

Financial Statements

**Kahana Falls Interval
Owners Association**

**For the Year Ended
December 31, 2014**

Kahana Falls Interval Owners Association

Contents

December 31, 2014

(Summarized Totals for 2013)

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, 2014, 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 2013 financial statements and, in our report dated February 20, 2014, 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
March 10, 2015
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, 2014, 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 10, 2015

Kahana Falls Interval Owners Association

Balance Sheet December 31, 2014 (Summarized Totals for 2013)

Page 3

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2014 Total</u>	<u>2013 Total</u>
Assets				
Cash, including interest-bearing deposits (Note 4)	\$ 1,791,108	\$ 933,169	\$ 2,724,277	\$ 2,498,702
Accounts receivable, net (Note 5)	62,444	-	62,444	20,205
Due from Kahana Falls AOAO	6,756	-	6,756	532
Interest receivable	689	-	689	880
Prepaid expenses (Note 6)	5,914	-	5,914	4,901
Property and equipment, net (Note 7)	-	-	-	-
Total assets	<u>\$ 1,866,911</u>	<u>\$ 933,169</u>	<u>\$ 2,800,080</u>	<u>\$ 2,525,220</u>
Liabilities and Fund Balances				
Accounts payable	\$ 62,517	\$ -	\$ 62,517	\$ 84,908
Due to Kahana Falls AOAO	50,365	-	50,365	14,906
Accrued expenses (Note 8)	147,238	-	147,238	132,960
Income tax payable	19,399	-	19,399	25,650
Advance deposits	-	-	-	1,475
Prepaid assessments	1,234,382	-	1,234,382	1,351,571
Total liabilities	<u>1,513,901</u>	<u>-</u>	<u>1,513,901</u>	<u>1,611,470</u>
Fund balances	<u>353,010</u>	<u>933,169</u>	<u>1,286,179</u>	<u>913,750</u>
Total liabilities and fund balances	<u>\$ 1,866,911</u>	<u>\$ 933,169</u>	<u>\$ 2,800,080</u>	<u>\$ 2,525,220</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, 2014 (Summarized Totals for 2013)

Page 4

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2014 Total</u>	<u>2013 Total</u>
Revenue				
Member assessments, net of discounts	\$ 1,887,836	\$ 320,404	\$ 2,208,240	\$ 2,154,032
Rental income	365,973	-	365,973	288,222
Interest income	4,074	2,111	6,185	5,043
Interval sales	60,889	-	60,889	1,926
Other income	16,032	-	16,032	14,972
Total revenue	<u>2,334,804</u>	<u>322,515</u>	<u>2,657,319</u>	<u>2,464,195</u>
Expenses				
Bad debt expense	315,307	-	315,307	326,425
Employee benefits	249,738	-	249,738	256,417
General and administrative Services (Schedule)	381,764	-	381,764	280,462
General excise tax	90,873	-	90,873	86,048
Income tax expense	54,399	-	54,399	33,750
Legal and professional	412	-	412	1,960
Management fees	88,200	-	88,200	88,200
Salaries and related	773,008	-	773,008	745,755
Supplies	49,794	-	49,794	44,078
Repairs and replacements	-	115,337	115,337	126,979
Utilities	166,058	-	166,058	167,622
Total expenses	<u>2,169,553</u>	<u>115,337</u>	<u>2,284,890</u>	<u>2,157,696</u>
Excess revenue (expense)	165,251	207,178	372,429	306,499
Fund balances, beginning of year	186,274	727,476	913,750	607,251
Fund transfers	<u>1,485</u>	<u>(1,485)</u>	<u>-</u>	<u>-</u>
Fund balances, end of year	<u>\$ 353,010</u>	<u>\$ 933,169</u>	<u>\$ 1,286,179</u>	<u>\$ 913,750</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, 2014 (Summarized Totals for 2013)

Page 5

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2014 Total</u>	<u>2013 Total</u>
Cash Flows From Operating Activities				
Excess revenue (expenses)	\$ 165,251	\$ 207,178	\$ 372,429	\$ 306,499
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:				
Changes in:				
Accounts receivable	(42,239)	-	(42,239)	37,480
Due from Kahana Falls AOA	(6,224)	-	(6,224)	6,841
Interest receivable	(107)	298	191	578
Prepaid expenses	(1,013)	-	(1,013)	1,243
Accounts payable	(22,391)	-	(22,391)	7,990
Due to Kahana Falls AOA	35,459	-	35,459	(120,971)
Accrued expenses	14,278	-	14,278	2,658
Income tax payable	(6,251)	-	(6,251)	19,931
Advance deposit	(1,475)	-	(1,475)	1,475
Prepaid assessments	(117,189)	-	(117,189)	115,348
Net cash provided (used) by operating activities	<u>18,099</u>	<u>207,476</u>	<u>225,575</u>	<u>379,072</u>
Cash Flows From Financing Activities				
Fund transfers	<u>1,485</u>	<u>(1,485)</u>	<u>-</u>	<u>-</u>
Net cash provided (used) by financing activities	<u>1,485</u>	<u>(1,485)</u>	<u>-</u>	<u>-</u>
Net increase (decrease) in cash	19,584	205,991	225,575	379,072
Cash, beginning of year	<u>1,771,524</u>	<u>727,178</u>	<u>2,498,702</u>	<u>2,119,630</u>
Cash, end of year	<u><u>\$ 1,791,108</u></u>	<u><u>\$ 933,169</u></u>	<u><u>\$ 2,724,277</u></u>	<u><u>\$ 2,498,702</u></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, 2014 (Summarized Totals for 2013)

Page 6

	<u>2014</u> <u>Total</u>	<u>2013</u> <u>Total</u>
General and Administrative Services		
Audit, tax and accounting fees	\$ 37,954	\$ 37,304
Bank and credit card charges	43,772	40,399
Building maintenance	15,407	16,238
Director expense	9,382	6,783
Foreclosure expense	100,038	15,785
Guest relations	60,454	49,055
Insurance	10,477	10,663
Meetings and education	944	728
Postage and freight	4,190	6,069
Printing	7,888	6,786
Reservation fees	55,000	55,000
Taxes and licenses	250	367
Other general and administrative	<u>36,008</u>	<u>35,285</u>
Total general and administrative services	<u>\$ 381,764</u>	<u>\$ 280,462</u>

The accompanying notes are an integral part of these financial statements

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2014 (Summarized Totals for 2013)

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

Comparative Information

The financial statements include certain 2013 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, 2013 from which the summarized information was derived.

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. 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.

Fund Accounting

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.

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.

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2014 (Summarized Totals for 2013)

Page 8

2. Significant Accounting Policies (concluded)

Member Assessments

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. 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.

Property and Equipment

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

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. Prepaid assessments include amounts received in advance from owners. The Association bills the monthly assessments in advance and some members pay the amount due in advance. These amounts are deferred at year-end, and then recognized into income when they are earned during the next assessment period.

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, 2014 and 2013. 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 and rental income.

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2014 (Summarized Totals for 2013)

Page 9

3. *Income Taxes* (concluded)

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 2011 through 2014. For the years ended December 31, 2014 and 2013, the Association paid \$131 and \$-0- income tax interest or penalties.

4. *Cash and Cash Equivalents*

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

	<u>2014</u>	<u>2013</u>
Operating Fund		
US Bank, checking	\$522,432	\$673,064
Bank of Hawaii, checking	4,782	5,132
Bank of Hawaii, checking	206,624	215,554
Citizens Business Bank, money market account	41,859	136,890
Wells Fargo Bank, money market account	218,411	43,884
Wells Fargo Bank, certificates of deposit	795,000	695,000
Petty cash	<u>2,000</u>	<u>2,000</u>
Total Operating Fund	<u>\$1,791,108</u>	<u>\$1,771,524</u>
Replacement Fund		
Wells Fargo Bank, money market account	\$71,046	\$72,528
Wells Fargo Bank, certificates of deposit	650,000	550,000
Citizens Business Bank, money market account	<u>212,123</u>	<u>104,650</u>
Total Replacement Fund	<u>\$933,169</u>	<u>\$727,178</u>

5. *Accounts Receivable*

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

	<u>2014</u>	<u>2013</u>
Regular assessments	\$1,008,717	\$826,747
Due from Trading Places International	62,444	20,205
Allowance for doubtful accounts	<u>(1,008,717)</u>	<u>(826,747)</u>
Accounts receivable, net	<u>\$62,444</u>	<u>\$20,205</u>

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2014 (Summarized Totals for 2013)

Page 10

6. Prepaid Expenses

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

	<u>2014</u>	<u>2013</u>
Insurance	\$5,831	\$4,818
Other prepaid expenses	<u>83</u>	<u>83</u>
Total prepaid expenses	<u>\$5,914</u>	<u>\$4,901</u>

7. Property and Equipment

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

	<u>2014</u>	<u>2013</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>2014</u>	<u>2013</u>
State Excise tax payable	\$22,402	\$20,764
Accrued vacation	58,718	53,608
Accrued other	<u>66,118</u>	<u>58,588</u>
Total accrued expenses	<u>\$147,238</u>	<u>\$132,960</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.

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2014 (Summarized Totals for 2013)

Page 11

9. Future Major Repairs and Replacements (concluded)

Association Reserves, Inc. conducted a study in March 2015 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 3 percent and interest of 0.5 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 \$320,404, based on a full funding plan, had been included in the 2014 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.

10. Related Party Transactions

The Association incurs certain shared costs with Kahana Falls Association of Apartment Owners (AOAO), a related Association, which is responsible for the maintenance and operation of the general common areas, building exteriors and mechanical systems. For the reporting periods the related party transactions are as follows:

	<u>2014</u>	<u>2013</u>
Reimbursed to the AOAO from Association	<u>\$53,138</u>	<u>\$93,882</u>
Due to AOAO from the Association	<u>\$50,365</u>	<u>\$14,906</u>
Due to the Association from the AOAO	<u>\$6,756</u>	<u>\$532</u>

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.

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2014 (Summarized Totals for 2013)

Page 12

10. Related Party Transactions (concluded)

The Association's management company, Trading Places International, is owned by Interval Leisure Group, Inc. The Association hired Meridian Financial Services, also a subsidiary of Interval Leisure Group, 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, 2014 and 2013 is \$11,106 and \$-0- 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>2014</u>	<u>2013</u>
Federal and state income tax payments	\$ <u>60,768</u>	\$ <u>13,819</u>
Total supplemental cash flows	\$ <u>60,768</u>	\$ <u>13,819</u>

12. 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 \$315,870 and \$373,362 at December 31, 2014 and 2013 respectively.

13. Commitments and Contingencies

The Association renewed its management agreement with Trading Places International (TPI) beginning May 1, 2014 and expiring on April 30, 2017. 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.

14. Subsequent Events

Management has evaluated subsequent events through March 10, 2015, the date which the financial statements were available for issue. Management has determined there are no subsequent events that require recognition or disclosure in these financial statements.

Supplemental Information

Kahana Falls Interval Owners Association

Supplemental Information on Future Major Repairs and Replacements December 31, 2014 (Unaudited)

Association Reserves, Inc. conducted a study in March 2015 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 3% and interest of 0.5%, 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 March 2015 Replacement Cost</u>	<u>Estimated 2015 Funding Requirement</u>	<u>Reserve Expenditures For the Year Ended 12/31/14</u>	<u>Replacement Cash Balance at 12/31/14</u>
3 drawer chests and furniture	1-8	430,800	63,154	-	326,375
Art décor	14	75,000	10,994	-	56,820
Bamboo floors and carpet	0-22	196,000	28,732	(5,029)	148,490
Bath tubs and toilets	2	385,300	56,481	-	291,904
Bathroom sinks and vanities	6	357,500	52,406	(2,871)	270,843
Beds and mattresses	0-7	177,100	25,961	-	134,171
Copier machine	7	5,000	733	-	3,788
Dishwashers	0	1,700	249	(2,440)	1,288
Faucets	0	3,500	513	(3,008)	2,652
Front desk	9	5,000	733	-	3,788
Ice machine	7	3,500	513	-	2,652
Interior surfaces	0	40,000	5,864	(47,332)	30,304
Kitchen cabinets	0	100,000	14,659	-	75,760
Kitchens	0	10,500	1,539	(603)	7,955
Lamps	1-8	13,850	2,030	(16,572)	10,493
Lanai furniture	7	21,000	3,078	-	15,910
Lighting	0	2,500	366	-	1,894
Microwaves	0	1,500	220	(2,203)	1,136
Mini refrigerators and refrigerators	0-3	41,500	6,084	(3,654)	31,441
Mirrors	0	2,500	366	-	1,894
Miscellaneous reserves	0	5,000	733	(3,475)	3,788
Ranges	0	4,100	601	(4,585)	3,106
Sofas	0	115,000	16,858	-	87,124
Televisions and DVD players	0	12,500	1,832	(21,516)	9,470
Tile floors	6	166,500	24,407	-	126,141
Washer and dryers	0	7,300	1,070	-	5,530
Washer and dryers (housekeeping)	2-9	\$ 42,750	\$ 6,267	\$ -	\$ 32,388
Water heaters	0	1,700	249	(2,048)	1,288
Window treatments	2	159,000	23,308	-	120,459
Cash deficit		-	-	-	(875,683)
Totals		\$ 2,387,600	\$ 350,000	\$ (115,337)	\$ 933,169

See report of independent auditor.