

Questions of GVR Director Tom Sadowski

April 24, 2017

- 1. Q: Please explain how the year budget information was misinterpreted which allowed the FAC to pass a motion to allocation approximately \$850 of the budget surplus to New Initiatives instead of Capital Repair and Replacement. A similar agenda was developed as an agenda item for the Board meeting but apparently changed at the last minute.**

The year-end numbers on the GVR internal financial statements with an initial surplus of \$1,022,551 matched exactly with the initial surplus number in the 2016 audit report. The original presentation of the surplus on the internal statements did not show the \$900,000 funding of the Maintenance & Repair Reserve fund and the earnings on that investment account even though they had occurred during the year. Once we revised the presentation on the internal statements they matched with the audit report presentation. Surplus before reserve allocation was \$1,022,551 - \$900,000 reserve funding - \$87,787 reserve earnings = \$34,764 net surplus to be allocated. The recommendation from Fiscal Affairs was to allocate the \$34,764 to the Initiatives Reserve fund, which the Board approved.

- 2. Q: Why are non-cash book expenditures budgeted for (i.e. Depreciation and Unrealized Gain/Loss on Investments)?**

It is a perfectly acceptable accounting practice to budget for non-cash items.

- 3. Q: Is there versioning of the Reserve Study? If so can I review the specific changes made to each version? What specific items were not performed in 2016? Were these items to another year or simply eliminated? Were any items removed in 2017 or deferred? How are changes tracked?**

You have been included in some discussion about the reserve study and were invited to participate in our recently conducted first annual meeting between staff and Bob Browning, President of the Browning Reserve Group. The Browning Reserve Group was selected to perform the reserve study and reports over a four-year contract. Perhaps you now understand how it works better than you did previously. The reserve study is updated every year with an accounting for each item that was designated for that year. Items not performed in the year originally assigned are moved to another year. Nothing is eliminated unless we don't own it anymore. At times, we add items and move some things to other years. We fill out a worksheet with any "adds" or changes and submit it to Browning Reserve. They make the requested changes, recalculate the funding requirement and give us a new reserve document. This will be accomplished each year during the four-year contract period. We will post the updated reserve report document on the GVR website when we receive it back from Browning Reserve.

4. Q: Is it possible to review the salary survey? Can it be posted to the library section of the Board Effect?

Yes, you may look at the independent compensation study conducted by CBIZ. I'll coordinate with Jen Morningstar to have the document posted to the BoardEffect library. I will notify the Board when it is available.

5. Q: What are the current requirements for Reserve fund balance at the end of FY 2017? Why wasn't this requirement fully funded in 2016?

The Reserve Fund balance was fully funded at the end of 2016. The reserve funding requirement for 2017 is \$914,400.

6. Q: What are the spending priorities by major category?

This changes year to year. Is there a particular year you are asking about? In general, the Board sets priorities through the annual Work Plan (tied to the five-year Strategic Plan) and other directives. Operations and maintenance of GVR facilities is a mainstay priority.

7. Q: Are there separate bank accounts for each major fund? If not, wouldn't it be easier to have separate bank accounts?

Yes, there are separate accounts for each reserve fund.

8. Q: Are you familiar with the IRS ruling regarding 30% tax on interest income? Are there tax consequences for moving money from reserves to operations?

Since we are a non-profit, we are not required to pay income tax on interest. This was reviewed with our outside CPA.

9. Q: Why is dues income any different than other income? How can you be sure that only non-dues income is used to fund the New Initiatives.

We know how much dues we receive and we know how much is applied to expenses for operations, current programs and maintenance. Dues income is much less than required to cover these expenses. Outside of special allocations from the Board on an "as needed" basis, no monies are available for New Initiatives.

10. Q: If we are able to clearly track revenue sources, why aren't we able to track costs of events, and maintenance by Centers.

We can and do track costs of events and all expenses by Centers. This information provides a central component of our annual budget development process.

11. Q: Could you explain how the GVR Foundation works? Why do we provide services to them at no cost? What benefits have we received from them?

The GVR Foundation (GVRF) receives tax-deductible donations and grants. Since GVR is a 501(c)(4), donors do not get a tax deduction for donating to GVR. The 501(c)(3) Foundation is able to offer a tax deduction and is able to apply for grants. So far, GVRF has received \$48,500 in grants and have applied for additional grant funding this year. GVR members represent more than 75% of Green Valley. Therefore, even community-based GVR Foundation activities favor GVR members. The GVR Foundation's RetireAZ.org website holds great potential to be financially self-sustaining and generate net income within two years of its launch, scheduled for October, 2017. The benefit to GVR will far outweigh any initial in-kind services provided to the Foundation. Hopefully you were able to hear the discussion at the May 24th Board meeting where Blaine and Brad answered these questions.

12. Q: Is performance of GVR tied at all to the budget?

We do not understand the question. What type of performance? Staff participate in annual performance reviews. These reviews are based on goals set between them and their respective supervisor. Merit pay, up to an authorized and budgeted amount, is dependent upon performance relative to expectations. GVR does not provide cost-of-living allowances. If instead you are talking about whether a department receives more money in the following years' budget if they meet performance goals, the answer is no.

Responses to Additional Questions Excerpted From Tom's Email to Kent, Monday, April 24, 2017 9:25 PM ([see full text, below](#))

Q: Issue 6-Your response didn't seem to address why GVR is different from the traditional revenue/expense model. I welcome the opportunity to meet with Jim and Richard to learn more about the foundation. I have a particular interest in the MAP program and how we are helping our low income members, and if we can do more to enhance this program and these benefits. Unfortunately some of our members are reluctant to discuss their financial affairs with GVR. I am curious to learn if there are other ways to help our members which may be less restrictive. Also, based on data there are approximately 1,200 homes in Green Valley at or below the poverty level. How can we reach and assist all of these members?

Tom, we still recommend that the revenue/expense model be addressed at the Board level, beginning with the Fiscal Affairs Committee. Here's why: The revenue/expense model that we employ for budget development and operations works well for GVR. GVR is in the service industry, we count smiles, not widgets. What we measure is satisfaction, as determined one-member-at-a-time. With 23,000 members having diverse needs, wants, interests and values, that is quite an undertaking. As a result, so-called cost-benefit analyses gets complicated. Making things even more complicated is that most of GVR's highest participation rates are in activities with no revenues (other than member dues), just expenses.

Issue 8-All new Board members would benefit from Fiscal training, perhaps it could be included as part of Governance training or held separately, but the more we know, the more comfortable we will be in voting on financial matters for GVR. While we can all attend FAC meetings, the scope of the meeting may be limited by the agenda, whereas a training class could cover many more areas of interest.

Agreed.

From: Tom Sadowski

Sent: Monday, April 24, 2017 9:25 PM

To: Kent Blumenthal <KBlumenthal@gvrec.org>

Cc: Jim Nelson <jnelson@gvrec.org>; Barbara Mauser <bmauser@gvrec.org>; Cheryl Moose <cheryl@gvrec.org>; Richard Kidwell <rkidwell@gvrec.org>; Carol Crothers <ccrothers@gvrec.org>; Rich Hill (resghill@gmail.com) <resghill@gmail.com>; Roger Myers <rmyers@gvrec.org>

Subject: Re: Response to Kent's Email

So here is some additional clarification so we can all be on the same page. I forget that not everyone speaks accounting. Over the last few days, we were continuing to work on our large bee issue. Cleaning and sanitizing the hive area, replacing drywall, and covering roof vents with smaller mesh, while continuing our shutdown and closing up of the house before we leave. I was finally able to sit down and write my response. I am sorry I wasn't able to send it sooner.

Issue 1-I have no idea why this issue came back up. It was originally requested in an email from me to Jen on March 17th. In this letter I asked only for the actual vs budget documents for FY 16. These had not been posted to the website, and the members who attended the March meeting were not given any of the meeting handouts, so it was difficult to follow the meeting discussions. Eventually, these numbers were posted to the website (after adjustments). I know that some people like to see all of the adjustments between initial and final numbers, I really like to consider the big picture, but it's nice to see before and after numbers to compare them and see which lines have changed. Had we been given handouts at the FAC meeting, this question (sent back in March) would never needed to be asked.

At Friday's meeting, I gave Cheryl a list of questions that I thought we could go over, but this questions was not on the list. I don't know why the subject even came up. I have attached a copy of the questions, I gave to Cheryl. As a management and program analyst, and an internal auditor, I try to understand 5 areas-condition, criteria, cause, effect, and recommendation. Condition is what happened, criteria is the rules, laws, and regulations which apply to the situation, cause is what created the issue or problem, effect usually means what are the financial consequences, and recommendation is what can we do to fix it. All of the attached questions address one or more of these general audit areas.

As a fiduciary and a CPA, I want to completely understand the financial areas which affect our organization and especially those that I may be required to vote on. I know that we have

liability insurance, but I have never been sued either personally or professionally, and I certainly don't want to start now. Because of my background, I may be held to a slighter higher standard than other board members. In my email response yesterday, I tried to give additional background as to why I wanted answers to each of these questions, and to illustrate that I don't have any hidden agenda.

Issue 2-This is great. If there is a spreadsheet which exists which tracks the changes (pluses or minuses), that I could review prior to the meeting, it would be beneficial. Unfortunately, since we are leaving tomorrow immediately after the Board meeting, we won't be able to meet until sometime in the fall.

Issue 3-I welcome the opportunity to read these. Can you tell me how long each study is? Again, if they can't be made available online (such as in the Board Effect) library, I can come down and read them in person. I seem to recall reading that one of these may be phased in over 3 years. Just let me know the appropriate venue to review these in.

Issue 4-seems to be missing in your email. Is this a typo or was there an issue 4?

Typo...there was no Issue #4.

Issue 5-Resolved

Issue 6-Your response didn't seem to address why GVR is different from the traditional revenue/expense model. I welcome the opportunity to meet with Jim and Richard to learn more about the foundation. I have a particular interest in the MAP program and how we are helping our low income members, and if we can do more to enhance this program and these benefits. Unfortunately some of our members are reluctant to discuss their financial affairs with GVR. I am curious to learn if there are other ways to help our members which may be less restrictive. Also, based on data there are approximately 1,200 homes in Green Valley at or below the poverty level. How can we reach and assist all of these members?

Tom, still recommend that the revenue/expense model be addressed at the Board level, beginning with the Fiscal Affairs Committee. Here's my take: The revenue/expense model that we employ for budget development and operations works well for GVR. GVR is in the service industry, we count smiles, not widgets. What we measure is satisfaction, as determined one member at a time. With 23,000 members with diverse needs, wants, interests and values, that is quite an undertaking. As a result, so-called cost-benefit analyses gets complicated. Making things even more complicated is that most of GVR's highest participation rates are in activities with no revenues (other than member dues), just expenses.

Issue 7-I am so sorry that I am unable to join the Audit Committee due to the CPA ethics rules regarding perceived conflict of interests. I know that the community as a whole has a great interest, and is much aware that this can be significant problem. We need to let our members know we have adequate controls in all of our programs, and fiscal areas to include procurement, small purchasing and travel.

Unfortunately, most people in our community have a very trusting nature, and can be easily fooled. It really doesn't a long time for this to happen (just a matter of a few days), but many times it's not uncovered for years. So it's the internal controls that provide reasonable but not absolute assurance that this will not occur.

It may be uncovered by an audit, but lack of controls is the underlying cause. As an auditor, this has always been a high priority for me. The recent HOA case (while not similar to our GVR structure), simply illustrates how significant a problem it can create if you lack adequate controls. I know that it is a high priority for you, and even though it may cost some money, these reviews really need to be done.

Issue 8-All new Board members would benefit from Fiscal training, perhaps it could be included as part of Governance training or held separately, but the more we know, the more comfortable we will be in voting on financial matters for GVR. While we can all attend FAC meetings, the scope of the meeting may be limited by the agenda, whereas a training class could cover many more areas of interest.

Agreed.

Issue 9-I look forward to this discussion and presentation at tomorrow's Board meeting.

So in conclusion, these questions were intended to better educate me in GVR finances, and if an issue or problem had been identified, to help us work through a solution. During the meeting on Friday, I assured everyone in the room that my interest is not in getting anyone in trouble or criticizing them , it's simply to identify the problem and figure out a solution. It doesn't do any good to just point out problems, without working towards a solution.

I know there is a great deal to learn, and I am just beginning the process. To further assist me, would it be possible to have the AZ statutes posted to the Board effect website, so that I can print and study these. I appreciate you taking the time to help me to understand these complex areas better. I did not intend or imply that I needed immediate answers. **Several months is still fine with me, and more in depth meetings and discussions can occur in the fall when I return.** So let's continue to work through this process. Thanks for your continued support and assistance, I truly appreciate it.

From: Tom Sadowski
Sent: Monday, April 24, 2017 3:08 PM
To: Kent Blumenthal
Subject: Re: Response to Kent's Email

Sorry been packing all day, will craft a detailed response today. Thank you.

Sent from my iPad

On Apr 24, 2017, at 1:36 PM, Kent Blumenthal <KBlumenthal@gvrec.org> wrote:
Hi Tom,

I appreciate you clarifying issues raised in correspondence I sent you last evening.

I want to be sure I fully understand what your requests of staff are. Please look at the following items and let me know if I got your list right.

1. (Tom) I would like to formally request that the actual planned vs actual budget expenditures be released immediately and posted to the GVR website.

- I think that you are referring to FY 2016 year-end results (December 31, 2016 statement). If so, that document is already posted on the GVR website. See: <http://www.gvrec.org/Information/Board/Fiscal%20Affairs/2016/Financial%20Stmts/12%202016%20Financials.pdf>
- If you are referring to the so-called 19% increase in the Personnel line between 2016 and 2017, that information is also already posted. I included the analysis of the 19% Personnel line increase between 2016 and 2017 in the written response I prepared for Alan Loew & Jim Cassidy questions. See: <http://www.gvrec.org/Information/Board/Fiscal%20Affairs/2017/Response-Member%20Questions%20re-Financial%20Admin%203-24-17.pdf>

2. (Tom) I would like to see a hard copy of the Reserve study and I would like to see the tracking of changes. I want to make sure that items deferred in the Reserve study are appropriately included in subsequent years, and they don't slip through the cracks. I want to understand what level of funding requirements we are attempting to meet. I want to understand our fund priorities-is it Operations, Capital, Emergency, then New?

- As you might hope for and expect, the 2016 GVR Reserve Study project received rigorous and comprehensive review and analysis by GVR directors, individual members and staff through past committee engagements and board meetings. In my opinion, the outcome of this concerted team effort is excellent.
- To become up to speed with the Reserve study, I suggest that you first review the 2016 Reserve study, and then follow up to discuss how changes to the Reserve study are tracked. Your follow-up conversations about tracking changes should probably include FA Committee chair Barb Mauser, CFO Cheryl, Roger Myers (Director Myers was instrumental in having the Reserve study completed), facilities director David Jund and COO Jim Conroy. I will try to attend as well, assuming I am available at the time of the meeting. It may also be a good idea to get the author of the Reserve study on the phone when the meeting occurs so that he can explain the rationale behind the Reserve study, how the overall process works, and what the Reserve study actually covers. I will meet with Cheryl and ensure that you have access to review the 2016 Reserve study.

3. (Tom) I am used to salary surveys which include High Rate Geographic Areas. I want to learn how this applied to GVR.

- In 2016, the GVR Board commissioned an independent salary and compensation study for the CEO position. As you would expect, results of the study were shared in executive session. Please contact GVR Pres. Jim Nelson to concerning the 2016 independent CEO salary and compensation study.
- Also in 2016, an independent compensation study was conducted by CBIZ of all GVR personnel lines. Please see Cheryl to review a copy of the report.

5. (Tom) My questions regarding bank accounts and taxes were answered clearly.

- Good.

6. (Tom) Traditionally revenue is revenue, and expenses are expense, how and why is GVR different from this model. Since we have the ability to do cost accounting, should we be doing it to measure costs vs benefits of various programs and events. I would really like to learn more about the foundation, and the income and expenses. What benefits is GVR deriving and what is it costing us. Do we measure management in reducing planned budget items? What cost savings have we identified and can quantify for our members.

- I must defer to the GVR Board to consider cost-benefit analyses of any GVR activity, since in general these considerations are related to a Strategic Goal. In most cases, both

near-term and long-term benefits are considered relative to costs, especially concerning new activities. That said you might want to begin the conversation at the FA Committee Level.

- There was extensive, if not exhaustive GVR Board examination of its relationship with the GVR Foundation during the 2016/2017 GVR governance year. A special task force was established with two GVR board members (Nelson & Kidwell) and two GVR foundation board members (Nisson & Stillahn). Legal counsel with expertise in Arizona nonprofit organizations and tax law was retained to assist in examining and establishing proper governance and financial protocols for the GVR Foundation, and clarify its affiliation with GVR. As an outcome of these efforts, a formal Resource Sharing Agreement (RSA) between GVR and the GVR Foundation was established. The GVR Foundation also amended its Bylaws that creates a quasi-affiliate relationship between GVR and the GVR Foundation and allows two GVR Board-appointed directors to serve on the Foundation board. The GVR CEO is not a director on the GVR Foundation board. For more information about the GVR Foundation as it relates to GVR, I suggest you speak with either Jim Nelson and/or Richard Kidwell.

7. (Tom) Finally, at the time I asked you about performing an internal control review, your statement to me was that you didn't feel that there would be findings of any significance, and you expressed concern that if it cost \$20,000 members would complain of the cost. I stated that it was still important to complete these. There was no other discussion on your views on Internal Controls. I believe that you understand the importance and relevance of internal controls, and that all of our members are more aware of their importance since the news story came out.

- I am quite aware that embezzlement is endemic in America. Embezzlement is costly and it is pervasive. Employee theft results in losses ranging from \$20 billion to \$90 billion a year (excluding intellectual property theft) according to the National White Collar Crime Center (2013). That said I am saddened to witness how the unfortunate nature surrounding an alleged embezzlement by a local HOA officer somehow spills over to GVR with such a sense of urgency.

8. (Tom) Carol did ask me if she could attend what I thought was just a meeting with Cheryl on Friday. In hindsight, I should have requested that she attend.

- FYI...in exercising my chief staff officer responsibilities, I intend to participate in all meetings between my staff and Directors that are outside the scope of committee work or Board activities (other than those that involve all directors).

9. Audit Committee members & chair – GVR has operated vis-à-vis historical precedent consistent with the Corporation's understanding of its Bylaws, whereas the Audit Committee chair appointed jointly by the president and CFO with board approval has never been a director of the GVR Board (at least to my knowledge). Following last Monday's Special Board Meeting, GVR general counsel, Wendy Ehrlich contacted me. She discussed with me the admittedly confusing GVR Bylaws requirements concerning the Audit Committee, and has a different interpretation than GVR has about its meaning and implementation. Wendy asked me to bring this up to the board at its next meeting and I agreed to do so when I present the "CEO Report" at tomorrow's regular session Board meeting.

Again, let me know if I have missed anything pertaining to your requests.

Thanks, Tom.

K

Kent J. Blumenthal, Ph.D., CAE

Chief Executive Officer

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