

THE SHEARWATER ASSOCIATION OF APARTMENT OWNERS
PRINCEVILLE, KAUAI, HAWAII
FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2022



TABLE OF CONTENTS

INDEPENDENT AUDITORS' REPORT 2-4

FINANCIAL STATEMENTS

 Balance Sheet 5

 Statement of Revenue, Expenses and Changes in Fund Balance 6

 Statement of Cash Flows 7

 Notes to Financial Statements 8-11

SUPPLEMENTARY INFORMATION

 Supplementary Information on Future Major Repairs and Replacements (Unaudited) 13

 Supplementary Information on Investments (Unaudited) 14

 Schedule of Operating Fund Revenue and Expenses - Budget to Actual 15



INDEPENDENT AUDITORS' REPORT

To the Board of Directors
of The Shearwater Association of Apartment Owners

Opinion

We have audited the accompanying financial statements of The Shearwater Association of Apartment Owners, which comprise the balance sheet as of December 31, 2022, and the related statements of revenue, expenses and changes in fund balance and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Shearwater Association of Apartment Owners as of December 31, 2022, and the results of its operations and its cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of The Shearwater Association of Apartment Owners and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about The Shearwater Association of Apartment Owners's ability to continue as a going concern within one year after the date that the financial statements are available to be issued.

To the Board of Directors
of The Shearwater Association of Apartment Owners

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with generally accepted auditing standards, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Shearwater Association of Apartment Owners's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about The Shearwater Association of Apartment Owners's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

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 13 be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by the Financial Accounting Standards Board, which 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 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 methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

To the Board of Directors
of The Shearwater Association of Apartment Owners

Report on Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary information on investments is presented for purposes of additional analysis and is not a required part of the financial statements. Such information, is the responsibility of the Association's management. The information has not been subjected to the auditing procedures applied in the audit of the financial statements, and, accordingly, we do not express an opinion or provide any assurance on it. The schedule of operating fund revenue and expenses - budget to actual is presented for purposes of additional analysis and is not a required part of the financial statements. Such information, which is the responsibility of the Association's management, was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information, except for the portion marked "unaudited," has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The information marked "unaudited" has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we do not express an opinion or provide any assurance on it.



MYERS, BRETT HOLTZ & COMPANY, PA
Fort Myers, Florida
March 16, 2023

THE SHEARWATER ASSOCIATION OF APARTMENT OWNERS
BALANCE SHEET
DECEMBER 31, 2022

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
Assets			
Cash and cash equivalents	\$ 149,118	\$ 551,318	\$ 700,436
Certificates of deposit	-	249,000	249,000
Due from Management Company	10,897	-	10,897
Prepaid expenses	<u>84,422</u>	<u>-</u>	<u>84,422</u>
 Total assets	 <u>\$ 244,437</u>	 <u>\$ 800,318</u>	 <u>\$ 1,044,755</u>
 Liabilities and Fund Balance			
Liabilities			
Accounts payable and accrued expenses	\$ 30,779	\$ 5,759	\$ 36,538
 Fund balance	 <u>213,658</u>	 <u>794,559</u>	 <u>1,008,217</u>
 Total liabilities and fund balance	 <u>\$ 244,437</u>	 <u>\$ 800,318</u>	 <u>\$ 1,044,755</u>

Read Independent Auditors' Report.
The accompanying notes are an integral part of the financial statements.

THE SHEARWATER ASSOCIATION OF APARTMENT OWNERS
 STATEMENT OF REVENUE, EXPENSES AND CHANGES IN FUND BALANCE
 FOR THE YEAR ENDED DECEMBER 31, 2022

	Operating Fund	Replacement Fund	Total
Revenue			
Member assessments	\$ 903,936	\$ 289,821	\$ 1,193,757
Interest	-	2,439	2,439
Total revenue	903,936	292,260	1,196,196
Expenses	903,537	94,577	998,114
Excess of revenue over expenses	399	197,683	198,082
Fund balance, beginning of year	213,259	596,876	810,135
Fund balance, end of year	<u>\$ 213,658</u>	<u>\$ 794,559</u>	<u>\$ 1,008,217</u>

Read Independent Auditors' Report.
 The accompanying notes are an integral part of the financial statements.

THE SHEARWATER ASSOCIATION OF APARTMENT OWNERS
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2022

	Operating Fund	Replacement Fund	Total
Cash Flows From Operating Activities			
Excess of revenue over expenses	\$ 399	\$ 197,683	\$ 198,082
Adjustments to reconcile to net cash flows from operating activities:			
Changes in:			
Due from Management Company	(10,897)	-	(10,897)
Prepaid expenses	(10,735)	-	(10,735)
Due from (to) funds	12,703	(12,703)	-
Accounts payable and accrued expenses	6,601	(175,241)	(168,640)
Due to Management Company	(1,719)	-	(1,719)
	(3,648)	9,739	6,091
Net cash flows from operating activities			
Cash Flows From Investing Activities			
Proceeds from redemptions of certificates of deposit	-	349,000	349,000
Purchases of certificates of deposit	-	(498,000)	(498,000)
	-	(149,000)	(149,000)
Net cash flows from investing activities			
Cash Flows From Financing Activities			
Principal payments on note payable	-	(97,326)	(97,326)
	-	(97,326)	(97,326)
Net decrease	(3,648)	(236,587)	(240,235)
Cash and cash equivalents, beginning of year	152,766	787,905	940,671
Cash and cash equivalents, end of year	\$ 149,118	\$ 551,318	\$ 700,436
Supplemental Information			
Income taxes paid	\$ -	\$ -	\$ -
Interest paid	\$ -	\$ 478	\$ 478

Read Independent Auditors' Report.
The accompanying notes are an integral part of the financial statements.

THE SHEARWATER ASSOCIATION OF APARTMENT OWNERS
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2022

NOTE 1 - ORGANIZATION AND PURPOSE

The Shearwater Association of Apartment Owners (the “Association”) was formed to operate and manage The Shearwater (the “Condominium”), a horizontal property regime recorded on August 1, 1993, under the laws of Hawaii. The Condominium consists of 32 interval ownership units and a clubhouse, located in Princeville, Kauai, Hawaii. The owners of all weeks in the Condominium and the clubhouse are the only members.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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 amount of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amount of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Presentation

The Association’s governing documents provide guidelines for governing its financial activities. To ensure observance of limitations on the use of financial resources, the Association maintains its accounts using fund 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 repairs and replacements.

Cash and Cash Equivalents

The Association considers all highly liquid investment instruments purchased with an original maturity of three months or less, at the date of purchase, to be cash equivalents.

Certificates of Deposit

The Association invests in federally insured certificates of deposit which are considered held-to-maturity. As a result, certificates of deposit are carried at amortized cost plus accrued interest. Subsequent write ups or write downs to fair value to recognize unrealized gains or losses are not recorded.

Property and Equipment

The Association follows prevalent industry practice, as contained in ASC Subtopic 972-360, “Real Estate - Common Interest Realty Associations - Property, Plant and Equipment” in accounting for the common property of the Association, which it is responsible to preserve and maintain. Property is capitalized only if the Association has title or other evidence of ownership of the property, and either the Association can dispose of the property or the property is used by the Association to generate significant cash flow from members on the basis of usage or from nonmembers.

Read Independent Auditors’ Report.

THE SHEARWATER ASSOCIATION OF APARTMENT OWNERS
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2022

Common property is not capitalized as these items do not meet the capitalization criteria, since ownership of the commonly owned assets is vested in the members, those assets are not titled in the Association's name and disposition of those assets by the Board of Directors (the "Board") is restricted. Additions and improvements to common property are accounted for as major repair and replacement expenditures in the replacement fund.

Leases

The Association determines if an arrangement is or contains a lease at inception. Leases may contain lease and non-lease components which are not separated by the Association. The Association does not report right-of-use assets or lease liabilities for their short-term leases (leases with a term of 12 months or less). Instead, the lease payments of those leases are reported as lease expense when incurred, as further described in Note 6.

Income Taxes

The Association can elect to file its income tax return as a Homeowners' Association, in accordance with Internal Revenue Code Section 528. Under that section, the Association is not taxed on uniform assessments to members and other income received from Association members solely as a function of their membership in the Association. The effect of the election is to tax the Association only on its "non-exempt function" income, reduced by a specific \$100 deduction at a flat 32% rate. If such election is not made, the Association's net income is subject to tax at statutory corporate rates.

Management has analyzed its various federal and state filing positions and believes that the Association's income tax filing positions and deductions are well documented, supported and contain no uncertain tax positions. Additionally, management believes that no accruals for tax liabilities, interest or penalties are required. Therefore, no reserves for uncertain income tax positions have been recorded. Further, no interest or penalties have been included since no reserves were recorded. When applicable, such interest and penalties will be reported as income tax expense. The Association's federal and state income tax returns remain subject to examination by the Internal Revenue Service and the State of Hawaii, respectively, for three years from the date of filing.

The Association has elected to be taxed as a Homeowners' Association, which has resulted in no income tax liability for the year ended December 31, 2022.

Fair Value Measurements

The Association measures certain assets at fair value in accordance with current accounting standards on fair value measurements. The standard defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) as opposed to the price that would be paid to acquire the asset or received to assume the liability (an entry price). The Association has determined that there were no material differences between the cost and carrying values of its financial assets and liabilities as of December 31, 2022.

Assessment Revenue

Member assessments revenue is recognized monthly in the amount of the membership assessment allocation specified for current period operations, based on the annual budget determined and approved by the Board. A proportionate share of the maintenance fees is assessed for each week based on unit type.

Member assessments for the weeks that have been sold are billed and collected through The Shearwater Interval Owners Association ("TSWIOA"). The fees are then transferred to the Association on a monthly basis. During the year ended December 31, 2022, maintenance fees that were billed through TSWIOA totaled \$1,137,603.

Read Independent Auditors' Report.

THE SHEARWATER ASSOCIATION OF APARTMENT OWNERS
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2022

Any amounts received in advance of the due date are deferred until due. The Financial Accounting Standards Board issued Accounting Standards Code 606 requiring deferral of the recognition of income until the services are rendered. The Association has determined ASC 606 does not apply to the Association as no customer relationship exists as it is defined by the Code. The Association does not defer the recognition of any portion of revenue as a contract liability.

Recently Adopted Accounting Guidance

As of January 1, 2022, the Association changed its accounting method for leases as a result of implementing the requirements in the Financial Accounting Standard Board's Accounting Standards Codification (ASC) 842, Leases, using the modified retrospective transition method. There was no cumulative effect adjustment to the Association's balance sheet as of January 1, 2022. The Association elected the package of practical expedients to account for existing leases, without reassessing (a) whether the contracts contain leases under the new standard (b) the lease classification, or (c) whether the unamortized initial direct costs would have met the definition in the new guidance at commencement. Adoption of the new guidance had no significant impact on the balance sheet or the statement of revenue, expenses and changes in fund balance or cash flows for the year ended December 31, 2022.

NOTE 3 - CONCENTRATIONS

Concentration of Credit Risk

Financial instruments that potentially subject the Association to concentrations of credit risk consist principally of cash. The Association maintains cash balances at various financial institutions. Accounts at each commercial banking institution are insured by the Federal Deposit Insurance Corporation (the "FDIC") up to \$250,000. As of December 31, 2022, these balances were fully insured based on the bank statement balances, less the FDIC insurance.

NOTE 4 - RELATED PARTY TRANSACTIONS

A Board member is an employee of PAHIO Resorts, Inc. (the "Management Company"), an affiliate of Wyndham Vacation Resorts, Inc. ("WVR"). In the normal course of business, the Association conducts certain transactions with the Management Company. The following amounts related to these transactions are included in the accompanying statement of revenue, expenses and changes in fund balances as follows:

Payroll and benefits	\$ 109,905
Accounting and data processing	12,445
Management fees	83,091
	<u>\$ 205,441</u>

As of December 31, 2022, \$10,897 was due from Management Company related to overpayment of the above expenses.

THE SHEARWATER ASSOCIATION OF APARTMENT OWNERS
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2022

NOTE 5 - FUTURE MAJOR REPAIRS AND REPLACEMENTS

The Association's replacement fund is utilized to accumulate funds for future major repairs and replacements, by an allocation of the maintenance fees assessment charged to each member and specifically designated for the fund in the annual budget. Deductions from the fund are recorded as costs, as incurred, which are determined by the Board, to meet the objective for which the fund was established. The Association's policy is to retain the interest earned on such funds in the replacement fund.

The 2022 funding requirement was computed over the estimated useful lives of the components, based on an independent appraiser's estimates of current replacement costs, updated by management.

The 2023 proposed budgeted funding is \$298,516, as shown in the unaudited supplementary information. The components' actual replacement costs, useful lives, and interest income may vary from estimated amounts and the variation may be material. Therefore, the Association's replacement fund may not be adequate to meet all future needs for major repairs and replacements. If additional funds are needed, the Board, on behalf of the Association, has the power to increase regular assessments, pass special assessments, or delay major repairs and replacements until funds are available.

NOTE 6 - COMMITMENTS

The Association has a management agreement with the Management Company through December 31, 2025. The contract automatically renews for successive three-year terms until terminated, under the laws of the State of Hawaii. The Management Company provides management, maintenance, administrative and accounting services. The management agreement provides that the Management Company may subcontract its rights, duties and obligations.

The Association has a one-year lease with the Management Company, to rent a portion of the clubhouse, renewable annually. The lease calls for a base rent in an amount equal to the actual costs and expenses relating to or arising from the use, maintenance, operation, repair, replacement and management of the leased premises, plus a pro-rata share of all utilities, master association assessments, condominium or vacation assessments, annual depreciation, and property taxes. Clubhouse expense for the year ended December 31, 2022, was \$11,883, included in recreation and amenities.

The Association has a five-year liquefied petroleum gas purchase agreement ending April 30, 2024. The contract automatically renews for successive one-month periods.

The Association has a five-year cable services agreement ending November 18, 2024. The contract automatically renews for successive one-year periods unless written notice of termination is provided by either party no less than 90 days prior to the end of the agreement.

NOTE 7 - SUBSEQUENT EVENTS

In preparing these financial statements, the Association has evaluated events and transactions for potential recognition or disclosure through March 16, 2023, the date the financial statements were available to be issued.

SUPPLEMENTARY INFORMATION

THE SHEARWATER ASSOCIATION OF APARTMENT OWNERS
SUPPLEMENTARY INFORMATION ON
FUTURE MAJOR REPAIRS AND REPLACEMENTS
DECEMBER 31, 2022
(Unaudited)

An independent appraiser conducted a study during 2020 to estimate the remaining useful lives and the replacement costs of the components of common property. The following table, which has been updated by management, is based on the study and presents significant information about the components of common property. Amounts are based on normal operation and without the effect of potential catastrophic occurrences.

Components	Estimated Remaining Useful Life (Years)	Estimated Current Replacement Costs	2023 Proposed Budgeted Funding
Building exterior renovation	-	\$ 21,218	
Doors	7.50	420,085	
Electrical	3.00	31,827	
Equipment	5.90	125,059	
Exterior building renovation	9.44	801,143	
Fire safety	-	36,050	
Fixtures	7.00	7,426	
Grounds	7.67	76,305	
Interior finishes	9.22	194,292	
Lighting	1.50	35,912	
Painting	2.00	448,910	
Pavement	8.50	221,400	
Pool and spa	5.36	107,078	
Recreation	8.33	31,297	
Roof	-	47,960	
Roofing	2.50	965,413	
Signage	11.00	28,252	
		<u>\$ 3,599,627</u>	<u>\$ 298,516</u>

Estimated current replacement costs are based on the assumption that the rate of interest income earned on replacement funds will be 2% and the rate of inflation 3%.

THE SHEARWATER ASSOCIATION OF APARTMENT OWNERS
SUPPLEMENTARY INFORMATION ON INVESTMENTS
DECEMBER 31, 2022
(Unaudited)

<u>Description</u>	<u>Acquired Date</u>	<u>Maturity Date</u>	<u>Cost Basis</u>
Safra National Bank	1/14/2022	7/20/2023	\$ 100,000
Goldman Sachs Bank	1/14/2022	7/26/2023	149,000
			<u>\$ 249,000</u>

Read Independent Auditors' Report.

THE SHEARWATER ASSOCIATION OF APARTMENT OWNERS
SCHEDULE OF OPERATING FUND REVENUE AND EXPENSES -
BUDGET TO ACTUAL
FOR THE YEAR ENDED DECEMBER 31, 2022

	<u>Budget</u> <i>(Unaudited)</i>	<u>Actual</u>	<u>Variance</u>
Revenue			
Member assessments	\$ 903,936	\$ 903,936	\$ -
Expenses			
Accounting and audit	19,858	18,522	1,336
Federal and state income and other taxes	901	110	791
General and administrative	64,989	60,811	4,178
Grounds and landscaping	194,456	175,701	18,755
Insurance	141,514	135,386	6,128
Management fees	83,091	83,091	-
Master association dues	15,360	17,403	(2,043)
Real estate and property taxes	263,382	284,101	(20,719)
Recreation and amenities	11,472	11,883	(411)
Security service	23,816	24,496	(680)
Utilities	95,164	92,033	3,131
Total operating fund expenses	<u>914,003</u>	<u>903,537</u>	<u>10,466</u>
(Deficiency) excess of revenue over expenses	<u>\$ (10,067)</u>	<u>\$ 399</u>	<u>\$ 10,466</u>