SSA TREASURER'S REPORT
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SEPTEMBER 28, 2007

Your Treasurer's Report for the September 2007 BOD meeting is largely a good one. This report highlights the key financial events of the past eight months.

1. Restoration of credibility of SSA financial reporting

At the end of 2006, the credibility of SSA's financial reporting was suspect, at best. Thanks in no small part to the dedication of SSA's Accounting Manager Judy Blalack, with considerable assist from SSA's accounting firm Johnson Miller & Company, as of September 2007 SSA's financial reporting function has been returned to almost complete normalcy. We have now regained control of our financial books and I can report with confidence that the financial information now being recorded and reported in Hobbs can be relied on. We now know what our assets and liabilities are and we have an excellent understanding of our revenue and expenses. Once again, the income statements and balance sheets of SSA can be relied upon as a management tool for making decisions about the future of our organization.

SSA has a complex set of financial books, caused in large part by the multiple sub-groups of SSA that either request or require separate financial reporting. These separate reporting groups are:

1. SSA Core Operations. The financial statements for what I call, for lack of a better term, "Core Operations" includes the functions and activities that most SSA members think of when they think of SSA. These include: dues and membership support, Soaring Magazine, merchandise sales, convention, Hilton Cup, headquarters operation (including all staff compensation), and the website.

2. SSA Foundation. The Foundation is a separate legal entity (a New Mexico not-for-profit corporation), wholly owned by SSA, Inc., that holds and manages funds that have been donated to SSA but are not intended to be immediately used for expenditures incurred in day-to-day operations. This money is sub-divided into individual funds (sometimes called accounting "buckets"), based on the purpose for which money was originally given to SSA. As of August 1, 2007, the SSA Foundation is managing over $1,000,000 in assets that are divided among 16 separate sub-funds.

3. U. S. Team Committee. Although the U. S. Team Committee is fully a part of the greater SSA, the financial operations of the U. S. Team Committee are recorded and reported separately from SSA Core Operations.

4. Soaring Safety Foundation. The Soaring Safety Foundation, although vested with considerable operational autonomy, is legally a part of SSA, Inc. – just as the U. S. Team Committee is part of SSA – and the SSA Board of Directors is responsible for the propriety of its fiscal operations. Nonetheless, as with the U.S. Team and the SSA Foundation, the financial status and results of operations for the SSF are recorded and reported separately from SSA Core Operations.

At my direction, we have distributed to the SSA Directors and have posted on the website – and will continue to distributed and post in the future – quarterly financial results for SSA Core Operations. It is my belief that these statements are most relevant to understanding the financial strengths and weaknesses of the greater SSA and so should be available to the Board and to the membership at large.

I have left it up to the other interest groups whose financial information is separately reported – the SSA Foundation, the U.S. Team Committee and the Soaring Safety Foundation – to decide what information regarding their operations they wish to make public or to distribute to the Board of Directors. It is my view that the Directors should have access to this information; however, I believe the information should be provided through the groups in question.

2. Audit of 2006 financial statements

An audit serves a number of different purposes, but the primary one is to assure persons interested in an organization that its financial statements are, indeed, accurate and reliable. The completion of the 2006 audit of SSA's consolidated financial statements now provides us with outside verification of where we are, financially, as of December 31, 2006.

For those of you who have not yet seen it, we have posted the audit report on the SSA website. It is available – after you logon – as a link under the appropriately titled news item. In short, the auditors gave us an UNQUALIFIED OPINION as to our balance sheet (aka, Statement of Financial Position) at 12/31/2006, which means they were able to satisfy themselves as to the balances in all our accounts, including in the SSA Foundation "buckets." They DISCLAIMED an opinion on the income statements (aka, Statements of

Activities) and Cash Flow Statements for the year, however, because to their inability to determine the beginning account balances for 2006. Because the ending balances for 2006 now becomes the beginning balances for 2007, that problem will not repeat next year and there is no reason to expect that next year their audit opinion will be anything less than unqualified in all respects.

The audited financial statements are consolidated, which means that they combine all SSA activities (Core and HQ Operations, SSA Foundation, US Team, Soaring Safety Foundation, and Hilton Cup) into one set of financial statements. This does not make the audited statements a very useful management tool. However, you are welcome to peruse the report. I will be happy to answer questions about the audit report at the fall Board meeting.

A byproduct of the audit process is the preparation of a "Management Letter" that advises the SSA Board of Directors of weaknesses in internal control that the auditors identified during the audit process. Because the information in the Management Letter is a bit sensitive, I have not posted it on the website and have not included it as part of the documents appended to this Treasurer's Report. I have, however, provided the report to the Excom and will provide a copy individually to any Director who requests a copy. The Management Letter did identify several areas of financial weakness that I have addressed elsewhere in this Treasurer's Report, below.

<u>3.</u> <u>Current financial statements for SSA Core Operations: Balance Sheet as of August 31, 2007 and Income Statement for first eight months of 2007</u>

Included as an Attachment to this Treasurer's Report are interim financial statements for SSA for the first eight months of 2007 (through August 31, 2007). In short, they show an operating profit for the first eight months of 2007 of more than $100,000. While this is encouraging indeed, we should not forget that the profit is largely a result of two factors: (1) a higher-than-normal year for donations to SSA (for 2007, over $38,000 through July 2007) and (2) at the end of 2206 we had cut staff to the bone, with a resulting reduction in the expenses for wages, salaries and employee compensation (total compensation down over $120,000 from 2006). As addressed below in the discussion of the draft budget for 2008, we should not expect to repeat the current year financial results in the future, particularly when we hire a new Executive Director and another staff member to serve, for example, as either a marketing assistant or as a full or part-time webmaster.

4. Issues regarding accounting by Soaring Safety Foundation

Unfortunately, one of the areas of weakness identified by the auditors involved the Soaring Safety Foundation. Although the SSF has considerable operational independence from SSA and the SSA Board of Directors, the SSF is not a separate legal entity, but rather is a constituent part of SSA, Inc. Thus, the assets and financial operations of SSF are included in the greater SSA's consolidated financial statements, including SSA's annual tax return.

Some years ago, a financial memorandum of understanding was reached between SSA and the SSF that permitted the SSF to maintain it's own bank account and to handle its own checking account. While the agreement required the SSF to provide SSA headquarters with timely notification of its financial transactions, SSF compliance with that obligation has been – at best – "spotty." The most egregious breach of this obligation came in January of this year when the failure of the SSF to provide its bank statements and other records caused a delay of the SSA audit, as the auditors refused to start their field work until all underlying financial records were physically present in Hobbs.

The audit revealed several troublesome issues with the way the SSF was operating it's financial affairs. These issues included a failure of the SSF to exercise any meaningful control over reimbursements to SSF members and others for performing training clinics and safety inspections. Perhaps the most significant of these issues was the discovery that SSF had obtained a credit card, provided to certain SSF members, which was used to pay for legitimate expenses incurred on behalf of the SSF. Unfortunately, the audit revealed that some of these expenses had been "double paid" when requests for reimbursement were submitted by individuals who had not actually paid the expense themselves, but rather had charged the expense to the SSF credit card. The SSF Treasurer inexplicably failed to note this and thus, over a two year period, improperly paid over $3,000 in expense reimbursements to one individual alone.

To their credit, once the problems with their financial control were brought to the attention of the SSF Trustees they agreed to modification of their unconventional accounting arrangements and the checkbook for the SSF has now been returned to Hobbs. Because the prior arrangement had been memorialized by a formal Memorandum of Understanding between SSA and the SSF, one of the action items we are presenting for consideration by the Board at the Fall meeting will be a revision of this MOU. The revised MOU is included as one of the attachments to this Treasurer's Report.

5. Status of dispute with IRS

The biggest financial uncertainty facing SSA at the moment continues to be the status of the IRS assessment of as much as $232,000 in penalties and interest for late-filing of SSA's quarterly payroll tax returns and tax payments from 2003 through the first half of 2006. As previously reported, we have retained a law firm in Dallas, Texas to assist us in our appeal of this assessment. The appeal, as of this writing, is assigned to the Austin, Texas IRS appeals office. Because this issue is obviously sensitive, I will say no more in writing at this time but will be available to answer questions in person about the status of the appeal at the BOD meeting at the end of September.

6. Status of claim against Alan Gleason

Alan Gleason has entered into a tentative plea agreement with the District Attorney's office in Lea County, New Mexico, that calls for him to plead guilty to either one or two counts of embezzlement and to pay restitution of $60,000. If he accepts the plea offer, he will not have to actually enter the plea of guilty until the case is called for trial, which may be several months in the future.

Unfortunately, SSA's insurance carrier, which paid us the policy limits of $75,000 on our claim for employee dishonesty, has a right of subrogation arising from that payment, which means that the insurance carrier may have first claim to any restitution Mr. Gleason is ordered to pay. We are working to see if that unfortunate result can be avoided, but at the moment the matter is unresolved. The prospect of any additional recovery from Mr. Gleason, other than restitution he may be required to pay at the time he enters his guilty plea, is doubtful because of Mr. Gleason's current financial condition.

7. Status of financial function in general

Our Accounting Manager, Judy Blalack, has just about finished "catching up" with almost five years of accounting malfeasance. While she is now able to keep our books and records current without heroic effort, there are several deficiencies in the financial function at SSA headquarters that concern me, as Treasurer.

First, SSA is heavily dependent on Ms. Blalack to maintain our financial books and records. Ideally, no organization should be dependent on one person to maintain their financial books. I have been pushing our Office Administrator, Denise Layton, to cross-train other members of the staff in at least some key accounting functions, but to date we have not made as much progress in this area as I would like for reasons that are not necessarily Ms. Layton's fault. Rest assured, I do not intend to ignore this concern and will maintain efforts to prevent SSA from becoming as dependent on a single key accounting person as we were when our previous financial manager, Alan Gleason, was employed.

Second, some of you may remember the disaster that SSA's previous web-based accounting system, called DMG, was for SSA. Dennis Wright replaced DMG with a $250 off-the shelf software package called "Peachtree for Non-Profits." While Peachtree is in many respects an improvement over DMG, Peachtree has a number of weaknesses that are becoming more and more problematic. Indeed, some of these problems were noted by the auditors in their Management Letter on internal control weaknesses.

SSA has a very complex set of financial books and it is my view that SSA needs to transition to a more robust accounting software system to handle the load. I have been told by our accountants, however, that a full transition to a new accounting system suitable for our needs will cost between $5,000 and $10,000. I have not yet decided whether to recommend a change to a new system, but will be exploring the issue as one of my priority projects in the coming months.

Finally, SSA has operated for years without a formal manual of accounting and financial procedures. As a result, when Dennis Wright and Alan Gleason departed almost simultaneously it left a huge gap in SSA's institutional knowledge. Judy Blalack and I are working to correct this deficiency with the preparation of a comprehensive procedures manual. This is a large project and will be on-going throughout at least the next year.

One step we have already taken in this area is the preparation of a list of reports that are due to various governmental agencies and private parties so that as there is turnover in personnel at the offices in Hobbs we will not lose the institutional memory on these requirements and so that the Board of Directors can exercise better oversight of these activities. A copy of the current compliance report is included as an attachment to this report.

8. Status of internal controls

As Treasurer, I consider it one of my primary responsibilities to keep a watch over the internal financial controls at SSA headquarters in order to minimize the possibility of SSA being victimized by one or more dishonest employees. To that end, I paid a personal visit to Hobbs July 15-17, where one of my main missions was to review the status of internal controls, including in particular some controls that were put in place immediately after Alan Gleason's dismissal. Generally, I found that the controls were still in place and being followed, but I found that some controls were not understood and were not being followed. This is an area that requires constant vigilance and I intend to provide as much oversight as I reasonably can.

One of the most important controls is to separate accounting functions among as many people as possible. As one example, the person responsible for recording transactions should never have responsibility for signing checks or for reconciling the bank balances. Unfortunately, in small offices such as SSA, which currently has only seven headquarters employees, it is not possible to have as much separation as one would like to see.

As mentioned above in the discussion of the 2006 audit, the Management Letter provided by the auditors noted several issues that needed to be addressed. We have dealt with most of these issues and are working on the rest.

9. Unpleasant accounting surprises

There were at least two unpleasant accounting surprises that have arisen so far this year. Both have been dealt with by the Excom and the staff. However, because they have had more than a trivial impact on our revenues I am bringing them to the Board's attention for information purposes.

Royalties owed on Helmut Reichmann's book, *Cross-Country Soaring*: Several years ago the German publisher of Helmut Reichmann's book, *Cross-country Soaring*, licensed the publishing rights for the U.S. edition to the Soaring Society of America. Unfortunately, during the Alan Gleason years he failed to pay over to the book's copyright owner (the representative of the estate of author Helmut Reichmann) the 8% royalty that was due on sales of the book. SSA was contacted in 2007 by the copyright owner and demand was made for outstanding royalties. We have now calculated the royalties owed for sales through June 2007 to be $4,669 and have now made payment of that amount.

Donation of proceeds from Chris Woods' DVDs to Kolstad Scholarship: In 2005, Chris Woods, who created and produced the very popular DVDs "The Quiet Challenge" and "Running on Empty," donated all rights to those DVDs to SSA with the proviso that all proceeds from sales of the DVDs be donated to the Kolstad Youth Scholarship fund. Significantly, the donation was to include not only any money Mr. Woods might have made as wholesaler from selling the DVDs to SSA, but also all profits SSA would have made from the sales of the DVDs at retail.

Dennis Wright accepted this offer without consulting any member of the Board or Excom. While Mr. Woods was certainly free to donate his profits from sales of the DVDs to the Kolstad Fund, the propriety of Mr. Wright giving away SSA profits from merchandise sales to a particular group is more problematic. In any event, the deed was done and SSA is honoring the agreement. In August we made our first "donation," under the agreement, forwarding over $8,900 to the Kolstad Youth Scholarship fund for sales of 753 DVDs from 1/1/2006 through May 2007. Candidly, I regret the loss of this revenue to SSA, Inc. – even though it is going to a very worthwhile cause – and I will be strongly opposed to any suggestion that a similar deal be reached in the future regarding the donation of other revenue sources by SSA to other interest groups.

10. Budget for 2008

The Budget and Finance Committee has begun the process of preparing an operating budget for 2008; a copy of the initial draft is included as an attachment to this Treasurer's Report. The draft budget is a work in progress and is far from complete; however, at this time I would note the following highlights and key budgetary assumptions.

1. The budget assumes dues revenue will increase slightly.

2. The budget assumes income from contributions (Eagle Fund and otherwise) will total $57,000. This figure compares to over $79,000 in contributions received in 2006 and over $38,000 received to date in 2007 (with November and December, our two biggest months for contributions by far, yet to come.) Frankly, this is the biggest wild card on the revenue side of the budget. We raised more money during the Eagle Fund campaign in 2006-2007 than we ever had before; while we should not expect to repeat the success of that campaign in 2007-2008 and 2008-2009, a significant decline in contributions will impact our ability to hire all of staff and perform all of the functions for the membership we would like to.

3. The budget assumes the hiring of an Executive Director for SSA, with a salary of $75,000 and benefits starting in January 2008. It remains to be seen whether an ED can be hired at that compensation level.

4. While SSA has been generating a considerable operating profit in 2007, that profit has come largely as a result of cutting the headquarters staff to the bone. The 2008 budget assumes the hiring of another additional staffer in addition to a new Executive Director, as noted in the preceding paragraph. Those additional labor costs alone will absorb the operating surplus that was realized in 2007 and prevent it from being achieved again in 2008. Thus, while total compensation, benefits and personnel taxes in the 2007 budget was set at $273,000, that same line item in the 2008 budget is $399,000, or about $126,000 more. For purposes of comparison, total wage costs were $393,000 in 2005 and $396,000 in 2006.

5. The budget includes repayments of principal and interest on the loan from the SSA Foundation of $85,400. This payment amount will fully repay the loan in a total of five years.

6. The budget makes no provision for any payments to the IRS of additional principal and interest. Because the amount of that figure is unknowable at this point, I am anticipating that we will simply have to deal with it when the amount becomes known, probably from either an additional loan from the Foundation, liquidation of some of SSA's available funds in the Foundation, or a combination of both.

<u>11. Future actions and priorities</u>

In no particular order of priority, I view my most significant tasks over the next year to include the following:

1. Continue timely and accurate financial reporting.
2. Supervise operation of internal financial controls.
3. Help insure adequate staffing in the financial area.
4. Assess the need for a new accounting system and, if one is deemed needed, initiate the process for acquisition.
5. Help draft an accounting procedures manual.

ATTACHMENTS TO TREASURER'S REPORT:

A. 2007 interim financial statements: Balance Sheet for SSA, Inc. (Core Operations) as of August 31, 2007.

B. 2007 interim financial statements: Statement of Revenues and Expenses for SSA, Inc. (Core Operations) for period January 1 - August 31, 2007

C. Draft budget for SSA, Inc. for calendar year 2008

D. Revised Memorandum of Understanding Between the Soaring Society of America and the Soaring Safety Foundation (including Annex A, Financial Policies, Procedures and Actions Relative to the Soaring Safety Foundation)

E. Compliance list for reports due to various governmental agencies and private parties