

**AUDITED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION**

**ASSOCIATION OF APARTMENT OWNERS OF
THE PALMS AT WAILEA**

September 30, 2013 and 2012

**AUDITED FINANCIAL STATEMENTS
ASSOCIATION OF APARTMENT OWNERS OF THE PALMS AT WAILEA**

September 30, 2013 and 2012

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Board of Directors
Association of Apartment Owners
of The Palms at Wailea

Independent Auditor's Report

Report on the Financial Statements

I have audited the accompanying financial statements of the Association of Apartment Owners of The Palms at Wailea, which is comprised of the balance sheets as of September 30, 2013 and 2012 and the related statements of revenues and expenses and changes in fund balances and cash flows for the years 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.

Board of Directors
Association of Apartment Owners
of The Palms at Wailea

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Palms at Wailea as of September 30, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Disclaimer of Opinion on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the supplementary information on future major repairs and replacements on page 11, 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 the method 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.

 J. Kama, CPA, LLC

Wailuku, Hawaii
November 6, 2013

BALANCE SHEETS
ASSOCIATION OF APARTMENT OWNERS OF THE PALMS AT WAILEA

September 30, 2013 and 2012

	September 30, 2013			2012 Totals
	Operating Fund	Capital Reserve	Totals	
ASSETS				
CURRENT ASSETS				
Cash	\$ 336,864	\$ 463,617	\$ 800,481	\$1,618,757
Assessment receivable	75,668	--	75,668	58,283
Other receivables	--	--	--	206
Less allowance for doubtful accounts	(66,080)	--	(66,080)	(46,040)
	9,588	--	9,588	12,449
Prepaid insurance	68,207	--	68,207	67,706
Prepaid expenses	4,117	--	4,117	1,347
Prepaid income taxes	3,667	--	3,667	3,593
Prepaid WCA dues	15,264	--	15,264	14,554
TOTAL CURRENT ASSETS	\$ 437,707	\$ 463,617	\$ 901,324	\$1,718,406
LIABILITIES AND FUND BALANCES				
CURRENT LIABILITIES				
Accounts payable	\$ 45,771	\$ --	\$ 45,771	\$ 28,819
Insurance premium payable	42,658	--	42,658	42,679
General excise tax due	240	--	240	262
Deposits	7,900	--	7,900	7,900
Prepaid assessments	54,589	--	54,589	64,865
TOTAL CURRENT LIABILITIES	151,158	--	151,158	144,525
FUND BALANCES	286,549	463,617	750,166	1,573,881
TOTAL LIABILITIES AND FUND BALANCES	\$ 437,707	\$ 463,617	\$ 901,324	\$1,718,406

See notes to financial statements.

STATEMENTS OF REVENUES AND EXPENSES
ASSOCIATION OF APARTMENT OWNERS OF THE PALMS AT WAILEA

	Year ended September 30, 2013			2012 Totals
	Operating Fund	Capital Reserve	Totals	
REVENUES				
Owner assessments	\$1,258,186	\$ 224,443	\$1,482,629	\$1,482,630
Phone and internet assessment	78,876	--	78,876	72,303
Rental income	27,688	--	27,688	27,794
Delinquent fees	2,410	--	2,410	3,375
Interest income	942	1,403	2,345	4,416
Vending	366	--	366	326
House rule violations	50	--	50	25
Other	237	--	237	46
TOTAL REVENUES	1,368,755	225,846	1,594,601	1,590,915
OPERATING EXPENSES				
Payroll:				
Salaries and wages	141,384	--	141,384	135,354
Health insurance	17,741	--	17,741	15,872
Payroll taxes	13,495	--	13,495	11,874
Workers compensation insurance	4,908	--	4,908	4,818
Auto	1,500	--	1,500	1,505
	179,028	--	179,028	169,423
Repairs and maintenance:				
Grounds contract	285,000	--	285,000	285,000
Refuse	29,766	--	29,766	28,569
Air conditioning	12,934	--	12,934	9,046
Grounds	10,259	--	10,259	16,687
Building	9,559	--	9,559	10,301
Pool supplies	7,129	--	7,129	4,603
Pest control	6,521	--	6,521	6,589
Equipment	4,706	--	4,706	4,162
Fire equipment	3,165	--	3,165	2,838
Pool	2,661	--	2,661	5,254
Plumbing	1,398	--	1,398	782
Water feature	356	--	356	3,830
	373,454	--	373,454	377,661
Utilities:				
Water	177,298	--	177,298	186,497
Cable television/internet	134,317	--	134,317	122,977
Electricity	84,821	--	84,821	84,027
Sewer	78,985	--	78,985	80,366
Telephone	2,203	--	2,203	2,159
	477,624	--	477,624	476,026
SUBTOTAL OPERATING EXPENSES	\$1,030,106	\$ --	\$1,030,106	\$1,023,110

See notes to financial statements.

STATEMENTS OF REVENUES AND EXPENSES-Continued
ASSOCIATION OF APARTMENT OWNERS OF THE PALMS AT WAILEA

	Year ended September 30, 2013			2012 Totals
	Operating Fund	Capital Reserve	Totals	
SUBTOTAL OPERATING EXPENSES CARRIED FORWARD	\$1,030,106	\$ --	\$1,030,106	\$1,023,110
Administrative:				
Property and liability insurance	89,378	--	89,378	83,188
Outside services-security	60,835	--	60,835	60,835
Dues-WCA	60,346	--	60,346	57,932
Management fee	45,552	--	45,552	43,080
Bad debts	20,040	--	20,040	10,040
Professional fees	9,200	--	9,200	18,743
Office and administrative	5,520	--	5,520	5,440
Association meetings	5,322	--	5,322	6,185
General excise tax	1,324	--	1,324	1,439
Dues and subscriptions	1,256	--	1,256	205
Maintenance fees-NR2	562	--	562	562
Income taxes	476	--	476	1,505
	<u>299,811</u>	<u>--</u>	<u>299,811</u>	<u>289,154</u>
TOTAL OPERATING EXPENSES	1,329,917	--	1,329,917	1,312,264
RESERVE EXPENSES	--	1,088,399	1,088,399	389,539
TOTAL EXPENSES	1,329,917	1,088,399	2,418,316	1,701,803
EXCESS REVENUES OVER (UNDER) EXPENSES	\$ 38,838	\$ (862,553)	\$ (823,715)	\$ (110,888)

See notes to financial statements.

STATEMENTS OF CHANGES IN FUND BALANCES
ASSOCIATION OF APARTMENT OWNERS OF THE PALMS AT WAILEA

	<u>Year ended September 30, 2013</u>			<u>2012 Totals</u>
	<u>Operating Fund</u>	<u>Capital Reserve</u>	<u>Totals</u>	
FUND BALANCE BEGINNING OF YEAR	\$ 247,711	\$1,326,170	\$1,573,881	\$1,684,769
REVENUES OVER (UNDER) EXPENSES	38,838	(862,553)	(823,715)	(110,888)
FUND BALANCE END OF YEAR	<u>\$ 286,549</u>	<u>\$ 463,617</u>	<u>\$ 750,166</u>	<u>\$1,573,881</u>

See notes to financial statements.

STATEMENTS OF CASH FLOWS
ASSOCIATION OF APARTMENT OWNERS OF THE PALMS AT WAILEA

	Year ended September 30, 2013			2012 Totals
	Operating Fund	Capital Reserve	Totals	
OPERATING ACTIVITIES				
Revenues over (under) expenses	\$ 38,838	\$ (862,553)	\$ (823,715)	\$ (110,888)
Adjustment to reconcile revenue Over (under) expenses to net cash provided by operating activities-				
Bad debt provision	20,040	--	20,040	10,040
Change in operating assets and liabilities:				
(Increase) decrease in:				
Owner receivables	(17,385)	--	(17,385)	(5,796)
Other receivables	206	--	206	(206)
Interfund receivable	--	--	--	14,396
Prepaid insurance	(501)	--	(501)	418
Prepaid expenses	(2,770)	--	(2,770)	2,788
Prepaid income taxes	(74)	--	(74)	1,505
Prepaid WCA dues	(710)	--	(710)	(284)
Increase (decrease) in:				
Accounts payable	16,952	--	16,952	(47,216)
Interfund payable	--	--	--	(14,396)
Insurance premiums payable	(21)	--	(21)	1,363
General excise tax due	(22)	--	(22)	(28)
Deposits	--	--	--	(4,800)
Prepaid maintenance fees	(10,276)	--	(10,276)	20,666
NET CASH PROVIDED BY (USED IN)				
OPERATING ACTIVITIES	44,277	(862,553)	(818,276)	(132,438)
CASH AND EQUIVALENTS AT BEGINNING OF YEAR	<u>292,587</u>	<u>1,326,170</u>	<u>1,618,757</u>	<u>1,751,195</u>
CASH AND EQUIVALENTS AT END OF YEAR	<u>\$ 336,864</u>	<u>\$ 463,617</u>	<u>\$ 800,481</u>	<u>\$1,618,757</u>
 SUPPLEMENTAL DISCLOSURE:				
Interest paid	\$ --	\$ --	\$ --	\$ --
Income taxes paid	\$ 550	\$ --	\$ 550	\$ --

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS
ASSOCIATION OF APARTMENT OWNERS OF THE PALMS AT WAILEA

September 30, 2013 and 2012

NOTE A - NATURE OF ASSOCIATION AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Association: The Association of Apartment Owners of The Palms at Wailea is an organization of owners of 150 individual residential units and two non-residential units in a condominium complex located on 16.727 acres in Wailea, Maui, Hawaii. The Association was formed in 1992 for the purpose of providing for the management, maintenance and care of the common areas of the condominium as required by the Declaration of Condominium Property Regime filed with the State of Hawaii.

Principles of Accounting: It is the policy of the Association to prepare its financial statements using the accrual basis of accounting. Accordingly, revenues are recognized when earned and expenses are recognized when the obligations are incurred.

Cash and Cash Equivalents: Cash equivalents, if any, reflected in the financial statements include certificates of deposit and other investments with original maturities of three months or less.

Member Assessments: Association members are subject to monthly assessments to provide funds for the Association's operating expenses, future capital acquisitions, and major repairs and replacements. Assessments receivable at the balance sheet date represent fees due from unit owners. The Association's policy is to retain legal counsel and place liens on the properties of homeowners whose assessments are delinquent. Any excess assessments at year-end are retained by the Association for use in future years. For the year ended September 30, 2013 the Association specifically identified potential uncollectible assessments and recorded an allowance accordingly.

Property and Equipment: The Association capitalizes at cost all property and equipment to which it holds title or has other evidence of ownership. Real property owned by individual unit owners in common and property originally contributed to the Association by the developer and related improvements made by the Association to such property are not capitalized in the financial statements.

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.

Subsequent Events: Management has evaluated subsequent events through November 6, 2013, the date the financial statements were available to be issued.

NOTE B - INCOME TAXES

The Association is classified as a nonexempt membership organization for both federal and state income tax purposes. It does not qualify as an exempt organization. The Association is subject to specific rulings and regulations applicable to nonexempt membership organizations.

NOTES TO FINANCIAL STATEMENTS-Continued
ASSOCIATION OF APARTMENT OWNERS OF THE PALMS AT WAILEA

NOTE B - INCOME TAXES

In general, the Association is required to separate its taxable income and deductions into membership transactions, nonmembership transactions, and capital transactions. The Association is taxed on all net income from nonmembership activities reduced only by losses from nonmembership activities for which a profit motive exists. Nonmembership income may not be offset by membership losses, and any excess membership deductions may only be carried forward to offset membership income of future tax periods. Any net membership income not applied to the subsequent tax year is subject to taxation. The Association files Form 1120, which has graduated effective tax rates of 15% to 35% that are applied to net taxable income.

Accounting guidance clarifies the accounting for uncertain tax positions taken or expected to be taken in its income tax returns. The Association believes that reported tax provisions and accruals as well as tax positions taken or expected to be taken are appropriate.

The Association's federal and state income tax returns are generally subject to examination by taxing authorities for three years after the returns are filed, and the Association's federal and state income tax returns for fiscal years ended September 30, 2012, 2011 and 2010 remain open to examination.

There were no penalties and interest incurred in the Association's financial statements for the years ended September 30, 2013 and 2012.

NOTE C - FUND BALANCES

Operating Fund: The Operating Fund accounts for excess funds accumulated from operations. The Association may return this money to its members, apply it to subsequent year's operating budgets, or fund future major repairs and replacements.

Capital Reserve: The Hawaii Revised Statutes require that all condominium associations provide for funds to be accumulated for future major repairs and replacements. Associations must budget for such reserves and must be at least 50% funded by the segregated pooling method or 100% funded under the cash flow method. Accumulated funds are held in money market accounts and certificates of deposit and are generally not used for expenditure in normal operations. Interest earned in these accounts is added to the reserve.

The Association's Board of Directors adopted a study to estimate the remaining useful lives and the replacement costs of the components of common elements. The Association is funding for future major repairs and replacement costs over the remaining useful lives of the components estimated replacement costs and considering amounts previously accumulated in the Capital Reserve. Accordingly, the Association has estimated a reserve requirement and has incorporated it into the maintenance fees.

Funds are being accumulated in the Capital Reserve based on estimates of future needs for repairs and replacements of common property components.

NOTES TO FINANCIAL STATEMENTS-Continued
ASSOCIATION OF APARTMENT OWNERS OF THE PALMS AT WAILEA

NOTE C - FUND BALANCES

Actual expenditures may vary from the estimated future expenditures and the variations may be material. Therefore, amounts accumulated in the Capital Reserve 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 board of directors' approval, to increase regular maintenance fees, pass special assessments, or delay major repairs and replacements until the funds are available.

Expenditures charged to reserves for the year ended September 30, 2013 include:

Roofing project	\$ 663,352
Asphalt overlay	393,740
Sidewalk and curb repairs	13,978
Air conditioners	7,034
Landscape upgrades	5,299
ADA pool lift	4,996
	<u>\$1,088,399</u>

Expenditures charged to reserves for the year ended September 30, 2012 include:

Roofing project	\$ 200,113
Waterproofing	119,612
Awnings	45,247
Air conditioners	14,607
Landscaping	9,960
	<u>\$ 389,539</u>

ASSOCIATION OF APARTMENT OWNERS OF THE PALMS AT WAILEA
 SUPPLEMENTARY INFORMATION ON FUTURE MAJOR REPAIRS AND REPLACEMENTS (unaudited)

September 30, 2013

The Association's board of directors updated their reserve study in August 2013 which estimates the remaining useful lives and the replacement costs of the components of common property. Replacement costs were based on the estimated costs to repair and replace the common property components obtained from independent contractors and based on prior history. The study includes an inflation factor of 3.00% and a savings interest rate of 0.50%. Reserve funds amounted to \$463,617, as of September 30, 2013. Pursuant to the Hawaii Revised Statutes, the Association is utilizing the cash flow method of funding the reserves as the expenditures become due. As a result, reserve funds are allocated first to the components with the least remaining lives. The following information is based on the study and presents significant information about the components of common property.

Common Area Component	Estimated Useful Life (Years)	Estimated Remaining Useful Life (Years)	Estimated Current Replacement Cost
A/C Split system	1	1	\$ 9,250
ADA Compliance-pool lift	10	10	6,000
Asphalt overlay	20	20	354,740
Asphalt slurry seal	5	5	92,347
Awnings for windows	15	14	46,604
Backflow preventer-2" irrigation	10	7	7,252
Backflow preventer-3" clear access	10	2	25,788
Backflow preventer-Fire control	10	3	12,353
Backflow preventer-Main water	10	2	6,423
Bicycle racks	15	5	3,083
Bridges, walking	25	17	8,993
Doors accordion hardware	15	8	2,569
Dryer vent cleaning	4	2	12,760
Fence chain link 6 foot high	20	5	10,278
Fire extinguishers	18	9	7,649
Golf cart	5	3	4,625
Irrigation system	20	1	140,000
Kitchen, employee	15	2	2,060
Lighting common areas	10	2	30,000
Lobby refurbishment furnishings	10	2	15,416
Lobby refurbishment stone flooring	20	7	28,263
Mail boxes	25	7	9,635
Mail boxes-UPS Parcel Box Svc	15	6	2,686
Landscaping upgrades	1	1	6,500
Waterproofing exterior	9	7	415,500
Carpentry repairs	7	5	6,424
Painting, front doors	5	3	18,525
Trellis replacement	5	4	45,907
Phone cable replacement	15	7	17,202
Subtotal carried forward			<u>\$ 1,348,832</u>

ASSOCIATION OF APARTMENT OWNERS OF THE PALMS AT WAILEA
 SUPPLEMENTARY INFORMATION ON FUTURE MAJOR REPAIRS AND REPLACEMENTS (unaudited)
 September 30, 2013

Common Area Component	Estimated Useful Life (Years)	Estimated Remaining Useful Life (Years)	Estimated Current Replacement Cost
Subtotal carried forward			\$ 1,348,832
Pool area improvements I	20	13	25,694
Pool area improvements II	20	14	12,353
Pool deck replacement	20	2	61,800
Pool area spalling repairs	1	1	10,000
Pool and Jacuzzi equipment	3	3	3,183
Pool deck furniture	6	4	12,731
Pool and Jacuzzi tile	15	3	33,402
Pool fence	18	7	43,680
Pool lobby cabinets	20	13	8,351
Pump room door replacement	15	7	3,772
Recreation building bathrooms	20	20	5,710
Roof built up recoat full system	20	20	927,000
Roof built up removal and repair	40	29	--
Roof clay tile	35	12	120,248
Roof shake replacement Bldg. 20	20	17	57,383
Security monitors	3	3	2,207
Sewage line repairs	5	2	41,316
Sidewalk & curb repairs	5	5	15,914
Sidewalk ADA entry	50	39	5,781
Signage	20	9	15,914
Unscheduled reserves	1	1	10,000
Walkway railings	30	18	6,423
Walkway & balcony railing repairs	15	7	8,736
Water feature main-equipment	15	2	10,920
Water feature main-filters	20	19	5,396
Water feature small-mechanicals	10	3	1,343
Water feature-pump bskt/ph conv.brng	10	2	5,776
Jacuzzi salt cells	5	3	6,620
Water lines common element	10	6	10,934
Building 20 Foundation/Siding	30	27	107,728
			\$ 2,929,147