

FAIRLINGTON GLEN SUMMARY OF AUDIT OF CALENDAR YEAR

August 19, 2019

- Maynard H. Dixon, Treasurer

A corrected version of the audit of 2019, prepared by Goldklang Group, our audit and tax consultant, was completed in mid-August 2020, after an earlier version had been approved by the board at its June 2020 meeting.¹ The public portion of the audit will be published on the Glen's website.

The account balances from the audit appear in the Audit/Budget Table below. If you need more information or explanation, please e-mail me at maynardDixon@verizon.net.

During the audit, the auditor corrected the prior audits of 2017 and 2018 to re-classify legal expenses for environmental litigation to Account 61370 Damage Claims because we have a creditable claim for their reimbursement. For the details, see p. 11 of the audit report. This re-classification mainly affected 2017 (not shown in the table below). The 2018 operating results were revised only by an increase in Account 61370 Damage Claims from the originally reported \$44,211.38 to the \$44,329.88 in the table below.

Bottom Line Results

A key measure of the Glen's financial health is its operating results, comparing income with operating expenses. The Glen has always incurred operating surplus. An operating surplus allows us to contribute to reserves. Whether we end-up contributing as much to our reserves as we budget in any given year depends on how accurately we estimate revenues and expenses.

We ended 2019, as we always have, with an operating surplus; but our actual operating expenses exceeded out budgeted operating expenses by \$31,497. This was a large part of the loss of (\$32,227) that appears on the bottom-line Balance of Income and Uses in the Audit/Budget Table below.

Our overall results, however, were still quite favorable:

1. The Glen's operating results reflect expenditures to fix real maintenance and environmental problems, rather than weak revenue from unpaid dues or rising costs of utilities and administrative management costs.

¹ This analysis reflects the addition of a \$19,350 late 2019 payment for a reserve expense that had been mistakenly kept in accounts payable for payment in 2020. This transaction was discovered by the auditor after an earlier version of this article was published in the July 1, 2020 *Glen Echo*.

2. Despite our overall budget loss, our net worth, as shown at the bottom of the table below, increased by \$166,973. This happened because the funds contributed to reserve accounts exceeded the decrease in funds available for operations.

3. As explained in greater detail below, a large part of the \$32,227 overall budget loss can be attributed to \$19,219 in damage claims for attorney fees that will most certainly be reimbursed when our environmental litigation settles, probably by the end of 2020.

Here are the highlights of the audit, with the numbers in the discussion rounded to the nearest dollar:

Revenues

- **Interest.** An important part of our finances is the interest earned on Glen reserves, which is reported in Account 30270. In 2019, the Glen earned \$53,192, in comparison to the \$42,767 earned in 2018. The increase was due to the growth in our investable reserves, not more favorable interest rates. The interest earned on the Glen's reserves has been lagging due to the Federal Reserve Board's policy of keeping interest rates low to stimulate the economy – good for borrowers but bad for savers.

- **Bad Debt Recovery.** In 2019, as in 2018, the Glen recovered no bad debt revenue from debts that had previously been written-off. This is not unusual – from 2011-2019, the Glen recovered no bad debt revenue during 4 of those years. This result cannot be explained by lack of enforcement effort. The Glen has a vigorous dues collection program that recovers assessments that are overdue and a substantial portion (up to what the courts allow) of the legal fees spent to recover them. The most likely explanation is that the delinquency that generates our recovery effort has been low, as evidenced by the low delinquency lists in our management reports each month.

Operating Expenses

In 2019, our total operating expenses of \$1,055,941 were: (a) \$31,497 more than our budgeted operating expenses of \$1,024,444; and (b) \$47,868 more than the \$1,008,073 spent in 2018. As shown below, the main culprits were maintenance costs, the Account 51106 Professional Fees for bidding contract administration, and the legal cost of environmental litigation against a nearby shopping center:

- **Administrative.** In 2019, our Total Administrative Expense of \$168,253 substantially exceeded our budgeted \$151,254. A huge increase in our Account 51106 Professional Fees was responsible for most of the overage. These fees are paid to our engineering consultant, Restoration Engineering, Inc. (REI), for administration of projects that are not administered by our management company, such as roof replacement and maintenance, major sewer projects, brick repair, and parking pavement repair.

At its February 2020 meeting, the Board resolved that the typically large engineering fees that are an integral part of large reserve expenditures projects will

henceforth be charged to reserves; so, in future years, the swings in these large fees will not play havoc with our operating budget.

- Employees. In 2019, our total payroll-related expense of \$143,076 was slightly less than our budgeted \$145,293. Some of the under-budget was due to our not spending what was budgeted for temporary help. There was less temporary work for snow shovelers. The Glen also benefited from a less-than-budgeted amount spent on employee health insurance cost -- with no change in their longstanding high-benefit coverage. The cost of their insurance remains high, however, and it will not begin to decrease until 2021, when their adult children are removed from the plan after their 26th birthdays.

Partially offsetting these sources of under-budget was an increase in our Account 61420 Maintenance Payroll expense, mainly due to a \$1,000 bonus for Maria Castro for her 20 years of faithful service to the Glen. In a prior year, we gave the same bonus to Nelson Ordonez.

- Water/Sewer. The Glen's 2019 Account 71010 water/sewer expenditure of \$190,194 exceeded our budgeted \$186,322. The overage was due entirely to a summer water leak in one of the courts. Fortunately, volunteer Bill Worsley, who tracks water expenditures, discovered the leak in time for us to find its source and keep it from continuing into the autumn and winter.

In recent years, the Glen has benefited from usage-related declines in this expense, even as County rates continued their slow upward movement. The decline in usage was most likely due to conservation (water control devices, investigating leaks, less lawn watering, etc.). Our usage-related declines, however, cannot be expected to continue. In fact, our usage records show that our water consumption has reached a level bottom. (*Kudos to Bill Worsley for maintaining this database.*)

- Painting and Carpentry. A huge problem area continues to be exterior painting and carpentry. In 2019 the total of Accounts 61370 Exterior painting and 61284 Carpentry was \$151,356 (91 units), in comparison to the \$113,716 spent in 2018 (73 units), and the \$115,320 spent in 2017 (103 units) (not shown in the Table). The cost/residence has been rising.

We expected painting and carpentry expenses to grow as the community aged, but they have been growing faster than anticipated. One reason is that renovation prices have been increasing as the economy ramped-up. We have also been paying more attention to the timing and quality of the work, by: (1) using higher quality painting contractors; (2) doing unanticipated catch-up carpentry work; and (3) trying to spot needed work before damage results. Our need for catch-up carpentry work is in large part due to: (a) our past use of painting contractors whose surface preparation was inadequate; and (b) carpenters (sometimes subcontractors of the painters) who turned to lower quality wood when hard wood became expensive in prior decades. Hopefully, we will continue to use higher quality painting contractors.

These expenses should be leveling and then trending downward after we complete and continue the quality-oriented 4-year maintenance cycle that began in 2016. Paint that has been diligently applied in the past lasts longer. Catch-up carpentry work will level-off as we continue to coordinate the work of our painters, who mark rotten wood as they paint, and our carpenters.

We are also gradually replacing rotted wood with PVC, which never rots or requires painting. We decided to gradually replace wood with PVC in 2016, after observing that our painted wood blends well with newly installed PVC. We may also find it cost effective to be more proactive in replacing wood with PVC in shaded areas of the Glen that are prone to wood rot.

- Roof Repairs. In 2019, Account 61460 Roof Repairs balanced at \$9,729.50, below the budgeted amount of \$31,073. Much more work was actually done, however, because the Glen actually spent \$57,125.00 during 2019 (computed from ledger). The difference is due to our classification of \$47,395.50 of the amount spent as reserve expenditures because they increased the lifespan of the roofs.

Roof repairs have been experiencing steady growth, and we can expect this growth to continue as our older Vermont slate roofs age. In 2016, we began a spot roof and gutter repair cycle work that is identified and checked for quality by our engineering firm. We do not use budget roofing contractors, who work quickly (sometimes without scaffolding), employ less skilled labor, and are not supervised by engineering consultants using detailed specs. This program will minimize water damage from leaky roofs and gutters until degraded slate requires full roof replacement.

- Damage Claims. Account 61370 Damage Claims is used to record: (1) Glen claims against insurance companies, or other outside businesses; (2) Glen claims against residents; and (3) amounts paid to reimburse residents for damage for which the Glen is responsible under its Bylaws, most of which is damage resulting from defects in the common elements.

In 2019, the Account 61370 Damage Claims balance was \$25,538.30 This balance can be broken-down as follows:

1. Of this balance, \$19,219.29 was the amount paid to a law firm representing the Glen in a dispute with a nearby shopping center, against which the Glen has a legal claim based on groundwater pollution from a long-ago tenant. Before 2018, the shopping center was voluntarily reimbursing the Glen for its legal costs, even though the issue had not yet been resolved. In early 2018, however, as resolution of the dispute was delayed, that business ceased reimbursing us. We did not budget for these legal costs in either 2018 or 2019, believing that either the shopping center would continue to reimburse (2018) or the matter would settle (2019). Our counsel believes that the Glen's case is strong and that a favorable settlement, including reimbursement of our legal fees, is likely, which is why these expenses were posted to Account 61370 Damage Claims rather than Account 51090 Legal Fees.

2. The remaining \$6,911.51 portion of the 2019 balance (after subtraction of the costs of our litigation against the ground water pollutant) was paid to residents for damage to their property that was caused by defects in the common elements, such as sewer pipes under basement slabs. These expenses can be hefty, especially when the Glen is repairing damage to an owner's tile and walls that is caused by replacing pipe under a basement slab. These expenses will grow as our community ages.

Reserve Contributions

● Replacement. In 2019, the Glen contributed \$673,977 to replacement reserves (budgeted contribution + earned interest), in contrast to the \$661,724 contributed in 2018 and the

	Audited Replacement Reserves End of Year.	Accrued Depreciation 2018 Study	Full Funding Percentage 2018 Study	Accrued Depreciation 2013 Study	Full Funding Percentage 2013 study
2015	1,888,332			6,661,857	28.35%
2016	2,286,644			6,890,342	33.19%
2017	2,486,732			7,036,347	35.34%
2018	2,717,615	8,242,927	32.96%	7,241,900	37.53%
2019	2,889,066	8,718,333	33.14%	7,598,808	38.02%

\$624,920 contributed in 2017.

Despite this increased contribution in 2019, the Glen's progress toward full funding was smaller than in recent years.² The full-funding percentage under our 2018 study increased only negligibly in comparison to the 2 percentage points of recent years -- from 32.96% to 33.14%. The full funding percentages would have been larger under our 2013 reserve study, but only because our more accurate 2018 study added more depreciable assets. These 2019 results are shown in the following table, along with some results from prior years:

One reason for the slower progress in 2019 is that replacement cost inflation during 2019 exceeded the growth in our contributions to reserves:

(1) Our 2018 reserve study estimated that replacement cost inflation during 2019 would rise at 2.8% and will continue to rise at this rate in future years covered by the study. In our next reserve study, we will examine this projection in light of actual experience.

(2) Our total contribution to replacement reserves increased by only 1.8% in 2019. The interest portion of our total contribution did not grow at all because of low interest rates and taxes. The budgeted portion of our total contribution grew by only 2.1%. But for unanticipated spending in certain areas, such as damage claims, we could have added more to reserves.

² Full funding of reserves (reserves = accrued depreciation) is desirable for the Glen. For an explanation why, see the August 2019 newsletter.

Another reason for the slower progress in 2019 is that the 2018 reserve study's estimate of reserve spending in 2019 (\$81,992) significantly underestimated actual reserve spending in 2019 (\$310,980). Since reserve spending reduces accrued depreciation, the underestimate caused accrued depreciation at the end-of-2019 to be overestimated.

- **Contingency and Unappropriated Members Equity.** Our contingency reserve is a major part of what our accountant calls our "excess operating funds" (EOF) (contingency + unappropriated members equity after profit/loss). EOF funds are available for budgeted operations. On the asset side of our balance sheet, we try to keep our contingency reserve in a separate contingency bank account and our unappropriated members equity in our operating bank account. An adequate EOF protects us against temporary overdrafts, dues revenue drops, and unbudgeted expenses that cannot easily be avoided.

In 2019, the Glen's contingency reserve decreased to \$125,880 = \$146,936 (2018) + \$8,400 (2019 budgeted addition) - \$29,456 (our originally audited 2018 loss transferred from contingency to unappropriated equity).

The auditor recommends that we maintain EOF of from 10-20% of our annual assessments. The upper range of 20% would provide a sound buffer against uninsurable disasters, adverse governmental employment developments, and hidden property defects. For our budgeted 2020 assessment income = \$1,698,527, this larger buffer would require an EOF of \$339,705 = .20(\$1,698,527). At the end of 2019, we fell well short of this goal, with an EOF = \$205,483, as shown by the following table sourced to the Audit:

	2019	2018
Account 25620 Reserve/Contingency	125,880.00	146,936.00
Account 20410 Unappropriated Members Equity	111,830.30	111,957.01
Profit (Loss)	(32,227.00)	(29,574.71)
EOF	205,483.30	229,318.30

Our contingency will probably not begin to grow substantially again until 2021. In 2019, our contingency took a hit from a transfer to unappropriated equity so it could recoup the 2018 deficit of \$29,456 (later revised to \$29,575). In 2020, expect another such transfer to offset the 2019 deficit, but there will be most likely an offsetting larger infusion when the legal fees for our environmental litigation are reimbursed and added to contingency to make-up for prior losses.

Reserve Disbursements

In 2019, we disbursed \$310,980 for reserve expenditures in comparison to the \$408,826 disbursed in 2018, the \$417,518 disbursed in 2017, the \$180,545 disbursed in 2016, the \$758,930 disbursed in 2015, and the \$127,869 disbursed in 2014. These yearly disbursements reflect the timing of payments for work planned for prior and future years as well as the work that is planned

and contracted in the given year. Except for 2015, the reserve disbursements for each year 2014-2018 were less than our additions to replacement reserves. This is more evidence that the Glen can preserve its assets, avoid borrowing, and continue to move toward fully funded reserves.

Balance Sheet Equity

Even when there is an overall budget deficit (the bottom line of the Audit/Budget Table below), our total members equity can grow if the growth in our total reserve funds exceeds the decline in the funds available for everyday operations. This happened in 2019, as it did in 2018, 2016, and 2015. Despite our overall budget losses in those years, the revenue set aside for reserves was large enough to cause each year to end with an increase in the Glen’s Total Members Equity. The Glen ended 2019 with an increase in its Total Members Equity [Replacement Reserve + Contingency Reserve + Unappropriated Members’ Equity (other cash funds)] = \$117,624 = \$3,094,557 - \$2,946,933. Here is a summary table for 2014-2019, which reflects adjustments to equity made by the auditor in 2020 for years 2018 and 2017:

Year	Equity Growth
2019	\$117,624
2018	\$212,109
2017	\$223,772
2016	\$383,467
2015	\$183,204
2014	\$ 79,968

Audit/Budget Table

MANAGEMENT ACCOUNT	ACCOUNT NAME	2018 Balance After Audit (Revised 2020)	2019 Budget	2019 Balance After Audit
	INCOME			
30100	Assessment Income	1,606,115.00	1,652,140	1,651,296.00

30270	Interest	42,766.59	42,400	53,191.72
30290	Bad Debt Recovery	0.00	2,000	0.00
30171	Late Fees	1,825.00	1,300	1,175.00
30190	Pool Income	275.00	375	429.00
30260	Misc. Income	40.00	80	0.00
	Total Income	1,651,021.59	1,698,295	1,706,091.72
	ADMINISTRATIVE and MISCELLANEOUS			
51020	Postage	331.82	196	0.00
51030	Office Expense	2,650.67	1,180	2,341.00
51031	Copying/Printing	2,563.02	1,712	0.00
51050	Training & Education	60.00	100	0.00
51250	Entertainment & Social	0.00	256	203.15
51500	Misc. Expense	1,225.12	2,647	1,752.95
51550	Misc. Administrative	12,082.93	3,958	4,447.39
51110	Auditing, Taxes, and Accounting	6,950.00	7,050	7,050.00
51090	Legal Fees	18,360.04	17,000	12,602.89
51092	Legal Fee Reimbursement	(1,081.00)	(4,760)	(798.00)
51120	Management Fee	76,559.28	78,090	77,554.56
51125	Management Schedule B		11,299	6,875.96
51106	Professional Fees	34,554.75	28,800	52,124.00
51000	Telephone & Related	3,545.02	3,726	4,098.85
	Total	157,801.65	151,254	168,252.75
71050	INSURANCE	74,789.30	74,830	78,286.37
	EMPLOYEES			
61420	Maintenance Payroll	93,273.75	95,930	98,454.39
61301	Fed. FICA Tax	5,790.32	5,948	5,988.93
61308	Fed. Medicare Tax	1,185.46	1,391	1,400.66
61302	VA Unemployment Tax	18.35	41	17.59
61303	Fed. Unemployment Tax	84.00	84	83.99

71070	Group Insurance [Health]	26,982.12	29,150	26,864.88
61300	Payroll Administration	6,774.71	7,049	6,969.27
61360	Uniforms	0.00	200	196.10
61431	Temporary Help	1,080.00	5,500	3,100.00
	Total Payroll	135,188.71	145,293	143,075.81
	UTILITIES			
71030	Electricity	9,699.75	10,000	9,700.66
71010	Water/Sewer	184,769.57	186,322	190,194.19
	Total Utilities	194,469.32	196,322	199,894.85
	POOL COMPLEX			
61150	Pool Contract	38,350.00	39,117	39,117.00
61145	Pool Repair and Maintenance	5,947.02	11,620	5,874.96
61156	Pool Furniture	2,112.92	1,100	1,751.85
51258	Pool Committee	1,107.47	2,700	2,141.48
	Total Pool Complex	47,517.41	54,537	48,885.29
	LANDSCAPING			
61180	Landscaping Maintenance Contract	69,638.53	69,639	69,638.53
61188	Tree Service [after 2018 -- work related to maintenance and reserve projects]		2,000	2,580.00
61557	Landscaping Non- Contract	39,072.36	41,000	33,600.80
61570	Landscape Replacement [Damage from Contractor Negligence or Weather]	0.00	3,500	6,154.38
	Total Landscaping	108,710.89	116,139	111,973.71
	REPAIRS & MAINTENANCE			
61310	Exterior Painting	78,760.00	88,580	93,823.94

61284	Carpentry	34,955.62	23,201	57,531.86
61200	Property Repairs	28,005.55	32,000	24,235.28
61460	Roof Repairs	4,924.50	31,073	9,729.50
61010	Vehicle Expenses	796.92	979	771.70
61247	Playground Equipment	3,955.00	9,900	136.88
	Total Repairs & Maintenance	151,397.59	185,733	186,229.16
61370	DAMAGE CLAIMS	44,329.88	7,163	25,538.30
	SERVICES PROVIDED MAINLY BY CONTRACT			
61240	Exterminator	3,108.00	3,465	3,728.00
61581	Snow Removal	7,256.25	10,038	8,465.94
61250	Trash Removal	67,538.36	68,214	68,216.08
	Total Contracts	77,902.61	81,717	80,410.02
50400	BAD DEBTS EXPENSE	6,282.35	2,552	1,258.00
	INCOME TAX ACCOUNTS			
71140	Income Taxes	9,683.00	8,904	12,137.00
95000	Provision for Income Taxes			
	TOTAL EXPENSES	1,008,072.71	1,024,444	1,055,941.26
	RESERVE CONTRIBUTIONS			
90000	Replacement Reserve	618,957.00	631,955	631,956.00
90005	Replacement Reserve Interest	42,766.59	33,496	42,021.46
	Contingency Reserve Accounts Used			

90032	--Transfer to Reserves Phase II			
90061	--Contingency Reserve	10,800.00	8,400	8,400.00
	Total Reserve Contributions	672,523.59	673,851	682,377.46
	GRAND TOTAL EXPENSES	1,680,596.30	1,698,295	1,738,318.72
	BALANCE OF INCOME AND USES OF INCOME (- DEFICIT)	(29,574.71)	0	(32,227.00)