

**AUDITED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION**

**PRINCEVILLE AT HANAIEI
COMMUNITY ASSOCIATION**

June 30, 2002 and 2001

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Board of Directors
Princeville at Hanalei
Community Association

Independent Auditors' Report

We have audited the accompanying balance sheets of the Princeville at Hanalei Community Association as of June 30, 2002 and 2001, and the related statements of revenues, expenses and members' equity and cash flows for the years then ended. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Princeville at Hanalei Community Association as of June 30, 2002 and 2001, 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.

Hirose, Kato & Co. LLP

Lihue, Hawaii
September 18, 2002

BALANCE SHEETS
 PRINCEVILLE AT HANAIEI COMMUNITY ASSOCIATION

	June 30,	
	<u>2002</u>	<u>2001</u>
ASSETS		
Cash and cash equivalents		
Petty cash	\$ 300	\$ 300
Checking	28,094	33,614
Savings	347,543	124,077
Short term investments	322,584	322,521
	<u>698,521</u>	<u>480,512</u>
Accounts receivable		
Members	8,730	8,644
Allowance for doubtful accounts	(3,900)	(3,900)
	<u>4,830</u>	<u>4,744</u>
Prepaid expense		
Insurance	27,234	29,601
Other	1,000	--
	<u>28,234</u>	<u>29,601</u>
Property and equipment		
Vehicles	48,049	43,966
Park equipment	41,208	41,208
Office furniture and equipment	35,081	37,765
Patrol equipment	7,794	7,794
Leasehold improvements	29,787	--
	<u>161,919</u>	<u>130,733</u>
Less accumulated depreciation	(107,356)	(79,469)
	<u>54,563</u>	<u>51,264</u>
TOTAL ASSETS	<u>\$ 786,148</u>	<u>\$ 566,121</u>
LIABILITIES AND MEMBERS' EQUITY		
Accounts payable	\$ 15,716	\$ 5,307
Accrued payroll	15,381	7,838
Accrued vacation	8,288	5,742
Prepaid assessments	2,829	1,754
Design deposits	99,000	76,000
	<u>141,214</u>	<u>96,641</u>
TOTAL LIABILITIES	<u>141,214</u>	<u>96,641</u>
MEMBERS' EQUITY		
Operating	\$ 315,587	\$ 187,189
Road improvement reserve	329,347	282,291
	<u>644,934</u>	<u>469,480</u>
TOTAL LIABILITIES AND MEMBERS' EQUITY	<u>\$ 786,148</u>	<u>\$ 566,121</u>

See notes to financial statements.

STATEMENTS OF REVENUES AND EXPENSES
 PRINCEVILLE AT HANAIEI COMMUNITY ASSOCIATION

	Years ended June 30,	
	<u>2002</u>	<u>2001</u>
REVENUES		
Member assessments - operating	\$ 739,548	\$ 553,045
Member assessments - road improvement reserve	87,230	176,053
Interest and dividends	29,399	24,407
Design committee income	22,237	13,275
Other income	23,757	27,389
TOTAL REVENUE	<u>902,171</u>	<u>794,169</u>
OPERATING EXPENSES		
Salaries and wages	367,429	351,454
Employee benefits and payroll taxes	70,262	67,172
Insurance	48,914	55,641
Depreciation	41,198	18,127
Legal	25,439	41,094
Office rent	15,717	15,848
Vehicles	14,205	13,841
Telephone	13,686	13,378
Office and administrative	10,199	10,634
Maintenance supplies	10,183	10,591
Electricity	7,364	2,294
Equipment maintenance	6,579	1,769
Audit and tax preparation	6,042	6,896
License, fees and meetings	5,762	3,296
Professional fees	4,676	16,864
Property tax	3,734	3,816
Common area maintenance	3,630	3,232
Street sign maintenance	3,330	6,171
Bad debt	2,282	--
General excise tax	1,705	1,795
Equipment lease	1,238	1,226
Advertising and public relations	1,000	1,376
Prince Albert Park maintenance	264	3,597
Miscellaneous	9,596	6,499
TOTAL OPERATING EXPENSES	<u>674,434</u>	<u>656,611</u>
RESERVE EXPENSES	<u>52,283</u>	<u>225,348</u>
TOTAL EXPENSES	<u>726,717</u>	<u>881,959</u>
REVENUES OVER (UNDER) EXPENSES	<u>\$ 175,454</u>	<u>\$ (87,790)</u>

See notes to financial statements.

STATEMENTS OF MEMBERS' EQUITY
 PRINCEVILLE AT HANAIEI COMMUNITY ASSOCIATION

Years ended June 30, 2002 and 2001

	OPERATING	ROAD IMPROVEMENT RESERVE	TOTAL
MEMBERS' EQUITY, July 1, 2001	\$ 244,864	\$ 312,406	\$ 557,270
REVENUES	598,936	195,233	794,169
EXPENSES	<u>(656,611)</u>	<u>(225,348)</u>	<u>(881,959)</u>
REVENUES UNDER EXPENSES	<u>(57,675)</u>	<u>(30,115)</u>	<u>(87,790)</u>
MEMBERS' EQUITY, JUNE 30, -2001	187,189	282,291	469,480
REVENUES	802,832	99,339	902,171
EXPENSES	<u>(674,434)</u>	<u>(52,283)</u>	<u>(726,717)</u>
REVENUES OVER EXPENSES	<u>128,398</u>	<u>47,056</u>	<u>175,454</u>
MEMBERS EQUITY, JUNE 30, 2002	<u>\$ 315,587</u>	<u>\$ 329,347</u>	<u>\$ 644,934</u>

See notes to financial statements.

STATEMENTS OF CASH FLOWS
 PRINCEVILLE AT HANAIEI COMMUNITY ASSOCIATION

	<u>Years ended June 30,</u>	
	<u>2002</u>	<u>2001</u>
OPERATING ACTIVITIES		
Revenues over (under) expenses	\$ 175,454	\$ (87,790)
Adjustment to reconcile to net cash provided by operating activities:		
Depreciation	41,198	18,127
Provision for bad debts	2,282	--
Increase (decrease) in:		
Members receivable	(2,368)	36,029
Prepaid expenses	1,367	1,929
Increase (decrease) in:		
Accounts payable	10,409	3,717
Accrued payroll	7,543	569
Accrued vacation	2,546	(1,035)
Prepaid assessments	1,075	690
Design deposits	23,000	9,000
	<u>262,506</u>	<u>(18,764)</u>
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
CASH FLOWS FROM INVESTING ACTIVITIES		
Net purchases over disposal of property and equipment	(44,497)	(9,741)
	<u>(44,497)</u>	<u>(9,741)</u>
NET CASH USED IN INVESTING ACTIVITIES		
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		
	218,009	(28,505)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		
	<u>480,512</u>	<u>509,017</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR		
	<u>\$ 698,521</u>	<u>\$ 480,512</u>

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS
PRINCEVILLE AT HANAIEI COMMUNITY ASSOCIATION

June 30, 2002 and 2001

NOTE A--NATURE OF ASSOCIATION AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Organization: Princeville at Hanalei Community Association (a property owner's association) is a nonprofit Hawaii corporation organized on March 15, 1971. The Association was formed to levy and collect assessments, enforce the protective covenants for the safety and welfare of all residents, provide maintenance, patrol services and administration of the common areas, and to provide for construction and repair of common areas. The value of common land and road areas is not reflected in the financial statements. The Association is located on Kauai, Hawaii and consists of various properties including one hotel, 790 single family lots, 28 condominium/timeshare projects and multifamily lots all on approximately 1,000 acres.

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.

Member Assessments: Association members are subject to yearly 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 place liens on the properties of homeowners whose assessments are delinquent. Any excess assessments at year-end are retained by the Association and designated for use in future years.

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

Property and Equipment: The Association capitalizes at cost all property and equipment to which it holds title or has other evidence of ownership. The assets are depreciated using the straight-line method with estimated useful lives between 5 to 7 years.

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.

NOTES TO FINANCIAL STATEMENTS - Continued
PRINCEVILLE AT HANAIEI COMMUNITY ASSOCIATION

NOTE A--NATURE OF ASSOCIATION AND SIGNIFICANT ACCOUNTING POLICIES
- Continued

Income Taxes: The Association received tax exempt status from the Internal Revenue Service under IRC section 501(c)(4) on January 23, 1997. All income of the Association is tax exempt, except unrelated business income, of which the Association has none.

NOTE B--MEMBERS' EQUITY

Operating Fund: Designated by the board to reflect all activities required for the levy and collection of assessments and on-going maintenance and patrol services for the common areas.

Road Improvement Reserve: The Association's board of directors has elected to accumulate funds for future major road repairs and replacements. Accumulated funds, which aggregate approximately \$329,347 at June 30, 2002, are held in a separate account and are generally not available for expenditures for operating purposes. The Association's funding program is based on a Road Maintenance Plan that was reviewed in May 2001 by the Association's independent road consultant and asphalt repair contractor to estimate the maintenance and resurfacing costs of the Association's roads. Funds have been accumulated for unexpected emergency repairs and members are assessed annually for each year's estimated repair costs. In addition, the fund is designed to act as a buffer against large variations in the year to year assessments due to variations in the actual level of yearly road maintenance expenditures.

Actual expenditures may vary from the estimated future expenditures and the variations may be material. Therefore, amounts accumulated in the road improvements 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, to increase regular assessments, pass special assessments with membership approval, or delay major repairs and replacements until funds are available.

NOTE C--PROPERTY OWNED BY THE DEVELOPER

As of June 30, 2002, the community developer, Princeville Corporation owns nine properties. These properties represent 508 votes or approximately 20% of the total voting rights in the Association. Princeville Corporation paid \$125,859 and \$116,229 in assessments on its holdings for the years ended June 30, 2002 and 2001, respectively, which represents 15.2% and 15.9% of the total assessments billed by the Association.

NOTES TO FINANCIAL STATEMENTS - Continued
PRINCEVILLE AT HANAIEI COMMUNITY ASSOCIATION

NOTE D--MANAGEMENT'S USE OF 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.

NOTE E--ARRANGEMENTS WITH RELATED PARTIES

Office Lease: During the year ended June 30, 2001, the Association leased office space from Princeville Corporation.

As of August 20, 2001 the Association moved its offices to the Makai Clubhouse. The lease term ends July 31, 2004. Effective January 1, 2002, the Association leased 2000 square feet of land to be used as a maintenance facility. The lease term ends December 31, 2011. The landlord for both leases is Princeville Corporation. Monthly rent under both leases as of June 30, 2001 is \$2,615. Future minimum rent under both operating lease agreements are as follows.

Year ended June 30,

2003	\$ 19,375
2004	20,521
2005	7,604
2006	6,725
Thereafter	50,167
	<u>\$ 104,392</u>

Maintenance: The Association mows the Prince Albert Park with Phase II reimbursing the Association for one half the monthly costs. The Association reimburses Princeville Corporation for utilities and maintenance of street lights and gatehouse.

NOTE F--LEGAL MATTERS

The Association is involved in certain disputes. These matters have been referred to the Association's insurance company. Management feels a financial liability against the Association at this time is remote.

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INDEPENDENT AUDITORS' REPORT ON SUPPLEMENTARY INFORMATION

The following supplementary information on future road improvements is not a required part of the basic financial statements of the Princeville at Hanalei Community Association, but it is supplementary information required by the American Institute of Certified Public Accountants. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Hirose, Kato & Co. LLP

Lihue, Hawaii
September 18, 2002

PRINCEVILLE AT HANAIEI COMMUNITY ASSOCIATION
 SUPPLEMENTARY INFORMATION ON FUTURE ROAD IMPROVEMENTS
 (Unaudited)

June 30, 2002

An asphalt repair contractor and independent road consultant conducted a study in May 2001 to estimate the repair costs of the roads. Repair costs were based on the estimated costs to repair the roads at the date of the study. Estimated current repairs costs have not been advised since that date and do not take into account the effects of inflation between the date of the study and the date that the roads will require repair.

The following information is based on the study and presents significant information about the nature of the road repairs.

<u>Fiscal Year</u>	<u>Repair Work</u>			
	<u>Fog Seal</u>	<u>Overlay</u>	<u>Seal coat</u>	<u>Total</u>
2002/03	\$ 14,162	\$144,600	\$ --	\$158,762
2003/04	48,563	109,000	--	157,563
2004/05	--	164,000	3,391	167,391
2005/06	5,514	126,600	--	132,114
2006/07	<u>11,149</u>	<u>--</u>	<u>59,636</u>	<u>70,785</u>
	<u>\$ 79,388</u>	<u>\$544,200</u>	<u>\$ 63,027</u>	<u>\$686,615</u>