

**Financial Statements**

**Kahana Falls Association  
of Apartment Owners**

**For the Year Ended  
December 31, 2011**

# Kahana Falls Association of Apartment Owners

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December 31, 2011

(Summarized Totals for 2010)

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## 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, 2011 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. Information for the year ended December 31, 2010 is presented for comparative purposes only and was extracted from the financial statements presented by fund for that year, on which we expressed an unqualified opinion in our report dated April 8, 2011.

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, 2011 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.

*FITZGERALD & ASSOCIATES, INC. CPAs*

Redlands, California  
February 25, 2012

# Kahana Falls Association of Apartment Owners

## Balance Sheet December 31, 2011 (Summarized Totals for 2010)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2011 Total</u>	<u>2010 Total</u>
<b>Assets</b>				
Cash, including interest-bearing deposits (Note 4)	\$ 698,696	\$ 486,656	\$ 1,185,352	\$ 1,068,276
Accounts receivable-net (Note 5)	9,301	-	9,301	17,252
Interest receivable	-	1,266	1,266	895
Due from Kahana Falls IOA	70,697	-	70,697	44,998
Prepaid expenses (Note 6)	34,213	-	34,213	23,942
Total assets	<u>\$ 812,907</u>	<u>\$ 487,922</u>	<u>\$ 1,300,829</u>	<u>\$ 1,155,363</u>
<b>Liabilities and Fund Balances</b>				
Accounts payable	\$ 90,406	\$ -	\$ 90,406	\$ 42,009
Accrued expenses (Note 7)	34,551	-	34,551	15,702
Income taxes payable	1,182	-	1,182	-
Prepaid assessments	831,185	-	831,185	834,323
Total liabilities	<u>957,324</u>	<u>-</u>	<u>957,324</u>	<u>892,034</u>
Fund balances (deficits)	<u>(144,417)</u>	<u>487,922</u>	<u>343,505</u>	<u>263,329</u>
Total liabilities and fund balances	<u>\$ 812,907</u>	<u>\$ 487,922</u>	<u>\$ 1,300,829</u>	<u>\$ 1,155,363</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, 2011 (Summarized Totals for 2010)

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	<i>Operating Fund</i>	<i>Replacement Fund</i>	<i>2011 Total</i>	<i>2010 Total</i>
<b>Revenue</b>				
Member assessments	\$ 1,443,379	\$ 181,273	\$ 1,624,652	\$ 1,575,012
Rental income	28,692	-	28,692	24,744
Interest income	1,595	2,596	4,191	4,283
Other income (Schedule)	13,364	-	13,364	15,828
Total revenue	<u>1,487,030</u>	<u>183,869</u>	<u>1,670,899</u>	<u>1,619,867</u>
<b>Expenses</b>				
Payroll and related	387,223	-	387,223	349,675
Bad debt expense	160,472	-	160,472	167,596
Income tax expense	1,182	-	1,182	-
Facilities				
Maintenance	79,475	-	79,475	88,656
Utilities	212,238	-	212,238	195,252
General and administrative				
Services (Schedule)	148,197	-	148,197	126,730
Supplies	8,127	-	8,127	6,252
Landscape and maintenance	79,982	-	79,982	73,658
Property taxes	315,261	-	315,261	400,566
Repairs and replacements	-	198,566	198,566	74,534
Total expenses	<u>1,392,157</u>	<u>198,566</u>	<u>1,590,723</u>	<u>1,482,919</u>
Excess revenue (expenses)	94,873	(14,697)	80,176	136,948
Fund balance (deficit)-beginning	(221,744)	485,073	263,329	126,381
Fund transfers	<u>(17,546)</u>	<u>17,546</u>	<u>-</u>	<u>-</u>
Fund balance (deficit)-ending	<u>\$ (144,417)</u>	<u>\$ 487,922</u>	<u>\$ 343,505</u>	<u>\$ 263,329</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, 2011 (Summarized Totals for 2010)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2011 Total</u>	<u>2010 Total</u>
<b>Cash Flows From</b>				
<b>Operating Activities</b>				
Excess revenue (expenses)	\$ 94,873	\$ (14,697)	\$ 80,176	\$ 136,948
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:				
Changes in:				
Accounts receivable	7,951	-	7,951	3,975
Interest receivable	434	(805)	(371)	(895)
Due from Kahana Falls IOA	(25,699)	-	(25,699)	(14,479)
Prepaid expenses	(10,271)	-	(10,271)	750
Accounts payable	48,397	-	48,397	(41,428)
Accrued expenses	18,849	-	18,849	(10,104)
Income taxes payable	1,182	-	1,182	-
Prepaid assessments	(3,138)	-	(3,138)	125,033
Net cash provided (used) by operating activities	<u>132,578</u>	<u>(15,502)</u>	<u>117,076</u>	<u>199,800</u>
<b>Cash Flows From</b>				
<b>Financing Activities</b>				
Fund transfers	<u>(17,546)</u>	<u>17,546</u>	<u>-</u>	<u>-</u>
Net cash provided (used) by financing activities	<u>(17,546)</u>	<u>17,546</u>	<u>-</u>	<u>-</u>
Net increase (decrease) in cash	115,032	2,044	117,076	199,800
Cash-beginning of year	<u>583,664</u>	<u>484,612</u>	<u>1,068,276</u>	<u>868,476</u>
Cash-end of year	<u>\$ 698,696</u>	<u>\$ 486,656</u>	<u>\$ 1,185,352</u>	<u>\$ 1,068,276</u>

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

# Kahana Falls Association of Apartment Owners

## Statement of Other Operating Income and Expenses For the Year Ended December 31, 2011 (Summarized Totals for 2010)

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	<u>2011</u> <u>Total</u>	<u>2010</u> <u>Total</u>
<b>Other Income</b>		
Late fees	\$ 9,895	\$ 4,252
Other	3,469	11,576
	<u>          </u>	<u>          </u>
Total other income	<u>\$ 13,364</u>	<u>\$ 15,828</u>
<b>General and Administrative Services</b>		
Audit, tax and accounting fees	\$ 33,500	\$ 33,500
Insurance	38,859	29,933
Legal fees	3,256	-
Management fees	9,280	8,880
Other general and administrative	55,098	46,136
Postage and freight	1,633	1,674
Printing	1,495	1,809
Taxes and licenses	5,076	4,798
	<u>          </u>	<u>          </u>
Total general and administrative services	<u>\$ 148,197</u>	<u>\$ 126,730</u>

The accompanying notes are an integral part of these financial statements

# **Kahana Falls Association of Apartment Owners**

## **Notes to Financial Statements December 31, 2011 (Summarized Totals for 2010)**

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### ***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 financial statements include certain 2010 comparative information. With respect to the balance sheet, the statement of revenue, expenses, and fund balances, and the statement of cash flows, such prior year information is not presented by fund. Accordingly, such information should be read in conjunction with the Association's financial statement for the year ended December 31, 2010 from which the summarized information was derived.

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 8 for a further discussion of reserves.

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

Members are subject to monthly assessments to provide funds for operating expenses and future major repairs and replacements. The annual budget and assessments of owners are determined by the board of directors and are approved by the owners. Assessments receivable at the reporting dates represent amounts due from unit owners. The Association establishes an allowance for all unpaid accounts with delinquent balances outstanding for more than 90 days. The Association's policy is to accrue interest on all amounts due, including delinquent assessments, reasonable collection costs and late charges commencing 30 days after assessments become due.



# Kahana Falls Association of Apartment Owners

## Notes to Financial Statements December 31, 2011 (Summarized Totals for 2010)

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### **2. Significant Accounting Policies** (concluded)

In addition, the Association's policies permit various collection remedies for delinquent assessments, which include filing liens, foreclosing on the unit owner, and obtaining judgment on other assets of the owner. Any excess assessments at year-end are retained by the Association for use in the succeeding year. See Note 5 for additional information on assessments receivable.

The Association conforms to industry practice in recognizing real property and common areas as assets. Based on this practice, the Association would only capitalize 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. Since the real property and common areas are owned in common by the individual unit owners and not by the Association, they are not capitalized and presented in the financial statements of the Association. The acquisition costs and improvements to such properties are charged directly to current period replacements.

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**

Homeowner associations may elect to be taxed as regular corporations or as homeowner associations. The Association elected to be taxed as a homeowners' association in accordance with Internal Revenue Code Section 528 for the years ending December 31, 2011 and 2010. Under that Section, the Association is not taxed on assessments to members and other income received from association members solely as a function of their membership in the Association. The Association is taxed at the rate of 30% on its nonexempt function income such as interest.

The Association's state and federal income tax filings are subject to audit by various taxing authorities. While the Association currently has no income tax returns under audit, the open tax audit periods, for which the statute of limitations has not expired, are 2008 through 2010. For the years ended December 31, 2011 and 2010, the Association paid no income tax interest or penalties.

The Association has federal and state net operating losses of approximately \$139,000 and \$153,000 respectively, which expire between 2015 and 2026. Federal net operating losses can only be used if the Association files in accordance with the IRS Code 277.

# Kahana Falls Association of Apartment Owners

## Notes to Financial Statements December 31, 2011 (Summarized Totals for 2010)

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### 4. Cash and Cash Equivalents

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

	<u>2011</u>	<u>2010</u>
Operating Fund		
US Bank – checking	\$470,578	\$416,628
American Security Bank - checking	1,227	36
Wells Fargo Advisors – money market account	587	4,264
Wells Fargo Advisors – certificate of deposit	-0-	100,000
Bank of Hawaii - checking	223,769	57,519
Managers checking account	<u>2,535</u>	<u>5,217</u>
Total Operating Fund Cash	<u>\$698,696</u>	<u>\$583,664</u>
Replacement Fund		
Wells Fargo Advisors – money market account	\$72,828	\$179,611
Wells Fargo Advisors – certificates of deposit	300,000	190,000
American Security Bank – money market account	<u>113,828</u>	<u>115,001</u>
Total Replacement Fund Cash	<u>\$486,656</u>	<u>\$484,612</u>

### 5. Accounts Receivable

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

	<u>2011</u>	<u>2010</u>
Regular assessments	\$452,675	\$300,086
Due from Trading Places International	374	-0-
Allowance for doubtful accounts	<u>(443,748)</u>	<u>(282,834)</u>
Accounts receivable-net	<u>\$9,301</u>	<u>\$17,252</u>

### 6. Prepaid Expenses

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

	<u>2011</u>	<u>2010</u>
Insurance	\$30,493	\$20,319
Other prepaid expenses	<u>3,720</u>	<u>3,623</u>
Total prepaid expenses	<u>\$34,213</u>	<u>\$23,942</u>

# Kahana Falls Association of Apartment Owners

## Notes to Financial Statements December 31, 2011 (Summarized Totals for 2010)

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### 7. *Accrued Expenses*

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

	<u>2011</u>	<u>2010</u>
State Excise and TAT taxes payable	\$385	\$496
Accrued payroll and vacation	30,487	11,527
Accrued other	<u>3,679</u>	<u>3,679</u>
Total accrued expenses	<u>\$34,551</u>	<u>\$15,702</u>

### 8. *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 \$486,656, are held in separate bank accounts and are generally not available for operating purposes. The Association's policy is to allocate interest earned on such funds to the replacement fund.

The Association conducted a study in January 2009 to estimate the remaining useful lives and the replacement costs of the components of common property. The estimates were based on future estimated replacement costs.

Fund requirements consider an annual inflation rate of 2.25 percent and interest of 3.5 percent, net of taxes, on amounts funded for future repairs and replacements. The table included in the unaudited supplementary information on Future Major Repairs and Replacements is based on the study. See the supplemental information presented on page 11 for additional details.

The Association is funding for such repairs and replacements over the estimated useful lives of the components, based on the study's estimates of replacement costs, and considering amounts previously accumulated in the replacement fund. Actual expenditures may vary from the estimates, and the variations may be material. Accordingly, the available cash may not be sufficient to meet all future needs. If they need additional replacement funds, the Board may elect to increase monthly assessments, levy special assessments, or delay replacements until funds are available.

# **Kahana Falls Association of Apartment Owners**

## **Notes to Financial Statements December 31, 2011 (Summarized Totals for 2010)**

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### ***9. Related Party Transactions***

The Association incurs certain shared costs with Kahana Falls Interval Owners Association (IOA), a related Association, which is responsible for the maintenance and operation of the owners' units. For the reporting period, the IOA reimbursed the Association \$415,473 and \$396,131 in shared costs. At December 31, 2011 and 2010 the Association owed the IOA \$727 and \$575 and \$70,697 and \$44,998 was due to the Association from the IOA respectively for these shared costs at December 31, 2011 and 2010.

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

In December 2010, the Association's management company was bought by Interval International, Inc. The Association is provided collection services by one of Interval International, Inc.'s subsidiary companies. During the year ended December 31, 2011, \$567 was paid to this Company for collection services and \$-0- was due to or due from this Company at December 31, 2011.

### ***10. Supplemental Cash Flow Disclosures***

For the reporting periods, cash flows from operating activities include state and federal income tax payments of \$-0- and \$-0- for the years ended December 31, 2011 and 2010.

### ***11. Commitments and Contingencies***

The Association entered into a three-year management agreement with Trading Places International (TPI) beginning May 1, 2008 that automatically renewed on May 1, 2011 and now expires on May 1, 2014. 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.

### ***12. Subsequent Events***

Management has evaluated subsequent events through February 25, 2012, the date which the financial statements were available for issue.

## **Supplemental Information**

# Kahana Falls Association of Apartment Owners

## Supplemental Information on Future Major Repairs and Replacements (Unaudited) December 31, 2011

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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. Estimated current replacement costs have not been revised since the date of the study and do not take into account the effects of inflation between the date of the study and the date that the components will require repair or replacement. 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.

<b>Component</b>	<b>Estimated Remaining Useful Life (Years)</b>	<b>Estimated January 2009 Replacement Cost</b>	<b>Estimated 2012 Funding Requirement</b>	<b>Reserve Expenditures For the Year Ended 12/31/11</b>	<b>Replacement Cash Balance at 12/31/11</b>
AC Units	12	\$ 719,000	\$ 83,116	\$ (39,596)	\$ 433,992
ADA Compliance	0	15,000	1,734	-	9,054
Walkways	4	5,000	578	-	3,018
Carpet	3	7,500	867	(11,444)	4,527
Decks	0	6,000	694	-	3,622
Elevators	7	60,000	6,936	(1,025)	36,216
Painting	3-7	170,000	19,652	(95,730)	102,613
Fitness Center	12	24,500	2,832	(3,479)	14,788
Gates and fences	17	15,000	1,734	-	9,054
Landscape	7	10,000	1,156	(14,777)	6,036
Lobby	2-15	21,500	2,485	-	12,978
Lock system	10	49,500	5,722	(19,673)	29,878
Parking	12-21	91,000	10,520	-	54,928
Pool and spa	1-9	115,000	13,294	(8,064)	69,415
Roofs	15	120,000	13,872	(186)	72,433
Sprinkler	22	60,000	6,936	-	36,216
Telephone system	13	55,000	6,358	-	33,198
Windows	12-24	49,560	5,729	(4,592)	29,914
Water Heater	12	5,000	577	-	3,018
Cash deficit	-	-	-	-	(478,242)
Totals		<u>\$ 1,598,560</u>	<u>\$ 184,792</u>	<u>\$ (198,566)</u>	<u>\$ 486,656</u>

See auditor's report.