

Financial Statements

**Kahana Falls Interval
Owners Association**

**For the Year Ended
December 31, 2013**

Kahana Falls Interval Owners Association

Contents December 31, 2013 (Summarized Totals for 2012)

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 Expenses	6
Notes to Financial Statements	7-12
Supplemental Information on Future Major Repairs and Replacements	13

Report of Independent Auditor

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

We have audited the accompanying financial statements of Kahana Falls Interval Owners Association, which comprise the balance sheet as of December 31, 2013, and the related statements of income, expenses, fund balances, cash flows, and other operating expenses for the years then ended, and the related notes to the financial statements. The prior year summarized comparative information has been derived from the Association's 2012 financial statements and, in our report dated March 11, 2013, 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
Interval Owners Association
February 20, 2014
Page 2

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kahana Falls Interval Owners Association as of December 31, 2013, 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
February 20, 2014

Kahana Falls Interval Owners Association

Balance Sheet December 31, 2013 (Summarized Totals for 2012)

Page 3

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2013 Total</u>	<u>2012 Total</u>
Assets				
Cash, including interest-bearing deposits (Note 4)	\$ 1,771,524	\$ 727,178	\$ 2,498,702	\$ 2,119,630
Accounts receivable, net (Note 5)	20,205	-	20,205	57,685
Due from Kahana Falls AOAO	532	-	532	7,373
Interest receivable	582	298	880	1,458
Prepaid expenses (Note 6)	4,901	-	4,901	6,144
Property and equipment, net (Note 7)	-	-	-	-
Total assets	<u>\$ 1,797,744</u>	<u>\$ 727,476</u>	<u>\$ 2,525,220</u>	<u>\$ 2,192,290</u>
Liabilities and Fund Balances				
Accounts payable	\$ 84,908	\$ -	\$ 84,908	\$ 76,918
Due to Kahana Falls AOAO	14,906	-	14,906	135,877
Accrued expenses (Note 8)	132,960	-	132,960	130,302
Income tax payable	25,650	-	25,650	5,719
Advance deposits	1,475	-	1,475	-
Prepaid assessments	1,351,571	-	1,351,571	1,236,223
Total liabilities	<u>1,611,470</u>	<u>-</u>	<u>1,611,470</u>	<u>1,585,039</u>
Fund balances	<u>186,274</u>	<u>727,476</u>	<u>913,750</u>	<u>607,251</u>
Total liabilities and fund balances	<u>\$ 1,797,744</u>	<u>\$ 727,476</u>	<u>\$ 2,525,220</u>	<u>\$ 2,192,290</u>

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

Kahana Falls Interval Owners Association

Statement of Revenue, Expenses, and Fund Balances For the Year Ended December 31, 2013 (Summarized Totals for 2012)

Page 4

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2013 Total</u>	<u>2012 Total</u>
Revenue				
Member assessments, net of discounts	\$ 1,836,800	\$ 317,232	\$ 2,154,032	\$ 2,063,052
Rental income	288,222	-	288,222	210,817
Interest income	3,282	1,761	5,043	5,443
Other income	16,898	-	16,898	18,506
Total revenue	<u>2,145,202</u>	<u>318,993</u>	<u>2,464,195</u>	<u>2,297,818</u>
Expenses				
Salaries and related	745,755	-	745,755	752,944
Employee benefits	256,417	-	256,417	230,477
Bad debt expense	326,425	-	326,425	259,398
General excise tax	86,048	-	86,048	81,350
Income tax expense	33,750	-	33,750	7,019
Legal and professional	1,960	-	1,960	18,092
General and administrative Services (Schedule)	280,462	-	280,462	258,010
Management fees	88,200	-	88,200	88,200
Supplies	44,078	-	44,078	48,529
Repairs and replacements	-	126,979	126,979	196,237
Utilities	167,622	-	167,622	170,106
Total expenses	<u>2,030,717</u>	<u>126,979</u>	<u>2,157,696</u>	<u>2,110,362</u>
Excess revenue (expense)	114,485	192,014	306,499	187,456
Fund balances, beginning	70,326	536,925	607,251	419,795
Fund transfers	<u>1,463</u>	<u>(1,463)</u>	<u>-</u>	<u>-</u>
Fund balances, ending	<u>\$ 186,274</u>	<u>\$ 727,476</u>	<u>\$ 913,750</u>	<u>\$ 607,251</u>

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

Kahana Falls Interval Owners Association

Statement of Cash Flows For the Year Ended December 31, 2013 (Summarized Totals for 2012)

Page 5

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2013 Total</u>	<u>2012 Total</u>
Cash Flows From Operating Activities				
Excess revenue (expenses)	\$ 114,485	\$ 192,014	\$ 306,499	\$ 187,456
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:				
Changes in:				
Accounts receivable	37,480	-	37,480	(18,508)
Due from Kahana Falls AOA	6,841	-	6,841	(6,646)
Interest receivable	327	251	578	(1,458)
Prepaid expenses	1,243	-	1,243	360
Accounts payable	7,990	-	7,990	54,348
Due to Kahana Falls AOA	(120,971)	-	(120,971)	65,180
Accrued expenses	2,658	-	2,658	(45,536)
Income tax payable	19,931	-	19,931	4,388
Advance Deposit	1,475	-	1,475	-
Prepaid assessments	115,348	-	115,348	117,521
Net cash provided (used) by operating activities	<u>186,807</u>	<u>192,265</u>	<u>379,072</u>	<u>357,105</u>
Cash Flows From Financing Activities				
Principal payments on note payable	-	-	-	(533)
Fund transfers	1,463	(1,463)	-	-
Net cash provided (used) by financing activities	<u>1,463</u>	<u>(1,463)</u>	<u>-</u>	<u>(533)</u>
Net increase (decrease) in cash	188,270	190,802	379,072	356,572
Cash, beginning of year	<u>1,583,254</u>	<u>536,376</u>	<u>2,119,630</u>	<u>1,763,058</u>
Cash, end of year	<u>\$ 1,771,524</u>	<u>\$ 727,178</u>	<u>\$ 2,498,702</u>	<u>\$ 2,119,630</u>

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

Kahana Falls Interval Owners Association

Statement of Other Operating Expenses For the Year Ended December 31, 2013 (Summarized Totals for 2012)

Page 6

	<u>2013</u> <u>Total</u>	<u>2012</u> <u>Total</u>
General and Administrative Services		
Audit, tax and accounting fees	\$ 37,304	\$ 36,467
Bank and credit card charges	40,399	21,300
Building maintenance	16,238	13,827
Director expense	6,783	7,552
Guest relations	49,055	54,017
Insurance	10,663	10,988
Interest	-	14
Meetings and education	728	1,416
Postage and freight	6,069	9,288
Printing	6,786	9,774
Reservation fees	55,000	55,000
Taxes and licenses	367	375
Other general and administrative	51,070	37,992
Total general and administrative services	<u>\$ 280,462</u>	<u>\$ 258,010</u>

The accompanying notes are an integral part of these financial statements

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2013 (Summarized Totals for 2012)

Page 7

1. Organization and Other Matters

Kahana Falls Interval Owners Association (IOA) is a nonprofit mutual benefit corporation organized in Hawaii in March 1992 and is governed by a member-elected Board of Directors. The Association is responsible for the operation and maintenance of 70 timeshare apartment units. The property is located in Kahana, Hawaii on the island of Maui.

2. Significant Accounting Policies

The financial statements include certain 2012 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, 2012 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 account. 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.

Members are subject to monthly assessments to provide funds for operating expenses and future major repairs and replacements. 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 assessment, reasonable collection costs and late charges commencing 30 days after assessment becomes due.

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2013 (Summarized Totals for 2012)

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 details on assessments receivable amounts.

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 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 5-7 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

Timeshare associations may elect to be taxed either as a timeshare association or as a regular corporation. The Association elected to be taxed as a timeshare association in accordance with Internal Revenue Code Section 528 for the years ending December 31, 2013 and 2012. 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 32% 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 2010 through 2012. For the years ended December 31, 2013 and 2012, the Association paid no income tax interest or penalties.

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2013 (Summarized Totals for 2012)

Page 9

4. Cash and Cash Equivalents

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

	<u>2013</u>	<u>2012</u>
Operating Fund		
US Bank, checking	\$673,064	\$328,846
Bank of Hawaii, checking	5,132	17,685
Bank of Hawaii, checking	215,554	208,938
American Security Bank, money market account	136,890	3,369
Wells Fargo Bank, money market account	43,884	22,416
Wells Fargo Bank, certificate of deposit	695,000	1,000,000
Petty cash	<u>2,000</u>	<u>2,000</u>
Total Operating Fund	<u>\$1,771,524</u>	<u>\$1,583,254</u>
Replacement Fund		
Wells Fargo Bank, money market account	\$72,528	\$85,240
Wells Fargo Bank, certificate of deposit	550,000	150,000
American Security Bank, money market account	<u>104,650</u>	<u>301,136</u>
Total Replacement Fund	<u>\$727,178</u>	<u>\$536,376</u>

5. Accounts Receivable

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

	<u>2013</u>	<u>2012</u>
Regular assessments	\$826,747	\$681,384
Due from Trading Places International	20,205	10,788
Other receivables	-0-	24,207
Allowance for doubtful accounts	<u>(826,747)</u>	<u>(658,694)</u>
Accounts receivable, net	<u>\$20,205</u>	<u>\$57,685</u>

6. Prepaid Expenses

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

	<u>2013</u>	<u>2012</u>
Insurance	\$4,818	\$5,932
Other prepaid expenses	<u>83</u>	<u>212</u>
Total prepaid expenses	<u>\$4,901</u>	<u>\$6,144</u>

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2013 (Summarized Totals for 2012)

7. *Property and Equipment*

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

	<u>2013</u>	<u>2012</u>
Laundry equipment	\$47,612	\$47,612
Vehicle	15,549	15,549
Accumulated depreciation	<u>(63,161)</u>	<u>(63,161)</u>
Property and equipment, net	<u>\$-0-</u>	<u>\$-0-</u>

8. *Accrued Expenses*

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

	<u>2013</u>	<u>2012</u>
State Excise tax payable	\$20,764	\$28,496
Accrued vacation	53,608	42,587
Accrued other	<u>58,588</u>	<u>59,219</u>
Total accrued expenses	<u>\$132,960</u>	<u>\$130,302</u>

9. *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 \$317,221, based on a full funding plan, had been included in the 2013 budget.

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2013 (Summarized Totals for 2012)

Page 11

9. Future Major Repairs and Replacements (concluded)

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.

10. Related Party Transactions

The Association reimbursed Kahana Falls Association of Apartment Owners (AOAO), a related Association which is responsible for the maintenance and operation of the common areas, for certain shared costs incurred by the AOAO. During the years ended December 31, 2013 and 2012, the Association reimbursed the AOAO \$93,882 and \$103,072 respectively. At December 31, 2013 and 2012, the Association owed the AOAO \$14,906 and \$135,877 respectively, and the AOAO owed the Association \$532 and \$7,373 respectively.

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

The Association's management company, Trading Places International, is owned by Interval Leisure Group, Inc. (ILG). The Association hired Meridian Financial Services, also a subsidiary of ILG, to provide collection services. Outstanding balances were collected with service fees attached so the Association recovered the balances owed in full by the member. The amount collected in fees by Meridian during the years ended December 31, 2013 and 2012 is \$-0- and \$1,444 respectively. No amounts were owed to Meridian by the Association at the reporting dates.

11. Supplemental Cash Flow Disclosures

Supplemental cash flows at the reporting dates consist of:

	<u>2013</u>	<u>2012</u>
Federal and state income tax payments	\$13,819	\$2,599
Interest paid	-0-	14
Total supplemental cash flows	<u>\$13,819</u>	<u>\$2,613</u>

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2013 (Summarized Totals for 2012)

Page 12

12. Commitments and Contingencies

The Association renewed its management agreement with Trading Places International (TPI) beginning May 1, 2011 and expiring on April 30, 2014. The contract automatically renews for successive additional three-year terms unless terminated earlier by majority of the Association board members within a ninety-day window before the expiration of the then current term. TPI will provide administrative, financial, and accounting services for the Association.

13. Financial Instruments

The Association maintains operating and reserve accounts at certain financial institutions that are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. The Association occasionally maintains deposits in excess of federally insured limits. At the reporting date, the Association's uninsured cash balance totaled \$373,362 and \$47,762 at December 31, 2013 and 2012 respectively.

14. Subsequent Events

Management has evaluated subsequent events through February 20, 2014, the date which the financial statements were available for issue.

Supplemental Information

Kahana Falls Interval Owners Association

Supplemental Information on Future Major Repairs and Replacements December 31, 2013 (Unaudited)

Page 13

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.

Component	Estimated Remaining Useful Life (Years)	Estimated January 2009 Replacement Cost	Estimated 2014 Funding Requirement	Reserve Expenditures For the Year Ended 12/31/13	Replacement Cash Balance at 12/31/13
Appliances	7-15	\$ 62,160	\$ 9,581	\$ (27,405)	\$ 48,015
Bedrooms	3-19	406,100	62,592	(2,059)	313,687
Buildings	3-15	219,400	33,816	-	169,474
Cabinets	5-10	129,500	19,960	-	100,031
Carpets	0-6	258,600	39,858	-	199,753
Case goods	1	10,540	1,625	-	8,142
Electronics	3-10	125,200	19,297	(22,314)	96,710
Furniture	0-10	361,080	55,653	(11,898)	278,913
Miscellaneous	1-15	127,120	19,593	(51,288)	98,193
Plumbing	5-20	251,200	38,717	-	194,037
Soft goods	0-4	125,050	19,274	(12,015)	96,594
Cash deficit		-	-	-	(876,371)
Totals		<u>\$ 2,075,950</u>	<u>\$ 319,966</u>	<u>\$ (126,979)</u>	<u>\$ 727,178</u>

See report of independent auditor.