

May 14, 2015

TO: Executive Board
Knudson Ranch Association, Inc. d/b/a Bachelor Springs

FROM: Jim Arbour

As authorized by the homeowners at the 2014 Annual Meeting of the Knudson Ranch Association, Inc. d/b/a Bachelor Springs (the "Association"), I performed an internal financial review of the financial statements of the Association as of and for the year ended December 31, 2014, including the general ledger and certain supporting documents for transactions and balances recorded therein ("Financial Review"), and have prepared this report documenting the procedures performed and related findings and conclusions.

Please note that the Financial Review described herein is not an audit; it is less comprehensive than an audit. Current law does not require the Association to be audited. The annual meeting of the Association's members on December 30, 2014 ratified the Board's recommendation to have an internal financial review in lieu of an audit.

As a general observation, I found the Association's accounting records to be very well maintained and, subject to some improvements described in the "Recommendations" section at the end of this report, the Association's operations and funds appear to be managed in a well-documented and transparent manner, and to be subject to adequate controls.

Financial Controls:

The following process for reviewing, approving and paying invoices was described by John Henry, Treasurer:

- Robin Wolfhard (Property Manager) receives maintenance invoices via mail or email.
- Katherine Paison-Penn with Select Management Services (Association's accountant) picks up other invoices at the Association's P.O. box.
- Maintenance invoices are reviewed and approved by Robin Wolfhard (Property Manager) and then sent to John Henry (Treasurer).
- John reviews and codes the maintenance invoices and sends them to Don Vorous (President) if he agrees with the invoice or back to Robin if John has questions.
- The Association's accountant scans and sends all other invoices to John who reviews them and follows up if he has questions. John codes the approved invoices and sends them to Don for his approval.
- Don reviews, approves and sends invoices directly to the Association's accountant for payment.
- Phone and electric bills are directly charged to the Association's bank account; generally less than \$100 per month in total.

- Water bills are also directly charged to the Association's bank account. If something looks unusual, John has the Association's irrigation maintenance contractor follow-up, with particular emphasis on eliminating leaks in the system.
- Checks are written by the Association's accountant and sent to John for signature and mailing.
- Monthly statements are sent to the Board with a note from the Treasurer highlighting the important points and posted on the website. A notice is sent to the homeowners.
- The current financial statements (usually year-to-date) are reviewed by the Treasurer at each Board meeting.

Financial Review:

In conducting the Financial Review, I performed the following:

1. Financial Statements and General Ledger:
 - 1.1. Obtained copies of the Association's financial statements as of and for the year ended December 31, 2014, and the general ledger covering the same period.
 - 1.2. Agreed all financial statement line items to closing balances in general ledger without exception.
 - 1.3. Compared financial statements with approved budget and noted any significant differences.
 - 1.4. Read the minutes of Board and Annual Homeowners' Meeting and noted the following:
 - 1.4.1. Explanations of budget variances
 - 1.4.2. New or modified contracts
 - 1.4.3. Explanations of repair items
 - 1.4.4. Discussion of replacement reserve funding needs
 - 1.4.5. Bad debts/uncollectible receivables
 - 1.4.6. Commitments, contingencies, unpaid liabilities or payable existing at December 31, 2014
 - 1.5. Reviewed general ledger activity for significant unusual entries with none having been noted that were not readily explainable by reference to minutes of Board meetings or to supporting invoices, contracts, e-mails or other correspondence.
2. Income and related items:
 - 2.1. Ascertained that the financial statements properly reflect the total Association dues for 26 units for operating expenses (\$123,400) and capital reserve regular assessments (\$88,325), and for special assessments (\$260,000), and that all were collected as of December 31, 2014.
3. Cash and investments and related income:
 - 3.1. Agreed investment balances on the balance sheet with bank statements and/or correspondence from the bank.
 - 3.2. Reviewed the December 31, 2014 bank reconciliation; no unusual items noted.

- 3.3. Checked whether or not investments as December 31, 2014 were in accordance with the Association's investment policy and that no individual account had a balance in excess of U.S. Federal Deposit Insurance Corporation (FDIC) coverage limits. See recommendation 1 in "Recommendations" section further below.
 - 3.4. Determined that the amount of income earned on invested funds appears reasonable based on the amounts invested throughout the year and knowledge of current interest rates.
4. Disbursements
 - 4.1. Reviewed invoices, contracts, e-mails and other correspondence. Selected a sample of a number of general ledger expense entries and agreed amounts with approved invoices. Noted no instances of unauthorized or unapproved disbursements. Noted no disbursements that did not appear to be for legitimate Association business.
5. Balance Sheet:
 - 5.1. Reviewed bank account reconciliations as of December 31, 2014 and agreed amounts thereon with bank statements and cash balances in the general ledger. No unusual reconciling items were noted.
 - 5.2. Noted that the prepaid Insurance general ledger account was not adjusted during 2014 such that the balance at December 31, 2014 is the same as at December 31, 2013. As the Association's insurance policies are on a three-year contract with fixed annual premiums during the current three-year cycle, this non-adjustment did not result in an important misstatement of the Association's financial position or insurance expense.
6. Owners' Equity and Reserves:
 - 6.1. Reviewed the roll-forward of the Association's operating account, owners' capital account, and reserve account from December 31, 2013 to December 31, 2014. No unusual items were noted.

Recommendations:

1. At December 31, 2014, the Association had an aggregate approximately \$350,000 on deposit at Centennial Bank in two accounts, which is in excess of the \$250,000 FDIC limit. FDIC rules state, "All deposits by a corporation, association, or unincorporated association at the same bank are added together and insured up to \$250,000, separately from the personal accounts of the owners or members."

RECOMMENDATION: Association funds on deposit at any one FDIC insured bank should not exceed \$250,000 in order to comply with the Association's Investment policy dated May 15, 2013, which states in article 4 that, "Unless otherwise approved by the Board, all investments will be FDIC (Federal Deposit Insurance Corporation) insured and/or guaranteed by the United States Government."

2. As described above, the Association's Treasurer and President approve all disbursements of Association funds. When performing the financial review, it was noted that the President's approval is given by e-mail without reference to the specific invoices being approved. For example, in the Association's financial records is a printout of an e-mail dated January 15, 2014 from Don Vorous forwarding invoices to the Association's accountant for payment with his approval saying "These invoices are approved for payment". The printed e-mail copy in the Association's accounting records shows a PDF icon for the attached PDF file containing the copies of invoices approved for payment, but a reviewer is not able to readily see the invoices included in the PDF to determine which invoices were approved by Don.

RECOMMENDATION: For audit trail purposes, when invoices are approved and sent by the Association's President to the Association's accountant, the President (or the Treasurer if the e-mail received by the President from the Treasurer is being forwarded) should list in the e-mail the invoice numbers, dates, payees and amounts. This will ensure transparency and thereby eliminate any questions about whether all invoices have been properly approved by both the Treasurer and the President.

3. RECOMMENDATION: All disbursements of Association funds to an Association Board member (e.g. reimbursement for July 4th party expenses) other than for de minimus amounts should be approved by two Association Board members other than the Board member receiving the disbursement.

Submitted by:

Jim Arbour
