

BARRON SQUARE HOMEOWNERS ASSOCIATION

Thain Way ▪ Palo Alto ▪ California

**TO: All Members of
THE BARRON SQUARE HOMEOWNERS ASSOCIATION**

**FROM: Deborah McGraw, CCAM-PM-HR.CI®
Association Manager**

SUBJECT: COPY OF The Association's 2017 AUDIT

DATE: March 6, 2018

Enclosed please find your copy of the

***Independent Auditor's Report, Financial Statements and Supplementary
Information
for the Year Ended December 31, 2017***

more commonly referred to as the 2017 AUDIT, for The Barron Square Homeowners Association as prepared by Marcello Lara, Certified Public Accountant and Consultant, the Association's auditor. This 2017 AUDIT is being mailed to you as specified in Section 5305 of the California Civil Code.

Please keep your copy of the 2017 AUDIT with your other Association documents for easy reference and/or for availability in the event that you should sell or refinance your unit.

If you have any question regarding the 2017 AUDIT, please submit them, *in writing*, to the Board of Governors, in care of PML Management at the address below.

Encl.

audit cover letter 2017 bs

THE BARRON SQUARE HOMEOWNERS ASSOCIATION

INDEPENDENT AUDITOR'S REPORT,
FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

YEAR ENDED DECEMBER 31, 2017

MARCELLO LARA

Certified Public Accountant & Consultant

The Barron Square Homeowners Association

Contents Year Ended December 31, 2017

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Members of
The Barron Square Homeowners Association
Palo Alto, California

I have audited the accompanying financial statements of **The Barron Square Homeowners Association** (the Association), which comprise the balance sheet as of December 31, 2017, and the related statements of revenues, expenses and changes in fund balance and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, I express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **The Barron Square Homeowners Association** as of December 31, 2017, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.



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The Barron Square Homeowners Association
Palo Alto, California

Disclaimer of Opinion on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the information on future major repairs and replacements of common property on page(s) 12 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Financial Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. I have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about methods of preparing the information and comparing the information for consistency with management's responses to my inquiries, the basic financial statements, and other knowledge I obtained during my audit of the basic financial statements. I do not express an opinion or provide any assurance on the information because the limited procedures do not provide me with sufficient evidence to express an opinion or provide any assurance.

Comparative Information

Information for the year ended December 31, 2016 is presented for comparative purposes only and was extracted from audited financial statements on which I expressed an unqualified opinion in my report dated February 28, 2017.

Marcello Lara

February 2, 2018

The Barron Square Homeowners Association

Balance Sheets as of December 31, 2017

| | Note | 2017 | | | 2016 |
|---|------|--------------------|---------------------|---------------------|---------------------|
| | | Operations Fund | Replacement Fund | Total Funds | Total Funds |
| <i>(for comparative purposes only)</i> | | | | | |
| Assets | | | | | |
| Cash and cash equivalents | 2.4 | \$ 106,279 | \$ 446,952 | \$ 553,231 | \$ 1,233,781 |
| Investment in certificates of deposit | 4 | - | 507,914 | 507,914 | 107,184 |
| Prepaid insurance | | 3,995 | - | 3,995 | 4,892 |
| Other prepaid expenses | | 2,652 | - | 2,652 | 2,500 |
| Member receivables | 2.6 | 188 | - | 188 | 909 |
| Due from (to) operations fund | | - | 25 | 25 | (96,420) |
| Due (to) from replacement fund | | (25) | - | (25) | 96,420 |
| Total Assets | | \$ 113,089 | \$ 954,891 | \$ 1,067,980 | \$ 1,349,266 |
| Liabilities | | | | | |
| Assessments received in advance | | \$ 13,180 | \$ - | \$ 13,180 | \$ 12,465 |
| Accounts payable | | 5,411 | 3,375 | 8,786 | 177,810 |
| Income taxes payable | | 183 | - | 183 | - |
| Total Liabilities | | 18,774 | 3,375 | 22,149 | 190,275 |
| Fund Balance | | 94,315 | 951,516 | 1,045,831 | 1,158,991 |
| Total Liabilities and Fund Balance | | \$ 113,089 | \$ 954,891 | \$ 1,067,980 | \$ 1,349,266 |

See independent auditor's report and accompanying notes.

The Barron Square Homeowners Association

Statements of Revenues, Expenses and Changes in Fund Balances for the Year Ended December 31, 2017

| | | 2017 | | | 2016 |
|---------------------------------------|------|--------------------|---------------------|----------------|------------------------------------|
| | Note | Operations Fund | Replacement Fund | Total Funds | Total Funds |
| | | | | | (for comparative purposes only) |
| Revenues | | | | | |
| Member assessments | 2.8 | \$ 296,133 | \$ 325,287 | \$ 621,420 | \$ 609,504 |
| Interest income | 2.9 | 51 | 3,042 | 3,093 | 1,238 |
| Late charges and other income | | 4,755 | - | 4,755 | 74 |
| Total Revenues | | 300,939 | 328,329 | 629,268 | 610,816 |
| Expenses | | | | | |
| <u>Administration</u> | | | | | |
| Insurance | | 66,540 | - | 66,540 | 78,969 |
| Management | | 30,900 | - | 30,900 | 30,000 |
| General administration | | 5,180 | - | 5,180 | 5,845 |
| Legal, accounting and consulting | | 4,515 | - | 4,515 | 4,134 |
| Social functions | | 940 | - | 940 | - |
| Bank fees | | - | 300 | 300 | 300 |
| Income taxes | 2.10 | 183 | - | 183 | - |
| Total administration | | 108,258 | 300 | 108,558 | 119,248 |
| <u>Common Area Maintenance</u> | | | | | |
| Landscape maintenance | | 73,222 | - | 73,222 | 74,566 |
| Common area maintenance and repairs | | 20,125 | - | 20,125 | 8,667 |
| Gutters and downspouts | | 8,050 | - | 8,050 | 5,900 |
| Pool and spa maintenance and repair | | 6,678 | - | 6,678 | 5,366 |
| Custodial services | | 6,586 | - | 6,586 | 5,547 |
| Plumbing maintenance and repair | | 4,508 | - | 4,508 | 2,369 |
| Pest control | | 4,117 | - | 4,117 | 6,004 |
| Lighting and electrical | | 1,043 | - | 1,043 | 1,966 |
| Total Common Area Maintenance | | 124,329 | - | 124,329 | 110,385 |
| <u>Utilities</u> | | | | | |
| Water and sewer | | 42,000 | - | 42,000 | 45,333 |
| Gas and electricity | | 7,818 | - | 7,818 | 8,696 |
| Cable television | | 1,942 | - | 1,942 | 1,848 |
| Total Utilities | | 51,760 | - | 51,760 | 55,877 |

See independent auditor's report and accompanying notes.

The Barron Square Homeowners Association

Statements of Revenues, Expenses
and Changes in Fund Balances
for the Year Ended December 31, 2017

| Note | 2017 | | | 2016 |
|--|--------------------|---------------------|----------------|--|
| | Operations Fund | Replacement Fund | Total Funds | Total Funds |
| | | | | <i>(for comparative purposes only)</i> |
| <u>Major Repairs and Replacements</u> | | | | |
| Decks | - | 210,539 | 210,539 | - |
| Building exteriors | - | 94,234 | 94,234 | 414,581 |
| Other major repairs and replacements | - | 57,443 | 57,443 | 149,596 |
| Landscaping | - | 31,456 | 31,456 | 24,017 |
| Concrete surfaces | - | 21,850 | 21,850 | 1,450 |
| Lighting | - | 18,456 | 18,456 | 33,385 |
| Painting | - | 15,788 | 15,788 | - |
| Clubhouse | - | 8,015 | 8,015 | 39,998 |
| Roofs | - | - | - | 17,460 |
| Tennis courts | - | - | - | 5,800 |
| | - | 457,781 | 457,781 | 686,287 |
| Total Major Repairs and Replacements | | | | |
| Total Expenses | 284,347 | 458,081 | 742,428 | 971,797 |
| Excess (Deficiency) of Revenues Over Expenses | 16,592 | (129,752) | (113,160) | (360,981) |
| Permanent transfer | 95,307 | (95,307) | - | - |
| Fund Balance (Deficit), Beginning of Year | (17,584) | 1,176,575 | 1,158,991 | 1,519,972 |
| Fund Balance, End of Year | \$ 94,315 | \$ 951,516 | \$ 1,045,831 | \$ 1,158,991 |

See independent auditor's report and accompanying notes.

The Barron Square Homeowners Association

Statements of Cash Flows for the Year Ended December 31, 2017

| | 2017 | | | 2016 |
|--|--------------------|---------------------|-------------------|--|
| | Operations Fund | Replacement Fund | Total Funds | Total Funds |
| | | | | <i>(for comparative purposes only)</i> |
| <u>Operating Activities</u> | | | | |
| Excess (Deficiency) of Revenues Over Expenses | \$ 16,592 | \$ (129,752) | \$ (113,160) | \$ (360,981) |
| Adjustments to Reconcile Excess (Deficiency) of Revenues Over Expenses to Net Cash Provided by Operating Activities: | | | | |
| Permanent transfer | 95,307 | (95,307) | - | - |
| Decrease (Increase) in Assets: | | | | |
| Member receivables | 721 | - | 721 | (763) |
| Prepaid insurance | 897 | - | 897 | 89 |
| Prepaid income taxes | - | - | - | 381 |
| Other prepaid expenses | (152) | - | (152) | 150 |
| Due from operations fund | - | (96,445) | (96,445) | 111,105 |
| Due to replacement fund | 96,445 | - | 96,445 | (111,105) |
| Increase (Decrease) in Liabilities | | | | |
| Accounts payable | (168,124) | (900) | (169,024) | 173,809 |
| Assessments received in advance | 715 | - | 715 | (6,648) |
| Income taxes payable | 183 | - | 183 | - |
| Total Adjustments | 25,992 | (192,652) | (166,660) | 167,018 |
| Net Cash Provided by (Used for) Operating Activities | 42,584 | (322,404) | (279,820) | (193,963) |
| <u>Investing Activities</u> | | | | |
| Net (Purchase) Sale of investment in certificates of deposit | - | (400,730) | (400,730) | (696) |
| Net Cash Provided by (Used for) Investing Activities | - | (400,730) | (400,730) | (696) |
| Net Increase (Decrease) in Cash and Cash Equivalents | 42,584 | (723,134) | (680,550) | (194,659) |
| Cash and Cash Equivalents, Beginning of Year | 63,695 | 1,170,086 | 1,233,781 | 1,428,440 |
| Cash and Cash Equivalents, End of Year | \$ 106,279 | \$ 446,952 | \$ 553,231 | \$ 1,233,781 |
| <u>Supplemental Disclosures</u> | | | | |
| Income Taxes Paid | 2.10 \$ - | \$ - | \$ - | \$ (381) |

See independent auditor's report and accompanying notes.

The Barron Square Homeowners Association

Notes to Financial Statements
for the Year Ended December 31, 2017

1. Nature of Organization

The Barron Square Homeowners Association (the Association) is a common interest development located in Palo Alto, California which consists of 65 residential dwellings and certain common area property. The Association was organized as a nonprofit mutual-benefit corporation on February 08, 1979 to provide for management, maintenance and architectural control of the individual units and the common area property. The Association is governed by a member-elected Board of Directors which is responsible for enforcing provisions of the governing documents, which include covenants, conditions and restrictions (CC&Rs), by laws, and rules and regulations. Major decisions, as determined by the CC&Rs, are referred to the Association owners as a whole.

2. Summary of Significant Accounting Policies

2.1 Method of Accounting. The accompanying financial statements, and the Association's corporate income tax returns, have been prepared on the accrual basis of accounting, in accordance with accounting principles generally accepted in the United States of America, whereby revenues are recognized when earned and expenses are recognized when incurred.

2.2 Fund Accounting. The Association's governing documents provide certain guidelines for governing its financial activities. To ensure the observance of limitations and restrictions on the use of financial resources, the Association maintains its accounts using fund accounting. Financial resources are classified for accounting and reporting purposes in two funds established according to their nature and purpose.

Operations Fund - This fund is used to account for the financial resources available for the general day-to-day operations of the Association.

Replacement Fund - This fund is used to accumulate financial resources designated for future major repairs and replacements.

2.3 Comparative Information The financial statements include certain prior year summarized comparative information in total but not by fund. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the Association's financial statements for the year ended December 31 of the prior year, from which the summarized information was derived.

2.4 Cash and Cash Equivalents. For purposes of the balance sheet and the statement of cash flows, the Association considers cash on hand, demand deposits with financial institutions, money market accounts and all short-term investments with original maturities of three months or less to be included in cash and cash equivalents.

See independent auditor's report.

The Barron Square Homeowners Association

Notes to Financial Statements
for the Year Ended December 31, 2017

2.5 Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates, and the differences could be material.

2.6 Member Receivables at the balance sheet date represent aggregate amounts due from unit owners which may include regular assessments, late fees, fines, reimbursement assessments and other charges. The Association's policy is to retain legal counsel and place liens on the properties of homeowners whose assessments are thirty days or more delinquent.

It is the opinion of the Board of Directors that the Association will ultimately prevail against homeowners with delinquent assessments and, accordingly, no allowance for delinquent accounts is deemed necessary.

2.7 Real and Personal Common Property acquired by the original owners from the developer is not recognized in the Association's financial statements, in accordance with prevalent industry practice, because it is commonly owned by the individual Association members and its disposition by the Board of Directors is restricted. Similarly, major repairs, replacements and improvements to real and personal property are not recognized.

2.8 Member Assessments. Association members are subject to annual assessments, payable in equal monthly installments, to provide funds for the Association's operating expenses and major repairs and replacements. In addition to regular annual assessments, special and/or emergency assessments may be imposed by the Association's Board of Directors under certain circumstances without member approval. Any excess assessments at year end are retained by the Association for use in the succeeding year.

Monthly assessments for the years ended December 31, 2017 and 2016 were as follows:

| | | Monthly | | |
|----------------------------|------|--------------------|---------------------|-----------|
| | | Operations Fund | Replacement Fund | Total |
| Member assessments-average | 2017 | \$ 379.66 | \$ 417.03 | \$ 796.69 |
| Member assessments-average | 2016 | \$ 333.02 | \$ 448.39 | \$ 781.41 |
| | | Low | High | |
| Assessment Range | 2017 | \$ 647.00 | \$ 927.00 | |
| | 2016 | \$ 635.00 | \$ 909.00 | |

2.9 Interest Earned on operating and replacement funds, net of related income taxes, is retained in said respective funds.

See independent auditor's report.

The Barron Square Homeowners Association

Notes to Financial Statements
for the Year Ended December 31, 2017

2.10 Income Taxes. The Association elects annually to be taxed as either a regular corporation under Internal Revenue Code (IRC) § 277 or as a homeowners association under IRC § 528 in its tax filing with the Internal Revenue Service (IRS). Form 1120 is used when filing as a regular corporation and Form 1120-H is used when filing as a homeowners association.

For the year ended December 31, 2017 the Association elected to file Form 1120 and be taxed as a regular corporation. By doing so, the Association is taxed at graduated rates from 15% to 39% on net nonmembership income (generally investment interest income), less directly related expenses.

The Association is taxed by the California Franchise Tax Board (FTB) at a rate of 8.84% on its net nonmembership income.

The Association has qualified as a tax-exempt entity with the FTB under California Revenue and Taxation Code § 23701. To maintain tax-exempt status with FTB the Association must, among other things, file an annual informational return known as Form 199 and pay a \$10 filing fee.

The Association's income tax returns are subject to examination by various taxing authorities. In evaluating the Association's tax provisions and accruals, the Association believes that its estimates are appropriate based on current facts and circumstances.

2.11 Fair Value of Financial Instruments. The carrying amounts of financial instruments, including cash and cash equivalents, member receivables, and accounts payable, if any, approximate their fair value due to the short term maturities of these instruments.

3. Concentrations of Credit Risk

The Association maintains its deposits with what management believes to be high credit quality financial institutions and attempts to limit the amount of credit exposure to any one particular institution. The balances in those accounts may occasionally exceed the current Federal Deposit Insurance Corporation (FDIC) insurance protection of up to \$250,000 per depositor per institution. Amounts held with broker-dealers are not usually insured by the FDIC, but rather they are privately insured by the Securities Investor Protection Corporation (SIPC).

4. Investments

The Association categorizes its investments according to the Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) 320-10. Generally, and in line with prevalent industry practice, the Association only invests in securities classified as *Held to Maturity* or *Available for Sale*.

4.1 Debt securities held to maturity consist of federally-insured certificates of deposit that the

See independent auditor's report.

The Barron Square Homeowners Association

Notes to Financial Statements
for the Year Ended December 31, 2017

Investments (continued)

Association has both the intent and ability to hold to maturity. These investments are recorded at their amortized cost whose aggregate fair values at December 31, 2017 are \$507,914.

5. Future Major Repairs and Replacements

The Association's governing documents require that funds be accumulated for future major repairs and replacements. Accumulated cash, cash equivalents and investments, if any, are required to be held in separate savings accounts are generally not available for expenditures for normal operations.

In November 2017 a full component study was completed by Reserve Analysis Consulting, LLC to estimate the remaining useful lives and the replacement costs of the components of common property. The estimates were based on current estimated replacement costs. Funding requirements consider an annual component cost inflation rate of 3.00% and an interest rate of 2.00% earned on cash and investments on amounts funded for future major repairs and replacements. The table on page(s) 12 on future major repairs and replacements is based on the aforementioned study.

The Board is funding for major repairs and replacements over the remaining useful lives of the components based on the study's estimates of future replacement costs and considering amounts previously accumulated in the replacement fund. Accordingly, the Board has approved an annual contribution of \$342,365 in the 2018 operating budget. Additional information regarding the Association's funding model may be found in the annually-prepared pro forma operating budget and/or the assessment and reserve funding disclosure summary.

Funds are being accumulated in the replacement fund based on estimated future costs for repairs and replacement of common property components. Actual expenditures and investment income may vary from the estimated amounts, and the variations may be material. Therefore, amounts accumulated in the replacement fund may not be adequate to meet all future needs for major repairs and replacements. If additional funds are needed, the association has the right, subject to the constraints in its governing documents and California civil code, to increase regular assessments, pass special assessments, or delay major repairs and replacements until funds are available.

6. Commitments

The Association enters into contracts for management and/or maintenance services in the normal course of its business operations. These contracts are generally cancelable on thirty to ninety days' advance notice.

See independent auditor's report.

The Barron Square Homeowners Association

Notes to Financial Statements
for the Year Ended December 31, 2017

7. Date of Management's Review

In preparing the financial statements, the Association has evaluated events and transactions for potential recognition or disclosure through February 2, 2018, the date that the financial statements were available to be issued.

See independent auditor's report.

The Barron Square Homeowners Association

Supplementary Information on Future Major Repairs and Replacements December 31, 2017 (Unaudited)

In November 2017 a full component study was completed by Reserve Analysis Consulting, LLC to estimate the remaining useful lives and the replacement costs of the components of common property. The estimates were based on current estimated replacement costs. Funding requirements consider an annual component cost inflation rate of 3.00% and an interest rate of 2.00% earned on cash and investments on amounts funded for future major repairs and replacements.

The following table is based on the most recent component study and presents significant information about the components of common property.

| Components | Estimated Remaining Useful Lives (Years) | Estimated Current Replacement Costs |
|---|---|--|
| Signage | 2-12 | \$ 7,250 |
| Paving and concrete | 0-17 | \$ 112,223 |
| Fences, retaining walls and gates | 2-21 | \$ 195,871 |
| Irrigation and landscaping | (1)-23 | \$ 122,113 |
| Lighting | 0-29 | \$ 70,450 |
| Mailbox kiosks | (1)-19 | \$ 16,200 |
| Miscellaneous - grounds | (3)-9 | \$ 6,800 |
| Tennis court area | 4-11 | \$ 42,150 |
| Swimming pool & spa | (6)-27 | \$ 94,346 |
| Clubhouse: interior / building exterior | (3)-23 | \$ 130,044 |
| Garage and trash enclosure | 1-6 | \$ 133,000 |
| Residential building exteriors - stairs, landings, balconies | 1 | \$ 250,000 |
| Building exterior - roofs | 0-27 | \$ 1,039,366 |
| Residential building exteriors - repair / replace allowances | 0-15 | \$ 610,556 |
| Painting and staining | 5 | \$ 250,000 |
| Miscellaneous and contingency | (1)-16 | \$ 107,000 |
| | TOTAL | \$ 3,187,369 |
| Estimated cash reserves necessary to repair, replace, restore, or maintain the major components (*) as of December 31, 2017 | | \$ 1,418,000 |
| Replacement fund cash and investments at December 31, 2017 | | \$ 954,866 |
| Replacement fund balance at December 31, 2017 | | \$ 951,516 |
| 2018 Budgeted reserve contributions | | \$ 342,365 |

*Figure obtained from the Association's most recent full component study prepared by Reserve Analysis Consulting, LLC. Detailed information can be found in that report, dated November 2017.

See independent auditor's report.