

AUDITED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

ASSOCIATION OF APARTMENT OWNERS OF
THE PALMS AT WAILEA

September 30, 2014 and 2013

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

September 30, 2014 and 2013

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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, 2014 and 2013 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, 2014 and 2013, 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.

Wailuku, Hawaii
December 1, 2014

BALANCE SHEETS

ASSOCIATION OF APARTMENT OWNERS OF THE PALMS AT WAILEA

September 30, 2014 and 2013

	September 30, 2014			2013 Totals
	Operating Fund	Capital Reserve	Totals	
ASSETS				
CURRENT ASSETS				
Cash	\$ 323,127	\$ 666,473	\$ 989,600	\$ 800,481
Assessment receivable	76,598	--	76,598	75,668
Less allowance for doubtful accounts	(66,080)	--	(66,080)	(66,080)
	10,518	--	10,518	9,588
Prepaid insurance	70,337	--	70,337	68,207
Prepaid expenses	5,849	--	5,849	4,117
Prepaid income taxes	3,338	--	3,338	3,667
Prepaid WCA dues	15,974	--	15,974	15,264
TOTAL CURRENT ASSETS	\$ 429,143	\$ 666,473	\$1,095,616	\$ 901,324
LIABILITIES AND FUND BALANCES				
CURRENT LIABILITIES				
Accounts payable	\$ 57,127	\$ --	\$ 57,127	\$ 45,771
Insurance premium payable	37,374	--	37,374	42,658
General excise tax due	235	--	235	240
Deposits	6,900	--	6,900	7,900
Prepaid assessments	53,087	--	53,087	54,589
TOTAL CURRENT LIABILITIES	154,723	--	154,723	151,158
FUND BALANCES	274,420	666,473	940,893	750,166
TOTAL LIABILITIES AND FUND BALANCES	\$ 429,143	\$ 666,473	\$1,095,616	\$ 901,324

See notes to financial statements.

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

	<u>Year ended September 30, 2014</u>			<u>2013 Totals</u>
	<u>Operating Fund</u>	<u>Capital Reserve</u>	<u>Totals</u>	
REVENUES				
Owner assessments	\$1,225,490	\$ 257,139	\$1,482,629	\$1,482,629
Phone and internet assessment	78,876	--	78,876	78,876
Rental income	27,723	--	27,723	27,688
Delinquent fees	2,475	--	2,475	2,410
Interest income	844	1,111	1,955	2,345
Vending	308	--	308	366
Other	972	--	972	237
House rule violations	--	--	--	50
TOTAL REVENUES	1,336,688	258,250	1,594,938	1,594,601
OPERATING EXPENSES				
Payroll:				
Salaries and wages	149,782	--	149,782	141,384
Health insurance	20,207	--	20,207	17,741
Payroll taxes	12,733	--	12,733	13,495
Workers compensation insurance	6,165	--	6,165	4,908
Auto	1,500	--	1,500	1,500
	<u>190,387</u>	<u>--</u>	<u>190,387</u>	<u>179,028</u>
Repairs and maintenance:				
Grounds contract	285,000	--	285,000	285,000
Refuse	31,345	--	31,345	29,766
Grounds	19,482	--	19,482	10,259
Plumbing	10,125	--	10,125	1,398
Pool supplies	7,980	--	7,980	7,129
Building	7,148	--	7,148	9,559
Air conditioning	7,111	--	7,111	12,934
Pest control	6,109	--	6,109	6,521
Fire equipment	5,559	--	5,559	3,165
Pool	4,456	--	4,456	2,661
Water feature	4,172	--	4,172	356
Equipment	2,507	--	2,507	4,706
	<u>390,994</u>	<u>--</u>	<u>390,994</u>	<u>373,454</u>
Utilities:				
Water	179,629	--	179,629	177,298
Cable television/internet	136,064	--	136,064	134,317
Electricity	77,645	--	77,645	84,821
Sewer	81,200	--	81,200	78,985
Telephone	2,483	--	2,483	2,203
	<u>477,021</u>	<u>--</u>	<u>477,021</u>	<u>477,624</u>
SUBTOTAL OPERATING EXPENSES	\$1,058,402	\$ --	\$1,058,402	\$1,030,106

See notes to financial statements.

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

	<u>Year ended September 30, 2014</u>			<u>2013</u> <u>Totals</u>
	<u>Operating</u> <u>Fund</u>	<u>Capital</u> <u>Reserve</u>	<u>Totals</u>	
SUBTOTAL OPERATING EXPENSES CARRIED FORWARD	\$1,058,402	\$ --	\$1,058,402	\$1,030,106
Administrative:				
Property and liability insurance	86,668	--	86,668	89,378
Outside services-security	67,171	--	67,171	60,835
Dues-WCA	63,186	--	63,186	60,346
Management fee	47,736	--	47,736	45,552
Professional fees	9,633	--	9,633	9,200
Office and administrative	6,695	--	6,695	5,520
Association meetings	6,490	--	6,490	5,322
General excise tax	1,337	--	1,337	1,324
Income taxes	594	--	594	476
Maintenance fees-NR2	562	--	562	562
Dues and subscriptions	343	--	343	1,256
Bad debts	--	--	--	20,040
	<u>290,415</u>	<u>--</u>	<u>290,415</u>	<u>299,811</u>
TOTAL OPERATING EXPENSES	1,348,817	--	1,348,817	1,329,917
RESERVE EXPENSES	--	55,394	55,394	1,088,399
TOTAL EXPENSES	<u>1,348,817</u>	<u>55,394</u>	<u>1,404,211</u>	<u>2,418,316</u>
EXCESS REVENUES OVER (UNDER) EXPENSES	<u>\$ (12,129)</u>	<u>\$ 202,856</u>	<u>\$ 190,727</u>	<u>\$ (823,715)</u>

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, 2014</u>			<u>2013</u> <u>Totals</u>
	<u>Operating</u> <u>Fund</u>	<u>Capital</u> <u>Reserve</u>	<u>Totals</u>	
FUND BALANCE BEGINNING OF YEAR	\$ 286,549	\$ 463,617	\$ 750,166	\$1,573,881
REVENUES OVER (UNDER) EXPENSES	<u>(12,129)</u>	<u>202,856</u>	<u>190,727</u>	<u>(823,715)</u>
FUND BALANCE END OF YEAR	<u>\$ 274,420</u>	<u>\$ 666,473</u>	<u>\$ 940,893</u>	<u>\$ 750,166</u>

See notes to financial statements.

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

	<u>Year ended September 30, 2014</u>			<u>2013</u> <u>Totals</u>
	<u>Operating</u> <u>Fund</u>	<u>Capital</u> <u>Reserve</u>	<u>Totals</u>	
OPERATING ACTIVITIES				
Revenues over (under) expenses	\$ (12,129)	\$ 202,856	\$ 190,727	\$ (823,715)
Adjustment to reconcile revenue Over (under) expenses to net cash provided by operating activities-				
Bad debt provision	--	--	--	20,040
Change in operating assets and liabilities:				
(Increase) decrease in:				
Owner receivables	(930)	--	(930)	(17,385)
Other receivables	--	--	--	206
Prepaid insurance	(2,130)	--	(2,130)	(501)
Prepaid expenses	(1,732)	--	(1,732)	(2,770)
Prepaid income taxes	329	--	329	(74)
Prepaid WCA dues	(710)	--	(710)	(710)
Increase (decrease) in:				
Accounts payable	11,356	--	11,356	16,952
Insurance premiums payable	(5,284)	--	(5,284)	(21)
General excise tax due	(5)	--	(5)	(22)
Deposits	(1,000)	--	(1,000)	--
Prepaid maintenance fees	(1,502)	--	(1,502)	(10,276)
NET CASH PROVIDED BY (USED IN)				
OPERATING ACTIVITIES	(13,737)	202,856	189,119	(818,276)
CASH AND EQUIVALENTS AT BEGINNING OF YEAR	<u>336,864</u>	<u>463,617</u>	<u>800,481</u>	<u>1,618,757</u>
CASH AND EQUIVALENTS AT END OF YEAR	<u>\$ 323,127</u>	<u>\$ 666,473</u>	<u>\$ 989,600</u>	<u>\$ 800,481</u>
SUPPLEMENTAL DISCLOSURE:				
Interest paid	\$ --	\$ --	\$ --	\$ --
Income taxes paid	\$ 750	\$ --	\$ 750	\$ 550

See notes to financial statements.

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

September 30, 2014 and 2013

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, 2014 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 December 1, 2014, 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, 2013, 2012 and 2011 remain open to examination.

There were no penalties and interest incurred in the Association's financial statements for the years ended September 30, 2014 and 2013.

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, 2014 include:

Irrigation system	\$ 33,729
Water feature	8,303
Landscape upgrades	6,737
Air conditioners	6,625
	<u>\$ 55,394</u>

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>

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

September 30, 2014

The Association's board of directors updated their reserve study in August 2014 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 0.25%. Reserve funds amounted to \$666,473, as of September 30, 2014. 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	\$ 9,527
ADA Compliance-pool lift	10	9	6,180
Asphalt overlay	20	19	365,382
Asphalt slurry seal	5	4	95,117
Awnings for windows	15	13	48,003
Backflow preventer-2" irrigation	10	6	7,470
Backflow preventer-3" clear access	10	3	26,561
Backflow preventer-Fire control	10	2	12,723
Backflow preventer-Main water	10	3	6,616
Bicycle racks	15	4	3,176
Bridges, walking	25	16	9,263
Doors accordion hardware	15	7	2,646
Dryer vent cleaning	4	1	13,142
Fence chain link 6 foot high	20	4	10,586
Fire extinguishers	18	8	7,879
Golf cart	5	2	4,764
Irrigation system	20	20	140,000
Kitchen, employee	15	2	2,122
Lighting common areas	10	1	30,900
Lobby refurbishment furnishings	10	1	3,000
Lobby refurbishment stone flooring	20	6	29,111
Mail boxes	25	6	9,924
Mail boxes-UPS Parcel Box Svc	15	5	2,767
Landscaping upgrades	1	1	6,695
Waterproofing exterior	9	6	427,965
Carpentry repairs	7	4	6,616
Painting, front doors	5	2	19,081
Trellis replacement	5	3	47,284
Phone cable replacement	15	6	17,718
Subtotal carried forward			\$ 1,372,218

ASSOCIATION OF APARTMENT OWNERS OF THE PALMS AT WAILEA
SUPPLEMENTARY INFORMATION ON FUTURE MAJOR REPAIRS AND REPLACEMENTS (unaudited)
September 30, 2014

Common Area Component	Estimated Useful Life (Years)	Estimated Remaining Useful Life (Years)	Estimated Current Replacement Cost
Subtotal carried forward			\$ 1,372,218
Pool area improvements I	20	12	26,465
Pool area improvements II	20	13	12,723
Pool deck replacement	20	1	150,000
Pool and Jacuzzi equipment	3	2	3,278
Pool deck furniture	6	3	13,113
Pool and Jacuzzi tile	15	2	34,404
Pool fence	18	6	44,990
Pool lobby cabinets	20	12	8,601
Pump room door replacement	15	6	3,885
Recreation building bathrooms	20	19	5,881
Roof built up recoat full system	20	19	954,810
Roof clay tile	35	11	123,855
Roof shake replacement Bldg. 20	20	16	59,105
Security monitors	3	2	2,273
Sewage line repairs	5	3	100,000
Sidewalk & curb repairs	5	4	16,391
Sidewalk ADA entry	50	38	5,955
Signage	20	8	16,391
Unscheduled reserves	1	1	10,000
Walkway railings	30	17	6,616
Walkway & balcony railing repairs	15	6	8,998
Water feature main-equipment	15	1	32,000
Water feature main-filters	20	18	5,558
Water feature small-mechanicals	10	2	1,383
Jacuzzi salt cells	5	2	6,719
Water lines common element	10	5	11,098
Building 20 Foundation/Siding	30	26	<u>109,344</u>
			<u>\$ 3,146,054</u>