Revenue and Expense Variances for the Month Ended May 31, 2011** document); that is, since we spent more than we collected the difference reduced members' equity by a like amount.

Total Operating (Undesignated) \$57,879.75

CMI should change this label to Total Operating Reserves Invested.

As noted above the terms designated and undesignated should be discontinued.

To recap Change in Members Equity as of May 31, 2011

Members Equity start of year	\$686,859.00
Additions to Replacement Fund And Working Capital Fund	\$ 67,246.54
Less current expenses in excess of current operating revenue	<u>(\$ 3,491.89)</u>
Net Current Members Equity as of May 31	\$750,613.65

Finance Committee Recommendation: That the Board adopt the above highlighted changes in report format and directs CMI to take make the changes beginning with the June Financial Reports.

Board Action:

Approve X Disapprove Other as noted

Actual to Budget Revenue and Expense Variances for the Month Ended May 31, 2011

Note to clarify the nature of this report, CMI should use the title indicated above.

Board Action:

Approve X Disapprove Other as noted

While there are pluses and minuses for both revenues and expenses disclosed in the May report, which is to be expected, the actual expenses for 6105 (natural gas) and 6690 (building maintenance) are running at an unsustainable rates.

Accounts with significant variances are discussed below with the exception of those where the going rate variances are not relevant to the expense category, e.g. 6511 Carpet Cleaning that has not been scheduled, or in those cases where the variances are not expected to create a funding issue.

Approved balanced budget total: (Revenue/expense)	\$598,095.00
Earmarked for Replacement Fund Contribution	<u>\$137,333.00</u>
Net budget for operations	\$460,762.00
Less Contingency Expense budget	<u>\$ 33,978.00</u>
Total Planned Operations Expenses	\$426,784.00
Total Expenses from Operations	\$198,233.37

6060 Electric

Budget	\$ 43,200.00
Actual as of May 31	\$ 16,142.96

The original budget estimate assumed a rate increase of 3% as of January 1, 2011. Savings related to the LED lighting upgrades in the garage and stairwells offset this increase. Current expenses are running 10.3 percent below budget.

For the past three years the overall average per month ran at \$3,630.00 and this year to date the average is \$3228.40. A review of historical data suggests that electricity expenses are fairly uniform with winter heat and lights balancing out against summer cooling. At the current rates we may see a saving in this account at year-end of about \$4k.

Finance Committee Recommendation: Maintain current Electric expense budget without change.

Board Action:

Approve X Disapprove Other as noted

6105 Natural Gas

Budget	\$ 32,400.00
Actual as of May 31	\$ 20,138.76

The original budget estimate assumed no increase in rates for 2011. NWNG has published a 1 % rate increase effective June 1, 2011.

The current actual expense rate is running 49.2 % over budget. At this rate we will exhaust the budget by the end of August. CMI will ask NWNG to run tests on the water boiler burners to make sure they are calibrated for best efficiency. But the reality is we have unbudgeted expense that are relatively uncontrollable.

Actual expenses have averaged \$37,902.39 per year. Last year the actual was \$36,722.80, but at the time the budget was prepared CMI expected to end 2010 at \$32,659.68.

Clearly with have had a very long period of record rainfall and record low temperatures that were not anticipated (second coldest and wettest in 117 years according to the Oregonian). Historically, gas consumption falls off this time of year and doesn't ramp up again until November. However, we have had other peak years, for example 2009 hit \$40,729.27.

Finance Committee Recommendation: Based on the actuals for June through December 2011 plus the 1 % rate increase, increase the current budget from \$32,400.00 to \$40,400.00. This increase of \$8,000.00 is to be transferred from the Contingency Expense budget account.

Board Action:

Approve X Disapprove _____ Other as noted _____

6150 Sewer

Budget	\$ 42,000.00
Actual as of May 31	\$ 16,428.64

The original budget estimate assumed a 10% increase in rates for 2011 effective July 1, 2011. The City Council has approved a 6.0 % rate increase effective July 1, 2011. The current consumption rates lag budget by 6.1 %. Applying the 6% rate increase for the last 6 months of the year and using the average monthly consumption rates YTD suggest a possible budget savings in the \$1,000 to \$2000 range.

Finance Committee Recommendation: Maintain current sewer expense budget without change.

Board Action:

Approve X Disapprove _____ Other as noted _____

6195 Water

Budget	\$ 13,200.00
Actual as of May 31	\$ 5,931.96

Budget was estimated based on anticipated end of 2010 actual plus a rate increase effective July 1, 2011 of 6%. Current consumption rate is running 7.9% over budget. The City Council has approved a rate increase effective July 1 of 12.9%.

Finance Committee Recommendation: Increase current budget by \$2,000.00 to recognize consumption rates and new rate increase for the balance of the year, transferring funds from the Contingency Expense budget account.

Board Action:

Approve X Disapprove Other as noted

6525 Access Control Systems

Budget	\$ 400.00
Actual as of May 31	\$ 737.95

This budget was to correct the situation where fobs would not work when power was out, a one-time expense. Mislabeled in the Financial Report as Garage/Carport.

Finance Committee Recommendation: No change.

Board Action:

Approve X Disapprove Other as noted

6690 Building Maintenance

Budget	\$ 39,000.00
Actual as of May 31	\$ 37,766.00

This budget account is currently exhausted with 7 months remaining in the year. From the Balance Sheet we have \$12,534.31 Accrued Accounts Payable; CMI confirms that there are no maintenance items included. By definition, the Accounts Payable total of \$10,447.62 has all been expensed and is reflected in the accounts.

The discussion that follows focuses on questionable Building Maintenance Expense items through May 31 and provides recommendations for Board Action.

Gas Leak Related Expenses 2/24 – 5/26:

Gas related items include expenses of CMI Maintenance Division, Plumbing vendors, and Locksmith service calls.

Finance Committee Recommendation: Transfer these expenses to the budget contingency expense account \$7,502.63. Unlike the other items for which we recommend budget adjustments to the accounts, these costs are clearly contingency expenses and should not result in a base adjustment for the building maintenance program.

Board Action:

Approve X Disapprove _____ Other as noted _____

LED Lighting Upgrades Stairwells and Lobbies

This project clearly is an appropriate charge to the Replacement Fund as a capital investment to mitigate future light replacement costs. The associated sale of the tax credit of \$6,525.00 has been credit to the Replacement Fund as miscellaneous revenue. The Building Maintenance list identifies \$5,334.03 for this purpose, but other costs may not be broken out.

Finance Committee Recommendation: Board directs CMI to identify and transfer all associated lighting upgrade costs for 2011 from Building Maintenance Operating Expenses to the Replacement Fund.

Board Action:

Approve X Disapprove _____ Other as noted _____

Broken Window Unit 121

This window was broken by the police based on a welfare check request from a friend of the resident. It was determined that the resident was in distress. The cost to secure and replace the damaged window totals \$895.78.

Finance Committee Recommendation: Direct CMI to recover these costs from the owner of Unit 121 consistent with owner's responsibility Section 20.2 of Declarant document. See also Bylaws Sections 5.7 (page 19), 8.1.1 (page 28), and 8.1.3 (page 29).

Board Action:

Approve X Disapprove _____ Other as noted _____

Storage Unit Latches

Repair cost was \$17.23. Unless this repair was necessitated by CMI action, this cost is the unit owner's responsibility.

Finance Committee Recommendation: Direct CMI to recover these costs from the owner of the storage unit or units consistent with owner's responsibility Section 20.2 of Declarant document. See also Bylaws Sections 5.7 (page 19), 8.1.1 (page 28), and 8.1.3 (page 29).

Board Action:

Approve X Disapprove _____ Other as noted _____

Deck Drain Investigation Unit 201

It was discovered that this drain is not connected to the building drain network and is an apparent hidden construction defect. Reported costs total \$1,409.90. Additional costs have been incurred related to this on-going forensic investigation.

Finance Committee Recommendation: This work should not be classified as routine maintenance but should be transferred to the contingency expense budget. Direct CMI to transfer these costs to the contingency budget and charge all other related costs to contingency.

Board Action:

Approve X Disapprove _____ Other as noted _____

Cut locks

The report includes a total of \$173.67 for removal of private lock boxes.

Finance Committee Recommendation: Direct CMI to recover these costs from owners of the locks and to do so in the future when like cases arise pursuant to Owner Responsibilities Section 20.2 of Declarant document. See also Bylaws Sections 5.7 (page 19), 8.1.1 (page 28), and 8.1.3 (page 29).

Board Action:

Approve X Disapprove _____ Other as noted _____

Shower Valve Repair Unit 319

The report includes a total of \$250.00 for this repair, which should be a unit owner's expense in the view of both Buildings & Grounds and Finance Committees.

Finance Committee Recommendation: Direct CMI to recover these costs from unit owner. Board should clarify policy on where unit maintenance expenses fall to the HOA versus the owners pursuant to Boundaries of Units Section 4.3.1 and Section 5 Owner's Interest in Common Elements; General Common Elements. See also Bylaws Sections 5.7 (page 19), 8.1.1 (page 28), and 8.1.3 (page 29).

Note: New Information -- Subsequently Nancy LaVoie reports that the owner stopped her in the hall a couple days after the gas shut down. She told me that after the hot water came back on, she couldn't get any hot water in her shower. Nancy personally inspected it with Lonnie from Peninsula, and both agreed that this was almost certainly caused by some debris that broke loose in the plumbing pipes as a result of the temperature fluctuations during the shut down. Nancy told her we would dispatch D+F for her, and if it turned out to be her faucet that was faulty, she would probably end up with the bill, but if it was solder flakes as we suspected, the HOA would most likely take care of it.

Nancy warned her that regardless she may end up with the bill because it wasn't CMI's call, but she needed a plumber and agreed that if she had to, she would take care of the bill.

Board Action:

Approve _____ Disapprove X Other as noted _____

Note: Board concluded that based on CMI Maintenance Division representations of cause that the Association should pay for repairs as an exception.

Main Breaker Repair Unit 319

The report includes a total of \$1,317.35 for this repair, which was a failure of the central power breaker for this unit. This was not repair or replacement of circuit breakers in the unit itself. Therefore, these costs are appropriately charged to routine maintenance.

Finance Committee Recommendation: Board should ratify decision to assume responsibility for this cost on behalf of the Association.

Board Action:

Approve X Disapprove _____ Other as noted _____

Note: If all of these recommendations are approved, the net result will be a reduction in Building Maintenance account expenses by \$15,583.24 +or- to \$22,182.76 leaving a \$ 16,817.24 budget balance available for the remainder of the year. This will require much closer oversight of the maintenance work orders from here on out.

7120 Consultants

Budget	\$ 1,000.00
Actual as of May 31	\$ 2,912.00

The major cost spike is \$2,352.65 for the hiring of Rodger G. Bekooy, PE, LLC for assessment of the gas leak situation.

Finance Committee Recommendation: Direct CMI to transfer these costs to the contingency expense budget.

Board Action:

Approve X Disapprove _____ Other as noted _____

Contingencies

Budget	\$ 33,978.00
Actual as of May 31	\$ 0.00

CMI is not presenting this operating expense account properly in the monthly budget variance schedules. It is intended that this account be treated as a normal operating expense account, but with a couple of wrinkles. That is, when unbudgeted routine expenditures arise that are properly base operating expenses, such as unanticipated cold weather related gas consumption or unbudgeted utility rate increases, then with Finance Committee and Board approval an adjustment should be made to the operating expense line item budget and a corresponding reduction to the Contingency operating expense budget.

On the other hand when operating expenses arise that are unusual, such as the gas leak related expenses discussed above, then such costs, with Buildings and Grounds Committee approval, should be charged directly to the Contingency operating expense account.

If the recommendations of the Finance Committee were applied as detailed above, the changes would be reflected as follows:

Budget	\$ 33,978.0
Budget Adjustments	<u>(\$ 10,000.00)</u>
Revised Budget	\$ 23,978.00
Actuals as of May 31	\$ 11,265.18

Finance Committee Recommendation: Direct CMI to:

- Set up an operating expense account for contingencies,
- Eliminate the earmark or designation of Homeowners Fees for contingencies in the Income section of the monthly budget variance report, and
- Adjust the budget for contingency operating expenses and actuals as stipulated above (adjusting amounts for actual expenses from the accounting records).

Board Action:

Approve X Disapprove Other as noted

Year –to-date Ledger - Accrual

This report while important for audit purposes provides a level of detail of little immediate concern to Owners or the Board.

Finance Committee Recommendation: Direct CMI to remove this report from the monthly financial reports submitted to the Board and the Finance Committee.

Board Action:

Approve X Disapprove Other as noted

Accounts Receivable Aging Report

This report is important and should be continued, but as recommended earlier should be reformatted. In addition, a useful graphic to reflect trends should be included.

Finance Committee Recommendation: Direct CMI to develop and report a graphic presentation to reflect trends over time.

Board Action:

Approve X Disapprove Other as noted

Accounts Payable Aging Report

No changes recommended useful report as presented.

US Bank Business Statement Community Association Checking with Interest

No change except that the bank statements and related worksheets should be included in the financial reports immediately following the Balance Sheet.

Finance Committee Recommendation: Direct CMI to reorder the statements and worksheets as stated.

Board Action:

Approve X Disapprove Other as noted

The Vaux Condominiums (178) US Bank OPERATING Account Reconciliation for the Month Ended

Finance Committee Recommendation: Direct CMI to substitute “Checking” for “OPERATING” in the report title; and substitute “Ending” for “Beginning” in the description of the first entry

Board Action:

Approve X Disapprove Other as noted

US Bank Business Statement Community Association Money Market Savings

No changes.

THE VAUX CONDOMINIUMS (178) INVESTMENTS

Finance Committee Recommendation: Direct CMI to Adjust fund naming convention to remove designated and to separately identify the Working Capital Fund and the Replacement Fund. In addition to attribute appropriately investment earnings between the three accounts, and to reflect the YTD interest earnings for each account in the table.

Board Action:

Approve X Disapprove Other as noted