

Financial Statements

**Kahana Falls Interval
Owners Association**

**For the Year Ended
December 31, 2017**

Kahana Falls Interval Owners Association

Contents December 31, 2017 (Summarized Totals for 2016)

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Independent Auditors' Report

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, 2017, and the related statements of revenue, expenses, and changes in fund balances, cash flows and other operating income and expenses for the year then ended, and the related notes to the 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.

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, 2017, 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.

Other Matters

The prior year summarized comparative information has been derived from the Association's 2016 financial statements and, in our report dated March 5, 2017, we expressed an unqualified opinion on those financial statements

FITZGERALD & ASSOCIATES, INC. CPAs

Redlands, California
March 15, 2018

Kahana Falls Interval Owners Association

Balance Sheet December 31, 2017 (Summarized Totals for 2016)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2017 Total</u>	<u>2016 Total</u>
Assets				
Cash, including interest- bearing deposits (Note 4)	\$ 1,473,076	\$ 1,333,092	\$ 2,806,168	\$ 2,844,598
Accounts receivable, net (Note 5)	79,723	-	79,723	69,948
Due from Kahana Falls AOAO	10,831	-	10,831	21,281
Interest receivable	1,245	2,233	3,478	735
Prepaid expenses (Note 6)	42,667	-	42,667	48,573
Property and equipment, net (Note 7)	-	-	-	-
Total assets	<u>\$ 1,607,542</u>	<u>\$ 1,335,325</u>	<u>\$ 2,942,867</u>	<u>\$ 2,985,135</u>
Liabilities and Fund Balances				
Accounts payable	\$ 177,085	\$ -	\$ 177,085	\$ 146,445
Due to Kahana Falls AOAO	-	-	-	23,280
Accrued expenses (Note 8)	135,605	-	135,605	120,925
Prepaid assessments	1,125,299	-	1,125,299	1,162,079
Total liabilities	<u>1,437,989</u>	<u>-</u>	<u>1,437,989</u>	<u>1,452,729</u>
Fund balances	<u>169,553</u>	<u>1,335,325</u>	<u>1,504,878</u>	<u>1,532,406</u>
Total liabilities and fund balances	<u>\$ 1,607,542</u>	<u>\$ 1,335,325</u>	<u>\$ 2,942,867</u>	<u>\$ 2,985,135</u>

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

Kahana Falls Interval Owners Association

Statement of Revenue, Expenses, and Changes in Fund Balances For the Year Ended December 31, 2017 (Summarized Totals for 2016)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2017 Total</u>	<u>2016 Total</u>
Revenue				
Member assessments, net of discounts	\$ 1,643,474	\$ 368,480	\$ 2,011,954	\$ 2,133,019
Rental income	527,479	-	527,479	526,388
Interest income	7,138	8,718	15,856	10,021
Interval sales	3,294	-	3,294	30,121
Other income	22,695	-	22,695	25,530
Total revenue	<u>2,204,080</u>	<u>377,198</u>	<u>2,581,278</u>	<u>2,725,079</u>
Expenses				
Bad debt expense	316,773	-	316,773	322,761
Employee benefits	310,580	-	310,580	267,178
General and administrative Services (Schedule)	330,804	-	330,804	317,052
General excise tax	84,080	-	84,080	77,277
Income tax expense	25,701	-	25,701	60,339
Legal and professional	1,225	-	1,225	345
Management fees	88,200	-	88,200	88,200
Salaries and related	936,672	-	936,672	887,250
Supplies	55,767	-	55,767	53,085
Repairs and replacements	-	346,857	346,857	228,878
Reserve expense for Kahana Falls AOA	-	-	-	150,000
Utilities	112,147	-	112,147	98,293
Total expenses	<u>2,261,949</u>	<u>346,857</u>	<u>2,608,806</u>	<u>2,550,658</u>
Excess revenue (expense)	(57,869)	30,341	(27,528)	174,421
Fund balances, beginning of year	359,563	1,172,843	1,532,406	1,357,985
Fund transfers	(132,141)	132,141	-	-
Fund balances, end of year	<u>\$ 169,553</u>	<u>\$ 1,335,325</u>	<u>\$ 1,504,878</u>	<u>\$ 1,532,406</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, 2017 (Summarized Totals for 2016)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2017 Total</u>	<u>2016 Total</u>
Cash Flows From Operating Activities				
Excess revenue (expenses)	\$ (57,869)	\$ 30,341	\$ (27,528)	\$ 174,421
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:				
Changes in:				
Accounts receivable	(9,775)	-	(9,775)	(2,823)
Due from Kahana Falls AOAO	10,450	-	10,450	(18,476)
Interest receivable	(810)	(1,933)	(2,743)	(735)
Prepaid expenses	5,906	-	5,906	(41,342)
Accounts payable	30,640	-	30,640	82,385
Due to Kahana Falls AOAO	(23,280)	-	(23,280)	3,365
Accrued expenses	14,680	-	14,680	3,349
Income tax payable	-	-	-	(46,287)
Prepaid assessments	(36,780)	-	(36,780)	(80,445)
Net cash provided (used) by operating activities	<u>(66,838)</u>	<u>28,408</u>	<u>(38,430)</u>	<u>73,412</u>
Cash Flows From Financing Activities				
Fund transfers	<u>(132,141)</u>	<u>132,141</u>	<u>-</u>	<u>-</u>
Net cash provided (used) by financing activities	<u>(132,141)</u>	<u>132,141</u>	<u>-</u>	<u>-</u>
Net increase (decrease) in cash	(198,979)	160,549	(38,430)	73,412
Cash, beginning of year	<u>1,672,055</u>	<u>1,172,543</u>	<u>2,844,598</u>	<u>2,771,186</u>
Cash, end of year	<u><u>\$ 1,473,076</u></u>	<u><u>\$ 1,333,092</u></u>	<u><u>\$ 2,806,168</u></u>	<u><u>\$ 2,844,598</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, 2017 (Summarized Totals for 2016)

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	<u>2017</u> <u>Total</u>	<u>2016</u> <u>Total</u>
General and Administrative Services		
Audit, tax and accounting fees	\$ 37,954	\$ 37,954
Bank and credit card charges	52,380	51,219
Building maintenance	20,764	18,604
Director expense	7,791	8,943
Foreclosure expense	32,101	23,705
Guest relations	60,610	60,235
Insurance	13,321	12,441
Meetings and education	977	1,345
Postage and freight	14,502	8,802
Printing	-	5,049
Reservation fees	55,008	55,000
Taxes and licenses	935	229
Other general and administrative	34,461	33,526
Total general and administrative services	<u>\$ 330,804</u>	<u>\$ 317,052</u>

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

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2017 (Summarized Totals for 2016)

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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 2016 comparative information. With respect to the balance sheet, the statement of revenue, expenses, and changes in 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, 2016 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, 2017 (Summarized Totals for 2016)

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2. Significant Accounting Policies (concluded)

Cash and Cash Equivalents

For financial statement purposes, the Association considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

Member Assessments

Members are subject to annual 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. 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. Interest and related charges are recorded as income when billed to the owner. 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 against 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 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 annual 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.

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2017 (Summarized Totals for 2016)

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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, 2017 and 2016. Under that Section, the Association is not taxed on assessments from members and other income received from association members solely as a function of their membership in the Association. The Association is taxed for federal purposes at the rate of 32% and taxed for state purposes at a rate of 5.4% 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 2014 through 2017.

4. Cash and Cash Equivalents

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

	<u>2017</u>	<u>2016</u>
Operating Fund		
US Bank, checking	\$476,368	\$224,541
Bank of Hawaii, checking	13,514	5,447
Bank of Hawaii, checking	254,721	271,504
Citizens Business Bank, money market account	125,454	130,767
Wells Fargo Bank, money market account	56,019	52,796
Wells Fargo Bank, certificates of deposit	545,000	985,000
Petty cash	<u>2,000</u>	<u>2,000</u>
Total Operating Fund	<u>\$1,473,076</u>	<u>\$1,672,055</u>
Replacement Fund		
Wells Fargo Bank, money market account	\$270,030	\$503,288
Wells Fargo Bank, certificates of deposit	988,000	555,000
Citizens Business Bank, money market account	<u>75,062</u>	<u>114,255</u>
Total Replacement Fund	<u>\$1,333,092</u>	<u>\$1,172,543</u>
Total Cash	<u>\$2,806,168</u>	<u>\$2,844,598</u>

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2017 (Summarized Totals for 2016)

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5. Accounts Receivable

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

	<u>2017</u>	<u>2016</u>
Regular assessments	\$1,822,085	\$1,228,930
Due from Trading Places International	79,723	69,948
Allowance for doubtful accounts	<u>(1,822,085)</u>	<u>(1,228,930)</u>
Accounts receivable, net	<u>\$79,723</u>	<u>\$69,948</u>

6. Prepaid Expenses

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

	<u>2017</u>	<u>2016</u>
Insurance	\$7,903	\$7,313
Prepaid income taxes	<u>34,764</u>	<u>41,260</u>
Total prepaid expenses	<u>\$42,667</u>	<u>\$48,573</u>

7. Property and Equipment

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

	<u>2017</u>	<u>2016</u>
Vehicle	\$15,549	\$15,549
Accumulated depreciation	<u>(15,549)</u>	<u>(15,549)</u>
Property and equipment, net	<u>\$-0-</u>	<u>\$-0-</u>

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2017 (Summarized Totals for 2016)

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8. Accrued Expenses

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

	<u>2017</u>	<u>2016</u>
State excise tax	\$27,558	\$22,819
Payroll and related	77,072	74,511
Other	<u>30,975</u>	<u>23,595</u>
Total accrued expenses	<u>\$135,605</u>	<u>\$120,925</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.

Association Reserves, Inc. conducted a study in September 2017 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 2.5 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.

In 2017, the board of directors decided to fund 100 percent of the amount recommended by the study. Accordingly, \$368,480 was included in the 2017 budget. Because actual expenditures may vary from estimated future expenditures and the variations may be material, amounts accumulated in the replacement 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.

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2017 (Summarized Totals for 2016)

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10. Related Party Transactions (concluded)

For the reporting periods the related party transactions are as follows:

	<u>2017</u>	<u>2016</u>
Reimbursed to the AOA from Association	<u>\$65,360</u>	<u>\$87,349</u>
Due to AOA from the Association	<u>\$-0-</u>	<u>\$23,280</u>
Due to the Association from the AOA	<u>\$10,831</u>	<u>\$21,281</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.

11. Supplemental Cash Flow Disclosures

For the reporting periods, cash flows from operating activities include state and federal income tax payments of \$19,205 and \$147,886 for the years ended December 31, 2017 and 2016, respectively.

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 \$197,205 and \$215,950 at December 31, 2017 and 2016 respectively.

13. Commitments and Contingencies

The Association entered into a management agreement with Trading Places International (TPI) beginning May 1, 2017 and expiring on April 30, 2018. The contract automatically renews for successive additional one-year term 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.

**Kahana Falls Interval
Owners Association**

**Notes to Financial Statements
December 31, 2017
(Summarized Totals for 2016)**

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14. Subsequent Events

Management has evaluated subsequent events through March 15, 2018, the date that 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, 2017 (Unaudited)

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Association Reserves, Inc. conducted a study in September 2017 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 2.5% 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.

Component	Estimated Remaining Useful Life (Years)	Estimated September 2017 Replacement Cost	Estimated 2018 Funding Requirement	Reserve Expenditures For the Year Ended 12/31/17	Replacement Fund Balance at 12/31/17
Bathrooms	0-11	\$ 823,000	\$ 133,365	\$ (2,733)	\$ 460,283
Bedrooms	0-4	177,100	28,699	(35,018)	99,048
Common area	0-6	71,000	11,505	(41,583)	39,709
Electronics	0	12,500	2,026	(5,802)	6,991
Flooring	0-19	362,500	58,742	(35,629)	202,737
Furniture	0-5	548,300	88,851	(202,313)	306,650
Housekeeping	0-6	46,250	7,495	-	25,866
Kitchens	0-2	166,600	26,997	(18,155)	93,175
Lighting	0-5	16,350	2,649	(375)	9,144
Window treatments	0	159,000	25,766	-	88,925
Miscellaneous	0	5,000	810	(5,249)	2,796
Totals		\$ 2,387,600	\$ 386,904	\$ (346,857)	\$ 1,335,325

See report of independent auditor.