To: Board of Directors, Northeastern Region of the NMRA
From: Peter McKenney, Treasurer
Date: August 24, 2014

Treasurer's Annual Report for FYE June 2014

I am very pleased with the financial condition of the NER at this time. Having assumed the Treasurer's office on October 20, 2013, this is my first opportunity to present the financial picture to you and it is a pleasure to present such a favorable financial report. My predecessor, Larry Cannon, performed admirably for many years in helping guide the NER to such a strong financial position. Now, the Board of Directors has the opportunity to use this financial strength for the benefit of the members of the NER.

Turnover of officers presents an opportunity to consider different approaches. Whereas Larry served through a period that started with the NER suffering a major financial crisis and ended with it having good financial strength, I start off in a positive position with the freedom to focus more on the future rather than dwell on the past. Consequently, you will find the contents of this report having more forecast elements and fewer reminders of the past. Because this report covers the transition between two treasurers, it will include more detail than will be needed in future reports. My background includes a 17-year period in an international public accounting firm, too, so I will tend to present the financial reports in more standard formats that, hopefully, you are comfortable with.

Balance Sheet The attached Balance Sheet (Attachment 1) reflects an ending cash balance of $10,595, well-above the working capital that I believe is needed for the NER's routine operations. The invested funds, managed by RBC Wealth Management, grew 16% during the fiscal year. Going forward, I would assume an average annual growth rate of 6% (conservative) for planning purposes, but we can hope that the actual total return will average above that rate. The Life Member Equity Fund has grown to $19,513. I will test the reasonableness of this amount in light of the facts as I gather them in the near future and possibly recommend an adjustment (likely, substantial decrease) to this balance, if and when appropriate. For the time-being, carrying this obligation at this level is not hampering the operations of the NER. I note that the Spate Award Fund has not been frequently utilized by the NER. Although it is small, it should be a useful tool for the NER to recognize individuals or groups who meet its criteria, thereby giving positive reinforcement to good citizens in the model railroad world. Note that this balance sheet does not reflect all of the NER's assets. The Convention Committee maintains its own checking account and also owns equipment such as projectors, screens, display easels, and printers to be used at conventions.

Statement of Revenues, Expenditures and Changes in Fund Balances This statement is the "profit and loss statement, plus" for the fiscal year. See Attachment 2. It shows that the NER had operating income in excess of operating expenses, and its investment income was spectacular in FYE 2014. Tracks to Lakeport 2013 was a highly successful convention, resulting in an infusion of funds from the Convention Committee Fund to the NER checking account as well as enhancement of inventory of convention equipment. From Convention Committee Chair Ken May's report:

Total Gain from Convention	$5,744.08
50% to NER	$2,872.04
50% to Seacoast Division	$2,872.04
NER Share of Gain	$2,872.04
Purchase of 3rd projector	564.84
Purchase of Projector lamp	132.72
Purchase of Color Laser Printer	$450.00
Transfer to NER General Funds	$1,724.48

Subscription revenue for The Coupler exceeded publication and mailing costs by $2,291 during the fiscal year, but there is a "story" to be told. The Coupler is published quarterly and there should have been four issues paid for during FYE June 2014. Only the costs of three issues have been charged in FY 2014, however. After the close of the fiscal year, the July 2014 issue was published in July 2014 and the invoice for it was received well-after the close of the fiscal year books. Therefore, these costs will be reported in the FY 2015 financial statements. In the prior fiscal year, the same sequence occurred, but the FY 2013 was charged for the July 2013 publication costs in order to maintain consistent reporting of the cost of four publications per fiscal year. Given the timing of The Coupler issues over the past several quarters, however, I felt that it was time to recognize that July issues need to be charged in the fiscal year in which the costs are incurred. In FY 2015, once again there will be four issues charged. The cost of the July 2014 issue, including postage, was $2,672, well-over double the typical cost of an issue. This was an "election issue," printed and mailed to every member, not just the paid subscribers, and it included four more pages than a standard issue in order to retain regular content as well as contain the important voting information. The most important point to note is that the current subscription revenue is sufficient to cover regular publishing and mailing costs. This will be monitored constantly and the Board will receive notice when The Coupler's subscription revenue falls below cost of production and mailing.

This statement also shows how fund balances change during the fiscal year. Accounting for funds has been fairly simple as charges have not been allocated to them for several years. Theoretically, some of The Coupler costs should be borne by the Life Member Equity Fund. As I gain more facts, I may propose some adjustments to that fund accordingly.

Cash Controls The Treasurer is authorized to sign checks (without a co-signer) on the NER account up to $500. Checks for $500 or more require a second authorized signature. The President has traditionally co-signed the checks, when required. For administrative convenience, Larry Cannon has been authorized as an alternative second signer of checks.

At the request of the President, the Treasurer applied for and received debit cards on the Androscoggin Bank checking account for both the President and the Treasurer. The President has used his debit card to pay for internet services for the NER. On May 24, 2014, he incurred a debit charge of $559.16 for "Pro hosting, IP and backup services for 36 months" from Host

Monster. He made me aware in general of what his aim was prior to his debit transaction, although I was not involved in his actual transaction. The expenditure was documented after the fact with a copy of the electronic invoice. Needless to say, this method of disbursement is new to the NER and the "dual signature" requirement cannot be utilized in such a transaction. The Board may wish to update the dual signature policy in case similar situations arise in the future.

2013 Distributions to the NER Divisions Each NER division received a distribution from the NER in October, 2013. The total amount of $2,593.05 was distributed. This amount was a combination of one-half of the excess of liquid assets over the initial target financial reserve amount of $50,000, plus the NMRA rebate of $1,511 received in September, 2013. Although my predecessor circulated a copy of his calculations that supported these distributions (See Attachment 3) to the President and others, I do not see in any of the records of the deliberations of the Board a clear approval or ratification of the disbursements. I will ask the Board at its next session to take a formal vote of approval or ratification.

In my review of the history of the deliberations of the Board about the terms for a policy on distributions to the divisions, I note multiple entries, some of which seem inconsistent and somewhat incomplete or vague. I will also ask the Board to consider restating the distribution policy so that it will be clear as to the Board's intent, as well as streamlining the distribution process.

NER Budget The NER Operations Manual for NER Treasurer, Paragraph 1.0, requires the Treasurer to propose a budget to the Board for its consideration. I have drafted a proposed budget that is mostly based upon last year's level of performance and assumes that the new division distribution policy will entail 1) automatic distributions of any NMRA rebates received and 2) post fiscal year close distribution of one-half of any defined net asset growth. For FY 2015, I forecast that the division distributions would be a total of $5,621. See Attachment 4 for details of the FY 2015 budget. I have not received input from Directors as to whether there are plans to support other programs, e.g., the Boy Scouts, or another gift to the NMRA's projects. If other possible disbursements will be considered or if different expense assumptions should be used, it would help to know about them as early as possible. Although the draft budget shows substantial "deficit" spending before investment returns are considered, this is a natural result of delaying some of the NMRA rebate distributions to FY 2015, the extraordinarily high growth in certain investment assets in the prior fiscal year, and the extra cost of the election issue of The Coupler. In short, FY 2014 was "too profitable" and FY 2015 will be "too unprofitable." Combined, however, the two years reflect reasonable financial performance.

To further inform the Board, I have generated an analysis of the prior fiscal year budget in comparison to actual results. See Attachment 5. The total revenue in FY 2014 was better than budgeted in all categories. The transfers to the divisions was $1,093 above budget, too. Although this is a disbursement, it really is a "positive" variance in the respect that the NER helped its divisions more than it budgeted. Congratulations! As mentioned previously, The Coupler expenditures were under budget due to only having charges for three issues. The prior fiscal year budget did not attempt to forecast investment yields or investment management expenses. I have included them in the "actual" column for information. As you would anticipate from prior reports, the NER exceeded "budget" last fiscal year in a substantial, favorable fashion.

2014 Distribution to the Divisions Now for the exciting part. Based upon my understanding of the intent of the Board, formed in part by many conversations with my predecessor and the President, as well as my reading of the various work papers and records that I could locate, I have calculated what I believe to be an appropriate amount for the Board to vote to distribute by the Annual Meeting. See Attachment 6. Distributing $5,620.81 to the divisions will fully pay to them the remainder of the NMRA rebate received by the NER last fiscal year, plus pay out one-half of last fiscal year's growth in certain assets of the NER.

Note: If the proposed division disbursement policy is adopted and implemented, the FY 2015 NMRA rebates, estimated to be $3,000 in FY 2015, will also be distributed. *The combined distributions to the divisions in FY 2015 would total $8,621!* This is a unique and noteworthy level of support of the divisions and their members, largely due to the large market growth in FY 2014 and delay in paying one-half of the FY 2014 NMRA rebate. In comparison, I strongly suspect that FY 2016 NER distributions to its active divisions will only be the $3,000 from NMRA rebates.

Restatement of the Division Distribution Policy Despite efforts over several months, I have not been able to assemble a comprehensive and consistent set of terms for the Board's intended Division Distribution Policy. Rather than continue to research further, I believe that it is more useful for the Board to simply restate what its policy is. Based upon what I have learned, I have drafted what I believe is the policy intended by the Board. See Attachment 7. In drafting this resolution for the Board's consideration, I have added procedural terms and clarified the assets subject to the rule. Given that two years have elapsed since the first effort of the Board to adopt such a policy, I was able to recommend eliminating certain transition/cautionary terms. At least the President felt that I had captured the intent as well as the practicality of the situation. I hope that the full Board will agree.

Note that this version makes it automatic to distribute whatever NMRA rebates the NER receives and to distribute them timely. The post fiscal year additional distribution of half the growth in certain asset value can be made at any time up to the Annual Meeting. If the Board convenes in time, it can review and approve the calculation of the post-year distribution. If the Board does not have a chance to convene to approve it, the distribution can still be made by the Annual Meeting, but later reviewed, ratified or corrected, with authority to make the corrections out of future distributions. I would think that this commitment of significant, timely financial support by the NER Board to the NER divisions would be warmly appreciated by the divisions and their members.

My predecessor and I share a common trait of financial "conservatism." We tend to use conservative assumptions so that all "surprises" will be positive surprises, not bad ones. So my first test of this policy was to check its potential impact on net cash flow. As business advisors state, "There are three rules about financial management of an enterprise. The first rule is to <u>never run out of cash.</u> The other two rules are not important." The attached monthly cash flow analysis (Attachment 8) for FY 2015 shows that the Board can feel safe that the cash balance in the checking account during the year should never fall below $2,462 (January) and should recover to $4,451 by June, 2015. As Treasurer, I am comfortable with that level of cash balance in the operating account throughout the current fiscal year. I prefer to leave the remaining liquid assets in the investment account as long as possible as the checking account yields virtually no interest income. In the future, though, especially when the NER has asset growth that needs to be split with the active divisions, the NER will need to withdraw some portion of the invested assets in order to have cash to distribute to divisions. I look forward to that day as the NER's financial strength by then will be even better than it is today.

Audit Article V of the NER bylaws list the Standing Committees of the NER, one of which is the Audit Committee (Section 5). The members of that committee, appointed by the President, review the Treasurer's financial reports annually and report at the Annual Meeting. I served on the Audit Committee in early 2013 with Tom Coulombe to review the NER financial statements through December 31, 2012. That review covered FYE June 2010, 2011, and 2012, as well as the first six months of FYE June 2013. We issued our report dated April 13, 2013, and urged the President to convene an Audit Committee on an annual basis. I am not aware of the identities of the current Audit Committee and no audit has been conducted on transactions since the end of calendar year 2012.

Treasurer's Report for FYE June 2013 I have attached the prior Annual Report prepared by Larry Cannon to inform you as to prior history. Attachment 9.

Form 990-N I filed, and the IRS accepted on July 10, 2014, a completed Form 990-N for the taxable year ended June 30, 2014. The NER is current on all tax compliance matters.

If anyone has any questions, please send them my way.

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