

Financial Statements

Kahana Falls Interval Owners Association

For the Year Ended
December 31, 2009

Kahana Falls Interval Owners Association

Contents

December 31, 2009

(Summarized Totals for 2008)

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Independent Auditor's Report

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

We have audited the accompanying balance sheet of Kahana Falls Interval Owners Association as of December 31, 2009 and the related statement of revenue, expenses and fund balances, cash flows, and other operating income and expenses for the year then ended. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audit. Information for the year ended December 31, 2008 is presented for comparative purposes only and was extracted from the financial statements presented by fund for that year, on which we expressed an unqualified opinion in our report dated June 16, 2009.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kahana Falls Interval Owners Association as of December 31, 2009 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The supplemental information on future major repairs and replacements on page 12 is not a required part of the basic financial statements of Kahana Falls Interval Owners Association, but is supplemental information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

FITZGERALD & ASSOCIATES, INC. CPAs

Redlands, California
June 5, 2010

Kahana Falls Interval
Owners Association

Balance Sheet
December 31, 2009
(Summarized Totals for 2008)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2009 Total</u>	<u>2008 Total</u>
<i>Assets</i>				
Cash, including interest-bearing deposits (Note 4)	\$ 933,636	\$ 117,778	\$ 1,051,414	\$ 713,955
Accounts receivable - net (Note 5)	42,860	-	42,860	52,993
Prepaid expenses (Note 6)	8,603	-	8,603	3,233
Property and equipment-net (Note 7)	6,219	-	6,219	9,329
Total assets	<u>\$ 991,318</u>	<u>\$ 117,778</u>	<u>\$ 1,109,096</u>	<u>\$ 779,510</u>
<i>Liabilities and Fund Balances</i>				
Accounts payable	\$ 49,739	\$ -	\$ 49,739	\$ 14,519
Due to Kahana Falls AOAO	30,519	-	30,519	20,995
Accrued expenses (Note 8)	73,916	-	73,916	74,165
Income tax payable	399	-	399	1,486
Note payable (Note 9)	6,549	-	6,549	9,371
Prepaid assessments	822,170	-	822,170	589,848
Total liabilities	<u>983,292</u>	<u>-</u>	<u>983,292</u>	<u>710,384</u>
Fund balances (deficits)	<u>8,026</u>	<u>117,778</u>	<u>125,804</u>	<u>69,126</u>
Total liabilities and fund balances	<u>\$ 991,318</u>	<u>\$ 117,778</u>	<u>\$ 1,109,096</u>	<u>\$ 779,510</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, 2009
(Summarized Totals for 2008)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2009 Total</u>	<u>2008 Total</u>
<i>Revenue</i>				
Member assessments	\$ 1,388,474	\$ 260,631	\$ 1,649,105	\$ 1,821,930
Rental income	78,288	-	78,288	66,024
Interest income	4,852	6,816	11,668	8,800
Other income (Schedule)	21,607	-	21,607	21,173
Total revenue	<u>1,493,221</u>	<u>267,447</u>	<u>1,760,668</u>	<u>1,917,927</u>
<i>Expenses</i>				
Salaries and related	647,436	-	647,436	715,528
Employee benefits	268,973	-	268,973	257,274
Bad debt expense	68,054	-	68,054	113,484
Depreciation expense	3,110	-	3,110	3,110
General excise and tot tax	21,342	-	21,342	48,765
Income tax expense	1,519	-	1,519	1,486
Legal and professional	6,052	-	6,052	11,071
General and administrative				
Services (Schedule)	239,801	-	239,801	299,987
Management fees	88,200	-	88,200	88,200
Supplies	52,699	-	52,699	48,887
Repairs and replacements	-	306,804	306,804	194,976
Total expenses	<u>1,397,186</u>	<u>306,804</u>	<u>1,703,990</u>	<u>1,782,768</u>
Excess revenue (expenses)	96,035	(39,357)	56,678	135,159
Fund balance (deficit) - beginning	(88,009)	157,135	69,126	(66,033)
Fund transfers	-	-	-	-
Fund balance (deficit) - ending	<u>\$ 8,026</u>	<u>\$ 117,778</u>	<u>\$ 125,804</u>	<u>\$ 69,126</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, 2009
(Summarized Totals for 2008)

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2009 Total</u>	<u>2008 Total</u>
<i>Cash Flows From Operating Activities</i>				
Excess revenue (expenses)	\$ 96,035	\$ (39,357)	\$ 56,678	\$ 135,159
Noncash items included in excess revenue (expenses) -				
Depreciation	3,110	-	3,110	\$ 3,110
Changes in:				
Accounts receivable	10,133	-	10,133	(17,940)
Prepaid expenses	(5,370)	-	(5,370)	(500)
Accounts payable	35,220	-	35,220	(81,573)
Due to Kahana Falls AOAO	9,524	-	9,524	1,993
Accrued expenses	(249)	-	(249)	(111,309)
Income tax payable	(1,087)	-	(1,087)	1,486
Prepaid assessments	232,322	-	232,322	94,632
Net cash provided (used) by operating activities	<u>379,638</u>	<u>(39,357)</u>	<u>340,281</u>	<u>25,058</u>
<i>Cash Flows From Financing Activities</i>				
Payments on note payable	(2,822)	-	(2,822)	(2,448)
Fund transfers	-	-	-	-
Net cash provided (used) by financing activities	<u>(2,822)</u>	<u>-</u>	<u>(2,822)</u>	<u>(2,448)</u>
Net increase (decrease) in cash	376,816	(39,357)	337,459	22,610
Cash - beginning of year	<u>556,820</u>	<u>157,135</u>	<u>713,955</u>	<u>691,345</u>
Cash - end of year	<u>\$ 933,636</u>	<u>\$ 117,778</u>	<u>\$ 1,051,414</u>	<u>\$ 713,955</u>

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

Kahana Falls Interval
Owners Association

Statement of Other
Operating Income and Expenses
For the Year Ended December 31, 2009
(Summarized Totals for 2008)

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	<u>2009</u> <u>Total</u>	<u>2008</u> <u>Total</u>
<i>Other Income</i>		
Handling fees	\$ -	\$ 3,895
Other	<u>21,607</u>	<u>17,278</u>
Total other income	<u>\$ 21,607</u>	<u>\$ 21,173</u>
 <i>General and Administrative Services</i>		
Insurance	\$ 4,662	\$ 6,312
Interest	466	831
Postage and freight	6,061	7,772
Printing	11,243	15,857
Audit, tax and accounting fees	34,800	33,507
Reservation fees	55,000	50,423
Taxes and licenses	2,476	3,035
Other general and administrative	<u>125,093</u>	<u>182,250</u>
Total general and administrative services	<u>\$ 239,801</u>	<u>\$ 299,987</u>

The accompanying notes are an integral part of these financial statements

Kahana Falls Interval Owners Association

Notes to Financial Statements
December 31, 2009
(Summarized Totals for 2008)

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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

The financial statements include certain 2008 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, 2008 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 10 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 annual assessments to provide funds for operating expenses and future major repairs and replacements. Assessments receivable at the reporting date represent amounts due from members. See Note 5 for additional details on assessments receivable amounts.

Kahana Falls Interval Owners Association

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2. *Significant Accounting Policies* (concluded)

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 the property 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.

In June 2009, the Financial Accounting Standards Board (FASB) issued the FASB Accounting Standards Codification (the ASC). The ASC has become the single source of non-governmental accounting principles generally accepted in the United States (GAAP) recognized by the FASB in preparation of financial statements. The Association adopted the ASC as of December 31, 2009. The ASC does not change GAAP and did not have an effect on the Association's financial position, results of operations or cash flows.

In May 2009, the FASB issued SFAS No. 165 "*Subsequent Events*" (SFAS 165). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. SFAS 165 requires the disclosure of the date through which an entity has evaluated subsequent events and whether that date represents the date the financial statements were issued or were available to be issued. SFAS 165 is effective for interim or annual financial periods ending after June 15, 2009. The adoption of this standard did not have a material impact on the Association's financial statements.

In June 2006, the FASB issued Interpretation No. 48 "*Accounting for Uncertainty in Income Taxes*" which interprets the guidance in FASB Statement No. 109 (FIN 48). FIN 48 clarified the accounting and recognition for income tax positions taken or expected to be taken in the Association's income tax returns. FIN 48 is effective for interim and annual financial periods beginning after December 15, 2008. The adoption of this standard did not have a material impact on the Association's financial statements.

3. *Income Taxes*

The Association may elect to be taxed as either a time-share association or a regular corporation. The Association elected to be taxed as a regular corporation for the years ended December 31, 2009 and 2008. Under that election, the Association is subject to federal and state income tax only on income derived from non-member sources such as interest and rental income.

The Association has state net operating losses of approximately \$41,000 which expire between 2010 and 2026.

Kahana Falls Interval Owners Association

Notes to Financial Statements
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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 2006 through 2008. For the years ended December 31, 2009 and 2008, the Association paid no income tax interest or penalties.

4. *Cash and Cash Equivalents*

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

	<u>2009</u>	<u>2008</u>
Operating Fund		
US Bank – checking	\$330,235	\$186,172
Bank of Hawaii – checking	13,382	13,479
Bank of Hawaii – checking	100	-0-
American Security Bank – money market account	203,092	260,169
American Security Bank – certificate of deposit	-0-	95,000
Wells Fargo Bank – money market account	153,638	-0-
Wells Fargo Bank – certificate of deposit	200,000	-0-
Petty cash	<u>2,000</u>	<u>2,000</u>
Total Operating Fund	<u>\$902,447</u>	<u>\$556,820</u>
Replacement Fund		
Wells Fargo Bank (formerly Wachovia Securities) – money market account	\$758	\$841
Wells Fargo Bank (formerly Wachovia Securities) – certificate of deposit	148,000	76,000
American Security Bank – money market account	<u>209</u>	<u>80,294</u>
Total Replacement Fund	<u>\$148,967</u>	<u>\$157,135</u>

5. *Accounts Receivable*

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

	<u>2009</u>	<u>2008</u>
Regular assessments	\$176,927	\$139,093
Other receivables	42,860	27,384
Allowance for doubtful accounts	<u>(176,927)</u>	<u>(113,484)</u>
Accounts receivable - net	<u>\$42,860</u>	<u>\$52,993</u>

Kahana Falls Interval
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6. *Prepaid Expenses*

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

	<u>2009</u>	<u>2008</u>
Insurance	\$8,308	\$3,171
Other prepaid expenses	<u>295</u>	<u>62</u>
Total prepaid expenses	<u>\$8,603</u>	<u>\$3,233</u>

7. *Property and Equipment*

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

	<u>2009</u>	<u>2008</u>
Laundry equipment	\$47,612	\$47,612
Vehicle	15,549	15,549
Accumulated depreciation	<u>(56,942)</u>	<u>(53,832)</u>
Net property and equipment	<u>\$6,219</u>	<u>\$9,329</u>

8. *Accrued Expenses*

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

	<u>2009</u>	<u>2008</u>
State Excise and TAT taxes payable	\$5,866	\$11,055
Accrued vacation	34,634	35,681
Accrued other	<u>33,416</u>	<u>27,429</u>
Total accrued expenses	<u>\$73,916</u>	<u>\$74,165</u>

9. *Note Payable*

A note payable to Bank of Hawaii, secured by a 2007 Chevrolet Colorado, payable in 60 monthly installments of \$273.97, including interest at 7.755% per annum, maturing March 2, 2012

\$6,549

Kahana Falls Interval Owners Association

Notes to Financial Statements
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9. *Note Payable* (concluded)

The following is a schedule of future principal payments under the terms of the note as of December 31, 2009:

December 31, 2010	\$2,867
2011	3,098
2012	<u>584</u>
Total principal payments	<u>\$6,549</u>

10. *Future Major Repairs and Replacements*

The Association's governing documents require that funds be accumulated for future major repairs and replacements. These funds, which amount to \$148,967, are generally not available for operating purposes.

The Association conducted a study in January 2009 to estimate the remaining lives and replacement costs of the common property components. Actual expenditures may vary from the estimates, and the variations may be material. Amounts reserved may not be sufficient to meet future replacement cost requirements. When replacement funds are needed, the Board may elect to increase monthly assessments, levy special assessments, or delay replacements until funds are available. See page 12 for additional information on future major repairs and replacements.

11. *Related Party Transactions*

The Association reimbursed Kahana Falls Association of Apartment Owners (AOAO), a related organization, which is responsible for the maintenance and operation of the common areas, for certain shared costs incurred by the AOAO. During the reporting period, the Association reimbursed the AOAO \$254,566 and \$181,109 at December 31, 2009 and 2008, owed the AOAO \$21,655 and \$20,995.

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 entered into an agreement with Trading Places International (TPI), to provide certain rental and membership sales services. TPI collects the rental income and remits the income to the Association net of its commissions and fees. At December 31, 2009 and 2008, TPI owed the Association \$3,571 and \$17,325.

Kahana Falls Interval Owners Association

Notes to Financial Statements
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12. Supplemental Cash Flow Disclosures

For the reporting periods, cash flows from operating activities include state and federal income tax payments of \$1,120 and \$3,990 for the years ended December 31, 2009 and 2008.

13. Reclassifications

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.

14. Commitments and Contingencies

The Association entered into a three-year management agreement with Trading Places International (TPI) beginning May 1, 2008 and expiring May 1, 2011. 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.

The Hawaii State Department of Taxation (DOT) has conducted an audit of Kahana Falls IOA and has taken the position that due to the method which was used to collect the maintenance fees (the IOA collecting all funds and then distributing them to the AOAO) that all of the maintenance fees received by the IOA on behalf of the AOAO is subject to General Excise Tax. The DOT has made an assessment of tax, penalties and interest against the IOA and the IOA has appealed that assessment. The appeal is set for September 2010 and the outcome of the matter is unknown at the reporting date. However, if the state assesses the taxes, the IOA could owe as much as \$245,000 in General Excise taxes, penalties and interest.

15. Date of Management's Review

In preparing the financial statements, the Association has evaluated events and transactions for potential recognition or disclosure through April 21, 2010, the date that the financial statements were available to be issued.

Supplemental Information

Kahana Falls Interval
Owners Association

Supplemental Information on Future Major
Repairs and Replacements
December 31, 2009

The Association conducted a study January 2009 to estimate the remaining useful lives and replacement costs of the components of common property. Replacement costs were based on the estimated costs to repair or replace the common property components at the date of the study. The Association has assessed the present condition of all common property components and estimated replacement costs relying upon Board members, management company representatives, outside contractors and service representatives. Estimated annual funding has been calculated using the cash flow method with provisions for annual inflation at 2.25% and interest earnings at 3.5%.

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

<u>Component</u>	<u>Estimated Remaining Useful Life (Years)</u>	<u>Current Replacement Cost</u>	<u>Estimated 2010 Funding Requirement</u>	<u>Reserve Expenditures For the Year Ended 12/31/09</u>	<u>Replacement Cash Balance at 12/31/09</u>
Appliances	11-19	\$ 62,160	\$ 8,116	\$ (27,669)	\$ 34,660
Bedrooms	7-23	406,100	53,024	(1,456)	226,439
Buildings	7-19	219,400	28,647	(66,841)	122,336
Cabinets	9-14	129,500	16,909	-	72,209
Carpets	4-10	258,600	33,765	(203,566)	144,194
Case goods	5	10,540	1,376	-	5,877
Electronics	7-14	125,200	16,347	-	69,811
Furniture	4-14	361,080	47,146	(3,963)	201,337
Miscellaneous	5-19	127,120	16,598	-	70,881
Plumbing	9-24	251,200	32,799	(3,309)	140,068
Soft goods	4-8	125,050	16,329	-	69,727
Cash deficit	-	-	-	-	(1,008,572)
Totals		<u>\$ 2,075,950</u>	<u>\$ 271,056</u>	<u>\$ (306,804)</u>	<u>\$ 148,967</u>

See accountants' report.