

JEFFERSON SQUARE HOMEOWNERS ASSOCIATION

(A California Nonprofit Mutual Benefit Corporation)

FINANCIAL STATEMENTS,

INDEPENDENT ACCOUNTANTS' REVIEW REPORT

AND

SUPPLEMENTARY INFORMATION

September 30, 2016

Takemoto & Co.

JEFFERSON SQUARE HOMEOWNERS ASSOCIATION

FINANCIAL STATEMENTS,
INDEPENDENT ACCOUNTANTS' REVIEW REPORT
AND
SUPPLEMENTARY INFORMATION

September 30, 2016

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INDEPENDENT ACCOUNTANTS' REVIEW REPORT

To the Board of Directors
JEFFERSON SQUARE HOMEOWNERS ASSOCIATION
San Jose, California

We have reviewed the accompanying financial statements of JEFFERSON SQUARE HOMEOWNERS ASSOCIATION (a California Nonprofit Mutual Benefit Corporation), which comprise the balance sheet as of September 30, 2016 and the related statements of revenues, expenses and changes in fund balances and cash flows for the year then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's financial data and making inquiries of Association management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, we do not express such an opinion.

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.

Accountant's Responsibility

Our responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require us to perform procedures to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. We believe that the results of our procedures provide a reasonable basis for our conclusion.

Accountant's Conclusion on the Financial Statements

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the information about future major repairs and replacements of common property on page 7 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. We have not audited, reviewed, or compiled the required supplementary information, and, accordingly, we do not express an opinion or provide an assurance on it.

Takemoto & Co.

November 14, 2016
Redwood City, California

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JEFFERSON SQUARE HOMEOWNERS ASSOCIATION
BALANCE SHEET
September 30, 2016

(See Accompanying Notes and Independent Accountants' Review Report)

| | <u>OPERATING FUND</u> | <u>REPLACEMENT FUND</u> | <u>TOTAL</u> |
|---|---------------------------|-----------------------------|-------------------|
| <u>ASSETS</u> | | | |
| Cash | \$ 108,104 | \$ 271,702 | \$ 379,806 |
| Assessment receivable, net of allowance for doubtful accounts of \$30,800 | 3,448 | | 3,448 |
| Prepaid expenses | 15,856 | | 15,856 |
| Refundable income taxes | | 0 | - |
| Due from Operating Fund | | 13,950 | 13,950 |
| | | | |
| TOTAL ASSETS | <u>\$ 127,408</u> | <u>\$ 285,652</u> | <u>\$ 413,060</u> |
| <u>LIABILITIES</u> | | | |
| Accounts payable | \$ 7,167 | \$ 5,807 | \$ 12,974 |
| Assessments paid in advance | 2,274 | | 2,274 |
| Income taxes payables | | 2,223 | 2,223 |
| Due to Replacement Fund | 13,950 | | 13,950 |
| | | | |
| TOTAL LIABILITIES | 23,391 | 8,030 | 31,421 |
| | | | |
| FUND BALANCES | <u>104,017</u> | <u>277,622</u> | <u>381,639</u> |
| | | | |
| TOTAL LIABILITIES AND FUND BALANCES | <u>\$ 127,408</u> | <u>\$ 285,652</u> | <u>\$ 413,060</u> |

See accompanying notes to financial statements.

JEFFERSON SQUARE HOMEOWNERS ASSOCIATION
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND BALANCES
For the year ended September 30, 2016

(See Accompanying Notes and Independent Accountants' Review Report)

| | OPERATING FUND | REPLACEMENT FUND | TOTAL |
|---|-------------------|---------------------|-------------------|
| <u>REVENUES</u> | | | |
| Membership assessments | \$ 191,665 | \$ 123,840 | \$ 315,505 |
| Interest revenues | - | 2,131 | 2,131 |
| Cable revenue | 6,450 | | 6,450 |
| Other income | 5,190 | | 5,190 |
| TOTAL REVENUES | 203,305 | 125,971 | 329,276 |
| <u>EXPENSES</u> | | | |
| Insurance | 48,291 | | 48,291 |
| Utilities | 53,229 | | 53,229 |
| Landscaping | 20,924 | | 20,924 |
| Maintenance | 20,078 | | 20,078 |
| Pool | 5,224 | | 5,224 |
| Management | 20,563 | | 20,563 |
| Professional fees | 2,963 | | 2,963 |
| Administrative | 3,347 | | 3,347 |
| Income taxes | | 2,581 | 2,581 |
| Replacement expenditures | | 486,710 | 486,710 |
| TOTAL EXPENSES | 174,619 | 489,291 | 663,910 |
| Excess (deficit) of revenues over expenses | 28,686 | (363,320) | (334,634) |
| FUND BALANCES, Beginning of year | 75,331 | 640,942 | 716,273 |
| FUND BALANCES End of year | \$ 104,017 | \$ 277,622 | \$ 381,639 |

JEFFERSON SQUARE HOMEOWNERS ASSOCIATION
STATEMENT OF CASH FLOWS
For the year ended September 30, 2016

(See Accompanying Notes and Independent Accountants' Review Report)

| | <u>OPERATING FUND</u> | <u>REPLACEMENT FUND</u> | <u>TOTAL</u> |
|---|---------------------------|-----------------------------|-------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Excess (deficit) of revenues over expenses | \$ 28,686 | \$ (363,320) | \$ (334,634) |
| Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities: | | | |
| (Increase) decrease in: | | | |
| Assessment receivable | 778 | | 778 |
| Refundable income taxes | | 358 | 358 |
| Increase (decrease) in: | | | |
| Accounts payable | 2,470 | (32,690) | (30,220) |
| Assessments paid in advance | 340 | | 340 |
| Income taxes payables | | 2,223 | 2,223 |
| Net cash provided (used) by operating activities | <u>32,274</u> | <u>(393,429)</u> | <u>(361,155)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Purchase investments | | (200,000) | (200,000) |
| Matured investments | | 600,000 | 600,000 |
| Net cash provided (used) by investing activities | <u>-</u> | <u>400,000</u> | <u>400,000</u> |
| Net increase(decrease) in cash | 32,274 | 6,571 | 38,845 |
| Cash at beginning of year | <u>75,830</u> | <u>265,131</u> | <u>340,961</u> |
| Cash at end of year | <u>\$ 108,104</u> | <u>\$ 271,702</u> | <u>\$ 379,806</u> |
| Supplemental disclosure: | | | |
| Income taxes paid | | | <u>\$ -</u> |

JEFFERSON SQUARE HOMEOWNERS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
September 30, 2016

NOTE 1 - DESCRIPTION OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

JEFFERSON SQUARE HOMEOWNERS ASSOCIATION, incorporated on December 10, 1985, is a California Nonprofit Mutual Benefit Corporation. Its primary purpose is to provide for the maintenance, preservation and architectural control of the grounds and common areas of the 86 residences located in San Jose, California.

Membership in the Association is mandatory for the homeowners. Voting members of the Association consist of all owners, who are entitled to one vote for each unit owned. Each member is obligated to pay annual assessments to the Association on each unit owned for amounts to be expended for the benefit of residents, and the maintenance of the common areas. Annual assessments are payable to the Association in monthly installments, and may be secured by a lien upon the property against which the assessment is made. In addition to the annual assessment, special assessments may be levied by the Association.

Date of Management's Review - In preparing the financial statements, the Association has evaluated events and transactions for potential recognition or disclosure through November 14, 2016, the date that the financial statements were available to be issued.

Accounting Method and Basis - The Association's governing documents provide certain guidelines for governing its financial activities. To ensure observance of limitations and restrictions on the use of financial resources, the Association maintains its accounts, prepares its financial statements, and files its Federal and state income tax returns using fund accounting and accrual basis of accounting. Financial resources are classified for accounting and reporting purposes in the following funds established according to their nature and purpose:

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

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

Estimates - The preparation of financial statements in conformity with generally accepted accounting principles 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 and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Property and equipment - The Association capitalizes all property and equipment to which it has title or other evidence of ownership with exception of real property directly associated with the units. At September 30, 2016, property not capitalized consists of common areas that consist of roofs, parking, sidewalks, landscaping, fencing, lighting, recreational facilities, and other common area assets. Not capitalizing common area real property is common practice among homeowners associations, since all beneficial rights of ownership belong to the homeowners and not to the Association. According to the Association's governing documents, two thirds of all unit owners must approve disposition of any common area real property.

Collection Process - The Association's collection process for past due membership dues and assessments includes the levy of late charges, mailing delinquent dues reminder notices and sending itemized warning letters noting costs of collection and intent to process foreclosure. The judicial foreclosure process culminates with the sale of the property and a deficient dues judgment against the property owner for the amount of delinquent dues and all related costs of collection. At September 30, 2016, delinquent dues assessments and late charges amounted to \$34,248 and allowance for doubtful accounts amounted to \$30,800. Association considers all net assessment receivable balances at September 30, 2016 fully collectible.

Statement of Cash Flows - For purposes of the statement of cash flows, the Association considers all highly liquid investments purchased with stated maturity of three months or less to be cash equivalents.

Income Taxes - Income taxes are provided for in accordance with current regulations and case law pertaining to homeowners associations. Under Section 528 of the Internal Revenue Code and California Revenue and Taxation Act Section 23701t, qualified homeowners association may elect to be treated as tax-exempt organizations. The Association has elected to be taxed only on income from investments and business with nonmembers. For Federal tax purposes, the election may be made or waived each year. Under Federal tax-exempt status, nonexempt income (such as interest) is subject to tax after deducting directly related expenses. For California tax purposes, the election is usually permanent and must be made prior to the year in

JEFFERSON SQUARE HOMEOWNERS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
September 30, 2016

which tax exempt status is to become effective. Under California tax-exempt status, nonexempt income is subject to tax after deducting a specific homeowner deduction.

NOTE 2 - REPLACEMENT FUND FOR FUTURE REPLACEMENTS

The Replacement Fund for future replacements represents funds set aside for long-term maintenance within the development. Changes in the Replacement Fund are as follows:

| | |
|----------------------------|--------------------|
| Balance, Beginning of year | \$ 640,942 |
| Net contributions | 125,971 |
| Replacement expenditures | <u>(489,291)</u> |
| Balance, End of year | <u>\$ 277,622</u> |

The Association had a reserve study prepared by Association Reserves - San Francisco, LLC in 2016, to estimate the replacement cost and the remaining useful lives of the components of common property in the Association. As disclosed in the reserve study, based on the method of calculation in paragraph (4) of subdivision (b) of Section 5570 of the California Civil Code, the estimated fully funded amount in the Replacement Fund at year end is \$628,305. The reserve study projected the Replacement Fund having a balance of \$440,215. The actual balance in the Replacement Fund is \$277,622 at September 30, 2016. The Association is funding for such major repairs and replacements over the estimated useful lives of the components based on the reserve study's estimates of current replacement costs, considering amounts previously accumulated in the Replacement Fund. Actual expenditures, however, may be material. Therefore, amounts accumulated in the Replacement Fund may not be adequate to meet future needs. If additional funds are needed, however, the Association has the right, subject to member approval to increase regular assessments or levy special assessments, or it may delay major repairs and replacements until funds are available.

NOTE 3 - MANAGEMENT AGREEMENT

The Association employs the services of outside property management company. The fees are approximately \$20 per unit, per month.

NOTE 4 - INCOME TAXES

The provision for income taxes as of September 30, 2016, was as follows:

| | |
|------------|-----------------|
| Federal | \$ 1,840 |
| California | <u>741</u> |
| | <u>\$ 2,581</u> |

At September 30, 2016 the tax years that remain subject to examination by taxing authorities begin with the 2011 tax year. In evaluating the Association's tax provisions and accruals, the Association believes that its estimates are appropriate based on current facts and circumstances.

NOTE 5 - INSURED CASH BALANCES

The Association maintains its cash balances at City National Bank located in San Jose, California. City National Bank accounts are secured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. The Association had an aggregate cash balances at City National Bank at September 30, 2016 of \$151,793.

The Association also maintains cash and investments in certificates of deposit at Oppenheimer & Co., Inc. (Oppenheimer) located in San Francisco, California. The Association cash at Oppenheimer is held in a money fund which holds the funds in various FDIC institutions so that the cash is insured by the FDIC. The Association had an aggregate cash balance held in a money market fund at Oppenheimer at September 30, 2016 of \$228,013.

JEFFERSON SQUARE HOMEOWNERS ASSOCIATION
 SUPPLEMENTARY INFORMATION ON FUTURE REPAIRS AND REPLACEMENTS
 September 30, 2016

(See Accompanying Notes and Independent Accountants' Review Report)

The Association had a reserve study prepared by Association Reserves - San Francisco, LLC in 2016, to estimate the replacement cost and the remaining useful lives of the components of common property in the Association. Estimates in the analysis are based on an inflation rate of 3.00% and investment return of 1.00%.

The following table is based on the reserve study and presents significant information about the components of common property:

| Components: | Estimated Remaining Useful Life (Years) | Projected Replacement Cost | Replacement Fund Balance at September 30, 2016 |
|---|---|----------------------------------|--|
| Deck, walks, balconies, stair & stringers | 0 to 14 | \$ 468,415 | |
| Asphalt | 0 to 10 | 169,000 | |
| Lighting | 1 to 27 | 73,225 | |
| Fencing, rails, gates & doors | 0 to 11 | 71,535 | |
| Landscaping & irrigation | 0 to 3 | 27,240 | |
| Painting | 1 to 6 | 90,830 | |
| Exterior building surfaces - repairs | 1 | 13,850 | |
| Pool | 0 to 14 | 91,375 | |
| Roofing, gutters & downspouts | 29 | 376,900 | |
| Other components | 0 to 24 | 42,160 | |
| | | <u>\$ 1,424,530</u> | <u>\$ 277,622</u> |

The reserve study estimates funding requirements for the year ending September 30, 2017, to be membership contributions of \$129,000 and investments earnings of \$4,795 and inflated expenditures of \$54,855.