

Financial Statements

**Kahana Falls Association
of Apartment Owners**

**For the Year Ended
December 31, 2008**

Kahana Falls Association of Apartment Owners

Contents December 31, 2008

Page

Independent Auditor's Report	1
Financial Statements	
Balance Sheet	2
Statement of Revenue, Expenses, and Fund Balances	3
Statement of Cash Flows	4
Statement of Other Operating Income and Expenses	5
Notes to Financial Statements	6-10
Supplemental Information on Future Major Repairs and Replacements	11

Independent Auditor's Report

Board of Directors
Kahana Falls Association
of Apartment Owners
Kahana, Maui, Hawaii

We have audited the accompanying balance sheet of Kahana Falls Association of Apartment Owners as of December 31, 2008 and the related statements of revenue, expenses and fund balances, cash flows, and other operating income and expenses for the year 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 audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit 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 audit provides 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 Kahana Falls Association of Apartment Owners as of December 31, 2008 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The supplemental information on future major repairs and replacements on page 11 is not a required part of the basic financial statements of Kahana Falls Association of Apartment Owners, but is supplemental information required by accounting principles generally accepted in the United States of America. 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.

As more fully described in Note 13, subsequent to the issuance of the Association's 2008 financial statement and our report thereon dated May 8, 2009, we became aware that those financial statements incorrectly reflected the prepaid assessments and assessment revenues. In our original report we expressed an unqualified opinion on the 2008 financial statements, and our opinion on the revised statements, as expressed herein, remains unqualified.

FITZGERALD & ASSOCIATES, INC. CPAs

Redlands, California
June 16, 2009

Kahana Falls Association of Apartment Owners

Balance Sheet December 31, 2008

Page 2

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
Assets			
Cash, including interest- bearing deposits (Note 4)	\$ 346,227	\$ 314,508	\$ 660,735
Accounts receivable - net (Note 5)	70,095	-	70,095
Due from Kahana Falls IOA	20,995	-	20,995
Prepaid expenses (Note 6)	15,542	-	15,542
	<u> </u>	<u> </u>	<u> </u>
Total assets	<u>\$ 452,859</u>	<u>\$ 314,508</u>	<u>\$ 767,367</u>
Liabilities and Fund Balances			
Accounts payable	\$ 25,511	\$ -	\$ 25,511
Accrued expenses (Note 8)	21,283	-	21,283
Prepaid assessments	771,682	-	771,682
	<u> </u>	<u> </u>	<u> </u>
Total liabilities	<u>818,476</u>	<u>-</u>	<u>818,476</u>
Fund balances (deficits)	<u>(365,617)</u>	<u>314,508</u>	<u>(51,109)</u>
Total liabilities and fund balances	<u>\$ 452,859</u>	<u>\$ 314,508</u>	<u>\$ 767,367</u>

The accompanying notes are an integral part of these financial statements.

Kahana Falls Association of Apartment Owners

Statement of Revenue, Expenses, and Fund Balances For the Year Ended December 31, 2008

Page 3

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
Revenue			
Member assessments	\$ 1,246,281	\$ 152,028	\$ 1,398,309
Commercial assessments	86,643	-	86,643
Rental income	22,333	-	22,333
Interest income	-	6,632	6,632
Other income (Schedule)	34,145	-	34,145
	<u>1,389,402</u>	<u>158,660</u>	<u>1,548,062</u>
Expenses			
Bad debt expense	52,483	-	52,483
Employee benefits	88,730	-	88,730
Facilities			
Maintenance	98,748	-	98,748
Utilities	579,813	-	579,813
General and administrative			
Services (Schedule)	703,897	-	703,897
Supplies	9,931	-	9,931
Landscape and maintenance	75,356	-	75,356
Repairs and replacements	-	58,719	58,719
	<u>1,608,958</u>	<u>58,719</u>	<u>1,667,677</u>
Total expenses			
Excess revenue (expenses)	(219,556)	99,941	(119,615)
Fund balance (deficit) - beginning	<u>(146,061)</u>	<u>214,567</u>	<u>68,506</u>
Fund balance (deficit) - ending	<u>\$ (365,617)</u>	<u>\$ 314,508</u>	<u>\$ (51,109)</u>

The accompanying notes are an integral part of these financial statements.

Kahana Falls Association of Apartment Owners

Statement of Cash Flows For the Year Ended December 31, 2008

Page 4

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
Cash Flows From			
Operating Activities			
Excess revenue (expenses)	\$ (219,556)	\$ 99,941	\$ (119,615)
Changes in:			
Accounts receivable	61,078	-	61,078
Due from Kahana Falls IOA	(1,993)	-	(1,993)
Prepaid expenses	(1,097)	-	(1,097)
Accounts payable	(83,341)	(3,190)	(86,531)
Accrued expenses	(9,860)	-	(9,860)
Prepaid assessments	91,383	-	91,383
Interfund transfer	1,805	(1,805)	-
	<u>(161,581)</u>	<u>94,946</u>	<u>(66,635)</u>
Net cash provided (used) by operating activities			
	<u>(161,581)</u>	<u>94,946</u>	<u>(66,635)</u>
Net increase (decrease) in cash	(161,581)	94,946	(66,635)
Cash - beginning of year	<u>507,808</u>	<u>219,562</u>	<u>727,370</u>
Cash - end of year	<u>\$ 346,227</u>	<u>\$ 314,508</u>	<u>\$ 660,735</u>

The accompanying notes are an integral part of these financial statements.

Kahana Falls Association of Apartment Owners

Combined Statement of Other Operating Income and Expenses For the Year Ended December 31, 2008

Page 5

	<u><i>Total</i></u>
<i>Other Income</i>	
Handling fees	\$ 3,480
Late fees	9,455
Telephone income	577
Other	<u>20,633</u>
Total other income	<u>\$ 34,145</u>
<i>General and Administrative Services</i>	
Audit, tax and accounting fees	\$ 32,002
Insurance	39,028
Management fees	61,555
Other general and administrative	83,782
Postage and freight	4,628
Printing	7,127
Property taxes	472,509
Taxes and licenses	<u>3,266</u>
Total general and administrative services	<u>\$ 703,897</u>

The accompanying notes are an integral part of these financial statements

Kahana Falls Association of Apartment Owners

Notes to Financial Statements December 31, 2008

Page 6

1. Organization and Other Matters

Kahana Falls Association of Apartment Owners (AOAO) is a nonprofit mutual benefit corporation organized in Hawaii in May 1991 and is governed by a member-elected Board of Directors. The Association is responsible for the operation and maintenance of 70 timeshare apartment units and 4 commercial units. The property is located in Kahana, Hawaii on the island of Maui.

2. Significant Accounting Policies

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. These estimates and assumptions affect the reported amounts of assets and liabilities at the reporting date and revenues, and expenses during the reporting period. Actual results could differ from those estimates.

The Association's governing documents provide guidelines for managing its financial activities. To ensure compliance with limitations and restrictions on the use of financial resources, the Association maintains its records using fund accounting. They classify transactions for accounting and reporting purposes in funds established according to their nature and purpose.

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

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

Members pay a portion of their Association dues for reserve expenses, generally major repairs and replacements. The Association deposits these funds in a separate interest-bearing money market fund. See Note 9 for a further discussion of reserves.

The Association considers all temporary cash investments with maturity of three months or less to be cash equivalents.

Interest-bearing deposits consist of certificates of deposits stated at market value which approximates cost.

Members are subject to annual assessments to provide funds for operating expenses and future major repairs and replacements. Assessments receivable at the reporting date represent amounts due from members. See Note 5 for additional details on assessments receivable amounts.

Kahana Falls Association of Apartment Owners

Notes to Financial Statements December 31, 2008

Page 7

2. Significant Accounting Policies (concluded)

The Association conforms to industry practice in recognizing real property and common areas as assets. Based on this practice, the Association only capitalizes property to which it has title and to which the board of directors has discretion to dispose of the property and retain the proceeds for the Association's use. Other real property and common areas are owned by the members in common and not by the Association and therefore are not capitalized. Depreciation is calculated using the straight-line method over the 5-year estimated useful life of the asset. Repairs, replacements and improvements of common property are expensed as incurred. See Note 7 for additional information on property and equipment.

Prepaid assessments consist of members annual assessments received in advance. The Association recognizes these amounts as income when they are earned in the subsequent year.

3. Income Taxes

The Association may elect to be taxed as either a time-share association or a regular corporation. The Association elected to be taxed as a regular corporation for the year ended December 31, 2008. Under that election, the Association is subject to federal and state income tax only on income derived from non-member sources such as interest and rental income.

The Association uses the same accrual accounting methods to report income for tax and financial purposes. No material differences exist in the recognition of revenues and expenses, which result in deferred income taxes.

The Association has federal and state net operating losses of approximately \$154,000 and \$220,315 respectively, which expire between 2009 and 2021.

4. Cash and Cash Equivalents

Cash and cash equivalents at the reporting date consist of the following amounts:

Operating Fund	
US Bank – checking	\$318,927
American Security Bank - checking	27,082
Petty cash	<u>218</u>
Total Operating Fund	<u>\$346,227</u>
Replacement Fund	
Wachovia Securities – money market account	\$123,508
Wachovia Securities – certificates of deposit	<u>191,000</u>
Total Replacement Fund	<u>\$314,508</u>

Kahana Falls Association of Apartment Owners

Notes to Financial Statements December 31, 2008

Page 8

5. Accounts Receivable

Accounts receivable at the reporting date consists of the following amounts:

Regular assessments	\$113,803
SCI Enterprise receivable	43,224
Other receivables	5,918
Allowance for doubtful accounts	<u>(92,850)</u>
Net accounts receivable	<u>\$70,095</u>

6. Prepaid Expenses

Prepaid expenses at the reporting date consist of the following amounts:

Insurance	\$11,078
Other prepaid expenses	<u>4,464</u>
Total prepaid expenses	<u>\$15,542</u>

7. Property and Equipment

Property and equipment at the reporting date consist of the following amounts:

Telephone system	\$62,384
Accumulated depreciation	<u>(62,384)</u>
Net property and equipment	<u>\$-0-</u>

8. Accrued Expenses

Accrued expenses at the reporting date consist of the following amounts:

State Excise and TAT taxes payable	\$746
Accrued vacation	13,270
Accrued other	<u>7,267</u>
Total accrued expenses	<u>\$21,283</u>

Kahana Falls Association of Apartment Owners

Notes to Financial Statements December 31, 2008

Page 9

9. Future Major Repairs and Replacements

The Association's governing documents require that funds be accumulated for future major repairs and replacements. These funds, which amount to \$314,508, are generally not available for operating purposes.

The Association conducted a study in January 2009 to estimate the remaining lives and replacement costs of the common property components. Actual expenditures may vary from the estimates, and the variations may be material. Amounts reserved may not be sufficient to meet future replacement cost requirements. When replacement funds are needed, the Board may elect to increase monthly assessments, levy special assessments, or delay replacements until funds are available. See page 11 for additional information on future major repairs and replacements.

10. Related Party Transactions

The Association incurs certain shared costs with Kahana Falls Interval Owners Association (IOA), a related organization, which is responsible for the maintenance and operation of the owners' units. For the reporting period, the IOA reimbursed the Association \$181,109 in shared costs and at December 31, 2008, owed the IOA \$20,995.

A member of the Association's Board of Directors is the president of SCI Enterprises, which is the general partner of Kahana Falls, Ltd., which is the developer of Kahana Falls Resort. Kahana Falls, Ltd. owned 2 intervals and paid the Association \$86,643 for assessments during the reporting period. At December 31, 2008, the Developer owed \$43,224 to the Association.

Certain members of the Board of Directors of the Kahana Falls Association of Apartment Owners are also members of the Board of Directors of the Interval Owners Association.

The Association entered into an agreement with Trading Places International (TPI), to provide certain rental and membership sales services. TPI collects the rental income and remits the income to the Association net of its commissions and fees. At December 31, 2008, TPI collected \$-0- in rental income.

11. Supplemental Cash Flow Disclosures

For the reporting periods, cash flows from operating activities include state and federal income tax payments of \$-0- for the year ended December 31, 2008.

12. Commitments and Contingencies

The Association entered into a three-year management agreement with Trading Places International (TPI) beginning May 1, 2008 and expiring May 1, 2011. The contract automatically renews for successive additional three-year terms unless terminated earlier by majority of the members within a ninety-day window before the expiration of the current term. TPI will provide administrative, financial, and accounting services for the Association.

Kahana Falls Association of Apartment Owners

Notes to Financial Statements December 31, 2008

Page 10

13. Other

Subsequent to the issuance of the Association's financial statements, management became aware that the amount of reported prepaid assessments was understated and the amount of assessment revenues was overstated. The adjustment of these items in the revised financial statements has the effect of increasing liabilities by \$66,705 at December 31, 2008, and decreasing net income for the year ended December 31, 2008 by \$66,705.

Supplemental Information

**Kahana Falls Association
of Apartment Owners**

**Supplemental Information on Future Major
Repairs and Replacements
December 31, 2008**

The Association conducted a study January 2009 to estimate the remaining useful lives and replacement costs of the components of common property. Replacement costs were based on the estimated costs to repair or replace the common property components at the date of the study. The Association has assessed the present condition of all common property components and estimated replacement costs relying upon Board members, management company representatives, outside contractors and service representatives. Estimated annual funding has been calculated using the cash flow method with provisions for annual inflation at 2.25% and interest earnings at 3.5%.

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

Component	Estimated Remaining Useful Life (Years)	Current Replacement Cost	Estimated 2009 Funding Requirement	Reserve Expenditures For the Year Ended 12/31/08	Replacement Cash Balance at 12/31/08
AC Units	15	\$ 13,500	\$ 3,707	\$ (14,870)	\$ 26,105
ADA Compliance	0	15,000	4,119	-	29,005
Walkways	7	2,500	686	(11,594)	4,834
Carpet	6	7,500	2,059	-	14,503
Decks	3	6,000	1,648	-	11,602
Elevators	10	20,000	5,492	(1,600)	38,674
Painting	6-10	102,500	28,145	(11,429)	198,205
Fitness Center	15	3,500	961	(858)	6,768
Gates and fences	20	15,000	4,119	-	29,006
Landscape	10	10,000	2,746	-	19,337
Lobby	5-18	21,500	5,904	(6,791)	41,575
Lock system	13	300	82	-	580
Parking	15-24	91,000	24,987	-	175,968
Pool and spa	4-12	90,000	24,713	(7,503)	174,034
Roofs	18	60,000	16,475	-	116,023
Sprinkler	25	60,000	16,475	-	116,023
Telephone system	16	55,000	15,102	(2,274)	106,354
Windows	15-27	2,940	807	-	5,685
Water Heater	15	5,000	1,373	(1,800)	9,669
Cash deficit	-	-	-	-	(809,442)
Totals		\$ 581,240	\$ 159,600	\$ (58,719)	\$ 314,508

See accountants' report.