

Financial Statements

**Kahana Falls Association
of Apartment Owners**

**For the Year Ended
December 31, 2012**

Kahana Falls Association of Apartment Owners

Contents

December 31, 2012

(Summarized Totals for 2011)

Page

Report of Independent Auditor	1-2
Financial Statements	
Balance Sheet	3
Statement of Revenue, Expenses, and Fund Balances	4
Statement of Cash Flows	5
Statement of Other Operating Income and Expenses	6
Notes to Financial Statements	7-11
Supplemental Information on Future Major Repairs and Replacements	12

Report of Independent Auditor

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

We have audited the accompanying financial statements of Kahana Falls Association of Apartment Owners, which comprise the balance sheet as of December 31, 2012, and the related statements of income, expenses, fund balances, cash flows and other operating income and expenses for the year then ended, and the related notes to the financial statements. The prior year summarized comparative information has been derived from the Association's 2011 financial statements and, in our report dated February 25, 2012 we expressed an unqualified opinion on those 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

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 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, we 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.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Kahana Falls Association
Of Apartment Owners
March 11, 2013
Page 2

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, 2012, 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.

Report on Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The supplemental information, which is the responsibility of the Association's management, is presented for purposes of additional analysis and is not a required part of the financial statements. Such 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.

FITZGERALD & ASSOCIATES, INC. CPAs

Redlands, California
March 11, 2013

Kahana Falls Association of Apartment Owners

Balance Sheet December 31, 2012 (Summarized Totals for 2011)

Page 3

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2012 Total</u>	<u>2011 Total</u>
Assets				
Cash, including interest-bearing deposits (Note 4)	\$ 811,923	\$ 539,165	\$ 1,351,088	\$ 1,185,352
Accounts receivable, net (Note 5)	-	-	-	9,301
Interest receivable	-	255	255	1,266
Due from Kahana Falls IOA	135,877	-	135,877	70,697
Prepaid expenses (Note 6)	25,582	-	25,582	34,213
Total assets	<u>\$ 973,382</u>	<u>\$ 539,420</u>	<u>\$ 1,512,802</u>	<u>\$ 1,300,829</u>
Liabilities and Fund Balances				
Accounts payable	\$ 52,586	\$ -	\$ 52,586	\$ 89,679
Accrued expenses (Note 7)	34,760	-	34,760	34,551
Income taxes payable	796	-	796	1,182
Due to Kahana Falls IOA	7,373	-	7,373	727
Prepaid assessments	885,699	-	885,699	831,185
Total liabilities	<u>981,214</u>	<u>-</u>	<u>981,214</u>	<u>957,324</u>
Fund balances (deficits)	<u>(7,832)</u>	<u>539,420</u>	<u>531,588</u>	<u>343,505</u>
Total liabilities and fund balances	<u>\$ 973,382</u>	<u>\$ 539,420</u>	<u>\$ 1,512,802</u>	<u>\$ 1,300,829</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, 2012
(Summarized Totals for 2011)**

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2012 Total</u>	<u>2011 Total</u>
Revenue				
Member assessments	\$ 1,383,884	\$ 188,524	\$ 1,572,408	\$ 1,624,652
Rental income	39,373	-	39,373	28,692
Interest income	728	1,539	2,267	4,191
Other income (Schedule)	12,297	-	12,297	13,364
Total revenue	<u>1,436,282</u>	<u>190,063</u>	<u>1,626,345</u>	<u>1,670,899</u>
Expenses				
Payroll and related	377,203	-	377,203	387,223
Bad debt expense	180,714	-	180,714	160,472
Income tax expense	1,996	-	1,996	1,182
Facilities				
Maintenance	51,167	-	51,167	79,475
Utilities	216,762	-	216,762	212,238
General and administrative				
Services (Schedule)	143,211	-	143,211	148,197
Supplies	7,152	-	7,152	8,127
Landscape maintenance	72,224	-	72,224	79,982
Property taxes	250,552	-	250,552	315,261
Repairs and replacements	-	137,281	137,281	198,566
Total expenses	<u>1,300,981</u>	<u>137,281</u>	<u>1,438,262</u>	<u>1,590,723</u>
Excess revenue (expenses)	135,301	52,782	188,083	80,176
Fund balances (deficit), beginning	(144,417)	487,922	343,505	263,329
Fund transfers	1,284	(1,284)	-	-
Fund balances (deficits), ending	<u>\$ (7,832)</u>	<u>\$ 539,420</u>	<u>\$ 531,588</u>	<u>\$ 343,505</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, 2012 (Summarized Totals for 2011)

Page 5

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2012 Total</u>	<u>2011 Total</u>
Cash Flows From				
Operating Activities				
Excess revenue (expenses)	\$ 135,301	\$ 52,782	\$ 188,083	\$ 80,176
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:				
Changes in:				
Accounts receivable	9,301	-	9,301	7,951
Interest receivable	-	1,011	1,011	(371)
Due from Kahana Falls IOA	(65,180)	-	(65,180)	(25,699)
Prepaid expenses	8,631	-	8,631	(10,271)
Accounts payable	(36,453)	-	(36,453)	48,397
Accrued expenses	12,861	-	12,861	18,849
Income taxes payable	(386)	-	(386)	1,182
Due to Kahana Falls IOA	(6,646)	-	(6,646)	-
Prepaid assessments	54,514	-	54,514	(3,138)
	<u>111,943</u>	<u>53,793</u>	<u>165,736</u>	<u>117,076</u>
Net cash provided (used) by operating activities				
	<u>111,943</u>	<u>53,793</u>	<u>165,736</u>	<u>117,076</u>
Cash Flows From				
Financing Activities				
Fund transfers	1,284	(1,284)	-	-
	<u>1,284</u>	<u>(1,284)</u>	<u>-</u>	<u>-</u>
Net cash provided (used) by financing activities				
	<u>1,284</u>	<u>(1,284)</u>	<u>-</u>	<u>-</u>
Net increase (decrease) in cash	113,227	52,509	165,736	117,076
Cash, beginning of year	<u>698,696</u>	<u>486,656</u>	<u>1,185,352</u>	<u>1,068,276</u>
Cash, end of year	<u>\$ 811,923</u>	<u>\$ 539,165</u>	<u>\$ 1,351,088</u>	<u>\$ 1,185,352</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, 2012
(Summarized Totals for 2011)**

Page 6

	<u>2012</u> <u>Total</u>	<u>2011</u> <u>Total</u>
Other Income		
Late fees	\$ 7,927	\$ 9,895
Other	4,370	3,469
Total other income	<u>\$ 12,297</u>	<u>\$ 13,364</u>
General and Administrative Services		
Audit, tax and accounting fees	\$ 35,169	\$ 33,500
Insurance	42,073	38,859
Legal fees	246	3,256
Management fees	8,886	9,280
Other general and administrative	45,180	55,098
Postage and freight	1,700	1,633
Printing	4,353	1,495
Taxes and licenses	5,604	5,076
Total general and administrative services	<u>\$ 143,211</u>	<u>\$ 148,197</u>

The accompanying notes are an integral part of these financial statements

Kahana Falls Association of Apartment Owners

Notes to Financial Statements December 31, 2012 (Summarized Totals for 2011)

Page 7

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 2011 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, 2011 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 bank and brokerage accounts. 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, 2012 (Summarized Totals for 2011)

Page 8

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, 2012 and 2011. 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 and rental income.

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 2009 through 2011. For the years ended December 31, 2012 and 2011, the Association paid no income tax interest or penalties.

The Association has federal and state net operating losses of approximately \$67,760 and \$81,993 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, 2012 (Summarized Totals for 2011)

Page 9

4. Cash and Cash Equivalents

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

	<u>2012</u>	<u>2011</u>
Operating Fund		
US Bank, checking	\$212,709	\$470,578
American Security Bank, checking	26,629	1,227
Wells Fargo Advisors, money market account	934	587
Wells Fargo Advisors, certificates of deposit	400,000	-0-
Bank of Hawaii, checking	167,768	223,769
Managers checking account	3,883	2,535
Total Operating Fund Cash	<u>\$811,923</u>	<u>\$698,696</u>
Replacement Fund		
Wells Fargo Advisors, money market account	\$134,243	\$72,828
Wells Fargo Advisors, certificates of deposit	150,000	300,000
American Security Bank, money market account	<u>254,922</u>	<u>113,828</u>
Total Replacement Fund Cash	<u>\$539,165</u>	<u>\$486,656</u>

5. Accounts Receivable

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

	<u>2012</u>	<u>2011</u>
Regular assessments	\$654,663	\$452,675
Due from Trading Places International	-0-	374
Allowance for doubtful accounts	<u>(654,663)</u>	<u>(443,748)</u>
Accounts receivable, net	<u>\$-0-</u>	<u>\$9,301</u>

6. Prepaid Expenses

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

	<u>2012</u>	<u>2011</u>
Insurance	\$21,718	\$30,493
Other prepaid expenses	3,864	3,720
Total prepaid expenses	<u>\$25,582</u>	<u>\$34,213</u>

**Kahana Falls Association
of Apartment Owners**

**Notes to Financial Statements
December 31, 2012
(Summarized Totals for 2011)**

7. Accrued Expenses

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

	2012	2011
State Excise and TAT taxes payable	\$529	\$385
Accrued payroll and vacation	30,552	30,487
Accrued other	<u>3,679</u>	<u>3,679</u>
Total accrued expenses	<u>\$34,760</u>	<u>\$34,551</u>

8. Future Major Repairs and Replacements

The Association’s governing documents require that funds be accumulated for future major repairs and replacements. Accumulated funds are held in separate savings accounts and are generally not available for expenditures for normal operations.

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. Funding requirements consider an annual inflation rate of 2.25 percent and interest of 3.5 percent, net of taxes, on amounts funded for future major repairs and replacements. The table included in the unaudited supplementary information on Future Major Repairs and Replacements is based on the study.

The Board is funding for major repairs and replacements over the remaining useful lives of the components based on the study’s estimates of future replacement costs and considering amounts previously accumulated in the replacement fund. Accordingly, the funding requirement of \$188,524, based on a full funding plan, had been included in the 2012 budget.

Funds are being accumulated in the replacement fund based on estimated future costs for repairs and replacements of common property components. Actual expenditures and investment income may vary from the estimated amounts, and the variations may be material. Therefore, amounts accumulated in the replacements 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, subject to membership approval, to increase regular assessments, pass special assessments, or delay major repairs and replacements until funds are available.

Kahana Falls Association of Apartment Owners

Notes to Financial Statements December 31, 2012 (Summarized Totals for 2011)

Page 11

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 \$187,572 and \$450,284 in shared costs. At December 31, 2012 and 2011 the Association owed the IOA \$7,373 and \$727 respectively. At December 31, 2012 and 2011, \$135,877 and \$70,697 was due to the Association from the IOA respectively for these shared costs.

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, 2012 and 2011, 1,369 and \$567 was paid to this Company for collection services and \$-0- was due to or due from this Company at December 31, 2012.

10. Supplemental Cash Flow Disclosures

For the reporting periods, cash flows from operating activities include state and federal income tax payments of \$1,200 and \$-0- for the years ended December 31, 2012 and 2011.

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. Reclassification

Certain accounts in the prior-year financial statements have been reclassified for comparative purposes to conform to the presentation in the current-year financial statements.

13. Subsequent Events

Management has evaluated subsequent events through March 11, 2013, 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, 2012

Page 12

The Association conducted a study in January 2009 to estimate the remaining useful lives and replacement costs of the components of common property. The estimates were based on future estimated replacement costs. Funding requirements consider an annual inflation rate of 2.25% and interest of 3.5%, net of taxes, on amounts funded for future major repairs and replacements.

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

<u>Component</u>	<u>Estimated Remaining Useful Life (Years)</u>	<u>Estimated January 2009 Replacement Cost</u>	<u>Estimated 2013 Funding Requirement</u>	<u>Reserve Expenditures For the Year Ended 12/31/12</u>	<u>Replacement Cash Balance at 12/31/12</u>
AC Units	11	\$ 719,000	\$ 87,271	\$ (41,632)	\$ 369,844
ADA Compliance	0	15,000	1,821	-	7,716
Walkways	3	5,000	607	(407)	2,572
Carpet	2	7,500	910	-	3,858
Decks	0	6,000	728	-	3,086
Elevators	6	60,000	7,283	-	30,863
Painting	2-6	170,000	20,634	(15,385)	87,446
Fitness Center	11	24,500	2,974	(479)	12,602
Gates and fences	16	15,000	1,821	-	7,716
Landscape	6	10,000	1,214	(15,083)	5,144
Lobby	1-14	21,500	2,610	-	11,060
Lock system	9	49,500	6,008	(34,589)	25,462
Parking	11-20	91,000	11,045	-	46,809
Pool and spa	0-8	115,000	13,959	(4,497)	59,154
Roofs	14	120,000	14,565	(23,721)	61,726
Sprinkler	21	60,000	7,283	-	30,863
Telephone system	12	55,000	6,676	(1,488)	28,292
Windows	11-23	49,560	6,016	-	25,493
Water Heater	11	5,000	606	-	2,572
Cash deficit	-	-	-	-	(283,113)
Totals		<u>\$ 1,598,560</u>	<u>\$ 194,031</u>	<u>\$ (137,281)</u>	<u>\$ 539,165</u>

See auditors' report.