

Financial Statements

**Kahana Falls Association
of Apartment Owners**

**For the Year Ended
December 31, 2010**

Kahana Falls Association of Apartment Owners

Contents

December 31, 2010

(Summarized Totals for 2009)

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Independent Auditor's Report

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

We have audited the accompanying balance sheet of Kahana Falls Association of Apartment Owners as of December 31, 2010 and the related statements 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, 2009 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 5, 2010.

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 Association of Apartment Owners as of December 31, 2010 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 11 is not a required part of the basic financial statements of Kahana Falls Association of Apartment Owners, 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
April 8, 2011

Kahana Falls Association of Apartment Owners

Balance Sheet December 31, 2010

(Summarized Totals for 2009)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2010 Total</u>	<u>2009 Total</u>
Assets				
Cash, including interest-bearing deposits (Note 4)	\$ 583,664	\$ 484,612	\$ 1,068,276	\$ 868,476
Accounts receivable - net (Note 5)	17,252	-	17,252	21,227
Interest receivable	434	461	895	-
Due from Kahana Falls IOA	44,998	-	44,998	30,519
Prepaid expenses (Note 6)	23,942	-	23,942	24,692
Total assets	<u>\$ 670,290</u>	<u>\$ 485,073</u>	<u>\$ 1,155,363</u>	<u>\$ 944,914</u>
Liabilities and Fund Balances				
Accounts payable	\$ 42,009	\$ -	\$ 42,009	\$ 83,437
Accrued expenses (Note 7)	15,702	-	15,702	25,806
Prepaid assessments	834,323	-	834,323	709,290
Total liabilities	<u>892,034</u>	<u>-</u>	<u>892,034</u>	<u>818,533</u>
Fund balances (deficits)	<u>(221,744)</u>	<u>485,073</u>	<u>263,329</u>	<u>126,381</u>
Total liabilities and fund balances	<u>\$ 670,290</u>	<u>\$ 485,073</u>	<u>\$ 1,155,363</u>	<u>\$ 944,914</u>

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

Kahana Falls Association of Apartment Owners

Statement of Revenue, Expenses, and Fund Balances For the Year Ended December 31, 2010 (Summarized Totals for 2009)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2010 Total</u>	<u>2009 Total</u>
Revenue				
Member assessments	\$ 1,407,400	\$ 167,612	\$ 1,575,012	\$ 1,642,891
Commercial assessments	-	-	-	45,808
Rental income	24,744	-	24,744	28,087
Interest income	1,775	2,508	4,283	8,777
Other income (Schedule)	15,828	-	15,828	18,497
Total revenue	<u>1,449,747</u>	<u>170,120</u>	<u>1,619,867</u>	<u>1,744,060</u>
Expenses				
Payroll	349,675	-	349,675	341,641
Bad debt expense	167,596	-	167,596	80,558
Facilities				
Maintenance	88,656	-	88,656	76,027
Utilities	195,252	-	195,252	308,912
General and administrative				
Services (Schedule)	126,730	-	126,730	148,302
Supplies	6,252	-	6,252	8,704
Landscape and maintenance	73,658	-	73,658	70,365
Property taxes	400,566	-	400,566	462,152
Repairs and replacements	-	74,534	74,534	69,909
Total expenses	<u>1,408,385</u>	<u>74,534</u>	<u>1,482,919</u>	<u>1,566,570</u>
Excess revenue (expenses)	41,362	95,586	136,948	177,490
Fund balance (deficit) - beginning	(282,859)	409,240	126,381	(51,109)
Fund transfers	<u>19,753</u>	<u>(19,753)</u>	<u>-</u>	<u>-</u>
Fund balance (deficit) - ending	<u>\$ (221,744)</u>	<u>\$ 485,073</u>	<u>\$ 263,329</u>	<u>\$ 126,381</u>

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

Kahana Falls Association of Apartment Owners

Statement of Cash Flows For the Year Ended December 31, 2010 (Summarized Totals for 2009)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2010 Total</u>	<u>2009 Total</u>
Cash Flows From				
Operating Activities				
Excess revenue (expenses)	\$ 41,362	\$ 95,586	\$ 136,948	\$ 177,490
Changes in:				
Accounts receivable	3,975	-	3,975	48,868
Interest receivable	(434)	(461)	(895)	-
Due from Kahana Falls IOA	(14,479)	-	(14,479)	(9,524)
Prepaid expenses	750	-	750	(9,150)
Accounts payable	(41,428)	-	(41,428)	57,926
Accrued expenses	(10,104)	-	(10,104)	4,523
Prepaid assessments	125,033	-	125,033	(62,392)
Net cash provided (used) by operating activities	<u>104,675</u>	<u>95,125</u>	<u>199,800</u>	<u>207,741</u>
Cash Flows From Financing Activities				
Fund transfers	<u>19,753</u>	<u>(19,753)</u>	<u>-</u>	<u>-</u>
Net cash provided (used) by financing activities	<u>19,753</u>	<u>(19,753)</u>	<u>-</u>	<u>-</u>
Net increase (decrease) in cash	124,428	75,372	199,800	207,741
Cash - beginning of year	<u>459,236</u>	<u>409,240</u>	<u>868,476</u>	<u>660,735</u>
Cash - end of year	<u><u>\$ 583,664</u></u>	<u><u>\$ 484,612</u></u>	<u><u>\$ 1,068,276</u></u>	<u><u>\$ 868,476</u></u>

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

Kahana Falls Association of Apartment Owners

Statement of Other Operating Income and Expenses For the Year Ended December 31, 2010 (Summarized Totals for 2009)

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	<u>2010</u> <u>Total</u>	<u>2009</u> <u>Total</u>
Other Income		
Late fees	\$ 4,252	\$ 15,804
Other	11,576	2,693
Total other income	<u>\$ 15,828</u>	<u>\$ 18,497</u>
General and Administrative Services		
Audit, tax and accounting fees	\$ 33,500	\$ 33,500
Insurance	29,933	48,246
Management fees	8,880	8,880
Other general and administrative	46,136	50,303
Postage and freight	1,674	2,564
Printing	1,809	3,345
Taxes and licenses	4,798	1,464
Total general and administrative services	<u>\$ 126,730</u>	<u>\$ 148,302</u>

The accompanying notes are an integral part of these financial statements

Kahana Falls Association of Apartment Owners

Notes to Financial Statements December 31, 2010 (Summarized Totals for 2009)

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1. Organization and Other Matters

Kahana Falls Association of Apartment Owners (AOAO) is a nonprofit mutual benefit corporation organized in Hawaii in May 1991 and is governed by a member-elected Board of Directors. The Association is responsible for the operation and maintenance of 70 timeshare apartment units and 4 commercial units. The property is located in Kahana, Hawaii on the island of Maui.

2. Significant Accounting Policies

The financial statements include certain 2009 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, 2009 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 money market fund. See Note 8 for a further discussion of reserves.

The Association considers all temporary cash investments with maturity of three months or less to be cash equivalents.

Members are subject to 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 and are approved by the owners. Assessments receivable at the reporting dates represent amounts due from members. The Association allows as uncollectible any member accounts that are delinquent and outstanding greater than 90 days. The Association's policy is to accrue interest on all amounts due, including delinquent assessments, reasonable collection costs and late charges commencing 30 days after assessments become due.

Kahana Falls Association of Apartment Owners

Notes to Financial Statements December 31, 2010 (Summarized Totals for 2009)

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2. Significant Accounting Policies (concluded)

In addition, the Association's policies permit various collection remedies for delinquent assessments, ranging from the cancellation of existing reservations, to filing a lien on the delinquent interval. See Note 5 for details on accounts receivable.

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, 2010 and 2009. 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'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 2007 through 2009. For the years ended December 31, 2010 and 2009, the Association paid no income tax interest or penalties.

The Association has federal and state net operating losses of approximately \$139,000 and \$153,000 respectively, which expire between 2015 and 2026.

Kahana Falls Association of Apartment Owners

Notes to Financial Statements December 31, 2010 (Summarized Totals for 2009)

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4. Cash and Cash Equivalents

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

	<u>2010</u>	<u>2009</u>
Operating Fund		
US Bank – checking	\$416,628	\$355,565
American Security Bank - checking	36	35
Wells Fargo Advisors – money market account	4,264	101,864
Wells Fargo Advisors – certificate of deposit	100,000	-0-
Bank of Hawaii - checking	57,519	100
Managers checking account	<u>5,217</u>	<u>1,672</u>
Total Operating Fund Cash	<u>\$583,664</u>	<u>\$459,236</u>
Replacement Fund		
Wells Fargo Advisors – money market account	\$179,611	\$93,228
Wells Fargo Advisors – certificates of deposit	190,000	200,000
American Security Bank – money market account	<u>115,001</u>	<u>116,012</u>
Total Replacement Fund Cash	<u>\$484,612</u>	<u>\$409,240</u>

5. Accounts Receivable

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

	<u>2010</u>	<u>2009</u>
Regular assessments	\$300,086	\$169,988
SCI Enterprise receivable	-0-	21,227
Allowance for doubtful accounts	<u>(282,834)</u>	<u>(169,988)</u>
Accounts receivable-net	<u>\$17,252</u>	<u>\$21,227</u>

6. Prepaid Expenses

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

	<u>2010</u>	<u>2009</u>
Insurance	\$20,319	\$19,790
Other prepaid expenses	<u>3,623</u>	<u>4,902</u>
Total prepaid expenses	<u>\$23,942</u>	<u>\$24,692</u>

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Notes to Financial Statements December 31, 2010 (Summarized Totals for 2009)

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7. *Accrued Expenses*

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

	<u>2010</u>	<u>2009</u>
State Excise and TAT taxes payable	\$496	\$113
Accrued vacation	6,186	17,530
Accrued other	<u>9,020</u>	<u>8,163</u>
Total accrued expenses	<u>\$15,702</u>	<u>\$25,806</u>

8. *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 \$484,612, are held in separate bank accounts and are generally not available for operating purposes. The Association's policy is to allocate interest earned on such funds to the replacement fund.

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.

Fund requirements consider an annual inflation rate of 2.25 percent and interest of 3.5 percent, net of taxes, on amounts funded for future repairs and replacements. The table included in the unaudited supplementary information on Future Major Repairs and Replacements is based on the study. See the supplemental information presented on page 11 for additional details.

The Association is funding for such repairs and replacements over the estimated useful lives of the components, based on the study's estimates of replacement costs, and considering amounts previously accumulated in the replacement fund. Actual expenditures may vary from the estimates, and the variations may be material. Accordingly, the available cash may not be sufficient to meet all future needs. If they need additional replacement funds, the Board may elect to increase monthly assessments, levy special assessments, or delay replacements until funds are available.

Kahana Falls Association of Apartment Owners

Notes to Financial Statements December 31, 2010 (Summarized Totals for 2009)

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9. Related Party Transactions

The Association incurs certain shared costs with Kahana Falls Interval Owners Association (IOA), a related organization, which is responsible for the maintenance and operation of the owners' units. For the reporting period, the IOA reimbursed the Association \$396,131 and \$254,566 in shared costs and at December 31, 2010 and 2009, and owed the IOA \$44,998 and \$21,655.

A member of the Association's Board of Directors at December 31, 2008, is the president of SCI Enterprises, which is the general partner of Kahana Falls, Ltd., the developer of Kahana Falls Resort. Kahana Falls, Ltd. owned 2 commercial intervals and during the years ended 2010 and 2009 paid the Association \$-0- and \$45,808 respectively for assessments during the reporting period. At December 31, 2010 and 2009, the Developer owed \$-0- and \$21,227 to the Association respectively. All amounts due to the Association were paid subsequent to year-end. At December 31, 2009, the president of SCI Enterprises is no longer a member of the Board of Directors of the Association.

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.

10. Supplemental Cash Flow Disclosures

For the reporting periods, cash flows from operating activities include state and federal income tax payments of \$-0- and \$-0- for the years ended December 31, 2010 and 2009.

11. 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.

12. 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.

13. Subsequent Events

Management has evaluated subsequent events through April 8, 2011, the date which the financial statements were available for issue.

Supplemental Information

Kahana Falls Association of Apartment Owners

Supplemental Information on Future Major Repairs and Replacements (unaudited) December 31, 2010

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.

Component	Estimated Remaining Useful Life (Years)	Estimated Current Replacement Cost	Estimated 2011 Funding Requirement	Reserve Expenditures For the Year Ended 12/31/10	Replacement Cash Balance at 12/31/10
AC Units	13	\$ 13,500	\$ 4,088	\$ (47,126)	\$ 22,332
ADA Compliance	0	15,000	4,542	-	24,813
Walkways	5	2,500	757	-	4,135
Carpet	4	7,500	2,271	-	12,406
Decks	1	6,000	1,817	-	9,925
Elevators	8	20,000	6,056	-	33,084
Painting	4-8	102,500	31,035	(15,473)	169,555
Fitness Center	13	3,500	1,060	-	5,790
Gates and fences	18	15,000	4,541	-	24,813
Landscape	8	10,000	3,028	-	16,542
Lobby	3-16	21,500	6,510	-	35,565
Lock system	11	300	91	(7,019)	496
Parking	13-22	91,000	27,554	-	150,532
Pool and spa	2-10	90,000	27,251	(4,356)	148,878
Roofs	16	60,000	18,167	(560)	99,252
Sprinkler	23	60,000	18,167	-	99,252
Telephone system	14	55,000	16,653	-	90,981
Windows	13-25	2,940	890	-	4,864
Water Heater	13	5,000	1,514	-	8,271
Cash deficit	-	-	-	-	(476,873)
Totals		\$ 581,240	\$ 175,992	\$ (74,534)	\$ 484,613

See auditor's report.