

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 2018 AUDIT

DATE: April 26, 2019

Enclosed please find your copy of the

***Independent Auditor's Report, Financial Statements and Supplementary
Information
for the Year Ended December 31, 2018***

more commonly referred to as the 2018 AUDIT, for The Barron Square Homeowners Association as prepared by Marcello Lara, Certified Public Accountant and Consultant, the Association's auditor. This 2018 AUDIT is being mailed to you as specified in Section 5305 of the California Civil Code.

Please keep your copy of the 2018 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 2018 AUDIT, please submit them, ***in writing***, to the Board of Governors in care of PML Management at the address below.

Encl.

audit cover letter 2018.bs

THE BARRON SQUARE HOMEOWNERS ASSOCIATION

INDEPENDENT AUDITOR'S REPORT,
FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

YEAR ENDED DECEMBER 31, 2018

MARCELLO LARA
Certified Public Accountant & Consultant

The Barron Square Homeowners Association

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Year Ended December 31, 2018

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MARCELLO LARA
certified public accountant & consultant

303 Twin Dolphin Dr., Suite 600
Redwood City, CA 94065
PHN 650.632.4211 | FAX 650.551.9901
EML marco@lara-cpa.com

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, 2018, 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, 2018, 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.



MARCELLO LARA
certified public accountant & consultant

303 Twin Dolphin Dr., Suite 600
Redwood City, CA 94065
PHN 650.632.4211 | FAX 650.551.9901
EML marco@lara-cpa.com

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, 2017 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 02, 2018.

Marcello Lara

March 8, 2019

The Barron Square Homeowners Association

Balance Sheets as of December 31, 2018

	Note	2018			2017
		Operations Fund	Replacement Fund	Total Funds	Total Funds
Assets					
Cash and cash equivalents	2.4	\$ 159,439	\$ 697,190	\$ 856,629	\$ 553,231
Investment in US Treasury securities	4	-	348,015	348,015	-
Investment in certificates of deposit	4	-	109,273	109,273	507,914
Prepaid insurance		4,577	-	4,577	3,995
Other prepaid expenses		2,785	-	2,785	2,652
Member receivables	2.6	2,095	-	2,095	188
Due from operations fund		-	11,497	11,497	25
Due to replacement fund		(11,497)	-	(11,497)	(25)
Total Assets		<u>\$ 157,399</u>	<u>\$ 1,165,975</u>	<u>\$ 1,323,374</u>	<u>\$ 1,067,980</u>
Liabilities					
Insurance claim settlement obligation		\$ 26,886	\$ -	\$ 26,886	\$ -
Accounts payable		11,068	-	11,068	8,786
Assessments received in advance		10,806	-	10,806	13,180
Income taxes payable	2.10	<u>1,963</u>	<u>-</u>	<u>1,963</u>	<u>183</u>
Total Liabilities		<u>50,723</u>	<u>-</u>	<u>50,723</u>	<u>22,149</u>
Fund Balance		<u>106,676</u>	<u>1,165,975</u>	<u>1,272,651</u>	<u>1,045,831</u>
Total Liabilities and Fund Balance		<u>\$ 157,399</u>	<u>\$ 1,165,975</u>	<u>\$ 1,323,374</u>	<u>\$ 1,067,980</u>

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, 2018

	Note	2018			2017
		Operations Fund	Replacement Fund	Total Funds	Total Funds
<i>(for comparative purposes only)</i>					
Revenues					
Member assessments	2.8	\$ 288,559	\$ 342,365	\$ 630,924	\$ 621,420
Interest income	2.9	71	10,023	10,094	3,093
Late charges and other income		<u>422</u>	<u>-</u>	<u>422</u>	<u>4,755</u>
Total Revenues		<u><u>289,052</u></u>	<u><u>352,388</u></u>	<u><u>641,440</u></u>	<u><u>629,268</u></u>
Expenses					
<u><i>Administration</i></u>					
Insurance		70,764	-	70,764	66,540
Management		31,824	-	31,824	30,900
Legal, accounting and consulting		5,373	-	5,373	4,515
General administration		3,339	-	3,339	5,180
Income taxes	2.10	2,163	-	2,163	183
Bank fees		-	350	350	300
Social functions		<u>112</u>	<u>-</u>	<u>112</u>	<u>940</u>
Total administration		<u><u>113,575</u></u>	<u><u>350</u></u>	<u><u>113,925</u></u>	<u><u>108,558</u></u>
<u><i>Common Area Maintenance</i></u>					
Landscape maintenance		76,925	-	76,925	73,222
Gutters and downspouts		8,650	-	8,650	8,050
Pool and spa maintenance and repair		7,343	-	7,343	6,678
Other maintenance and repairs		7,324	-	7,324	20,125
Custodial services		5,705	-	5,705	6,586
Plumbing maintenance and repair		3,897	-	3,897	4,508
Pest control		3,322	-	3,322	4,117
Lighting and electrical		<u>2,635</u>	<u>-</u>	<u>2,635</u>	<u>1,043</u>
Total Common Area Maintenance		<u><u>115,801</u></u>	<u><u>-</u></u>	<u><u>115,801</u></u>	<u><u>124,329</u></u>
<u><i>Utilities</i></u>					
Water and sewer		35,838	-	35,838	42,000
Gas and electricity		9,471	-	9,471	7,818
Cable television		<u>2,006</u>	<u>-</u>	<u>2,006</u>	<u>1,942</u>
Total Utilities		<u><u>47,315</u></u>	<u><u>-</u></u>	<u><u>47,315</u></u>	<u><u>51,760</u></u>

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, 2018

	2018			2017
Note	Operations Fund	Replacement Fund	Total Funds	Total Funds
				<i>(for comparative purposes only)</i>
<u>Major Repairs and Replacements</u>				
Clubhouse	-	42,968	42,968	8,015
Landscaping	-	27,972	27,972	31,456
Building exteriors	-	22,838	22,838	94,234
Other major repairs and replacements	-	18,977	18,977	57,443
Roofs	-	13,644	13,644	-
Concrete surfaces	-	9,200	9,200	21,850
Lighting	-	1,980	1,980	18,456
Decks	-	-	-	210,539
Painting	-	-	-	15,788
	-	137,579	137,579	457,781
Total Major Repairs and Replacements				
Total Expenses	276,691	137,929	414,620	742,428
Excess (Deficiency) of Revenues Over Expenses	12,361	214,459	226,820	(113,160)
Fund Balance, Beginning of Year	94,315	951,516	1,045,831	1,158,991
Fund Balance, End of Year	\$ 106,676	\$ 1,165,975	\$ 1,272,651	\$ 1,045,831

See independent auditor's report and accompanying notes.

The Barron Square Homeowners Association

Statements of Cash Flows for the Year Ended December 31, 2018

	2018			2017
	Operations Fund	Replacement Fund	Total Funds	Total Funds
				<i>(for comparative purposes only)</i>
<u>Operating Activities</u>				
Excess (Deficiency) of Revenues Over Expenses	\$ 12,361	\$ 214,459	\$ 226,820	\$ (113,160)
Adjustments to Reconcile Excess (Deficiency) of Revenues Over Expenses to Net Cash Provided by Operating Activities:				
Decrease (Increase) in Assets:				
Member receivables	(1,907)	-	(1,907)	721
Prepaid insurance	(582)	-	(582)	897
Other prepaid expenses	(133)	-	(133)	(152)
Due from operations fund	-	(11,472)	(11,472)	(96,445)
Due to replacement fund	11,472	-	11,472	96,445
Increase (Decrease) in Liabilities				
Accounts payable	5,657	(3,375)	2,282	(169,024)
Assessments received in advance	(2,374)	-	(2,374)	715
Insurance claim settlement obligation	26,886	-	26,886	-
Income taxes payable	1,780	-	1,780	183
Total Adjustments	40,799	(14,847)	25,952	(166,660)
Net Cash Provided by (Used for) Operating Activities	53,160	199,612	252,772	(279,820)
<u>Investing Activities</u>				
Net (Purchase) Sale of investment in certificates of deposit	-	398,641	398,641	(400,730)
Net (Purchase) Sale of investment in US Treasury securities	-	(348,015)	(348,015)	-
Net Cash Provided by (Used for) Investing Activities	-	50,626	50,626	(400,730)
Net Increase (Decrease) in Cash and Cash Equivalents	53,160	250,238	303,398	(680,550)
Cash and Cash Equivalents, Beginning of Year	106,279	446,952	553,231	1,233,781
Cash and Cash Equivalents, End of Year	\$ 159,439	\$ 697,190	\$ 856,629	\$ 553,231
<u>Supplemental Disclosures</u>				
Income Taxes Paid	2.10 \$ 383	\$ -	\$ 383	\$ -

See independent auditor's report and accompanying notes.

The Barron Square Homeowners Association

Notes to Financial Statements
for the Year Ended December 31, 2018

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, 2018

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, 2018 and 2017 were as follows:

		Monthly		
		Operations	Replacement	
		Fund	Fund	Total
Member assessments-average	2018	\$ 369.95	\$ 438.93	\$ 808.88
Member assessments-average	2017	\$ 379.66	\$ 417.03	\$ 796.69
		Low	High	
Assessment Range	2018	\$ 657.00	\$ 941.00	
	2017	\$ 647.00	\$ 927.00	

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, 2018

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, 2018 the Association elected to file Form 1120 and be taxed as a regular corporation. By doing so, the Association is taxed at a flat 21% rate 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.

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. Fair Value Measurements

Financial Accounting Standards Board Accounting Standards Codification Topic 820, Subtopic 10 (FASB ASC 820-10), defines fair value, establishes a framework for measuring fair value, and expands disclosure requirements for fair value measurements.

FASB ASC 820-10 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Association determines

See independent auditor's report.

The Barron Square Homeowners Association

Notes to Financial Statements
for the Year Ended December 31, 2018

Fair value measurements (continued)

the fair values of its assets and liabilities based on the fair value hierarchy established in FASB ASC 820-10. The standard describes three levels of inputs that may be used to measure fair value (Level 1, Level 2, and Level 3). Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Association has the ability to access at the measurement date. An active market is a market in which transactions occur with sufficient frequency and volume to provide pricing information on an on-going basis. Level 2 inputs are inputs other than quoted prices that are observable for the asset or liability. Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs reflect the Association's own suppositions about the assumptions market applicants would use in pricing the asset or liability (including assumptions about risk). Unobservable inputs are developed based on the best information available in the circumstances and may include the Association's own data.

The following methods and assumptions were used to estimate the fair values of assets and liabilities:

(a) Cash and cash equivalents: the carrying amount equals fair value. All amounts, including interest bearing accounts, are subject to immediate withdrawal.

(b) Assessments receivable, trade accounts payable, assessments received in advance: The carrying values are considered equal to their fair values due to the short-term maturities of these instruments.

(c) Investments: The carrying values are determined by reference to quoted market prices and other relevant information generated by market transactions.

Fair values of assets measured as of December 31, 2018 are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Certificates of deposit	\$ 109,273	\$ -	\$ -	\$ 109,273
US Treasury securities	\$ 348,015	\$ -	\$ -	\$ 348,015
Total	<u>\$ 457,288</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 457,288</u>

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 2018 a component study update, with no site-visit 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

See independent auditor's report.

The Barron Square Homeowners Association

Notes to Financial Statements
for the Year Ended December 31, 2018

Future major repairs and replacements (continued)

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 \$353,069 in the 2019 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.

7. Date of Management's Review

In preparing the financial statements, the Association has evaluated events and transactions for potential recognition or disclosure through March 8, 2019, 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, 2018 (Unaudited)

In November 2018 a component study update, with no site-visit 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	1-11	\$ 7,250
Paving and concrete	0-16	\$ 117,411
Fences, retaining walls and gates	1-20	\$ 204,296
Irrigation and landscaping	0-22	\$ 124,059
Lighting	0-28	\$ 70,950
Mailbox kiosks	0-18	\$ 16,200
Miscellaneous - grounds	1-8	\$ 6,800
Tennis court area	3-10	\$ 42,150
Swimming pool & spa	0-26	\$ 94,559
Clubhouse: interior / building exterior	(4)-45	\$ 249,043
Garage and trash enclosure	0-5	\$ 133,000
Residential building exteriors - stairs, landings, balconies	0	\$ 250,000
Building exterior - roofs	0-30	\$ 1,041,866
Residential building exteriors - repair / replace allowances	0-14	\$ 597,840
Painting and staining	4	\$ 250,000
Miscellaneous and contingency	0-20	\$ 107,000
	TOTAL	\$ 3,312,424
Estimated cash reserves necessary to repair, replace, restore, or maintain the major components (*) as of December 31, 2018		\$ 1,747,000
Replacement fund cash and investments at December 31, 2018		\$ 1,154,478
Replacement fund balance at December 31, 2018		\$ 1,165,975
2019 Budgeted reserve contributions		\$ 353,069

*Figure obtained from the Association's most recent component study update, with no site-visit prepared by Reserve Analysis Consulting, LLC. Detailed information can be found in that report, dated November 2018.

See independent auditor's report.