

**Financial Statements**

**Kahana Falls Interval  
Owners Association**

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

# Kahana Falls Interval Owners Association

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December 31, 2010

(Summarized Totals for 2009)

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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, 2010 and the related statement of revenue, expenses and fund balances, cash flows, and other 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 Interval Owners Association 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 13 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  
February 23, 2011

# Kahana Falls Interval Owners Association

## 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>
<b>Assets</b>				
Cash, including interest-bearing deposits (Note 4)	\$ 1,111,734	\$ 239,614	\$ 1,351,348	\$ 1,051,414
Accounts receivable - net (Note 5)	48,696	-	48,696	42,860
Prepaid expenses (Note 6)	9,523	-	9,523	8,603
Property and equipment-net (Note 7)	3,109	-	3,109	6,219
Total assets	<u>\$ 1,173,062</u>	<u>\$ 239,614</u>	<u>\$ 1,412,676</u>	<u>\$ 1,109,096</u>
<b>Liabilities and Fund Balances</b>				
Accounts payable	\$ 22,335	\$ -	\$ 22,335	\$ 49,739
Due to Kahana Falls AOA	44,998	-	44,998	30,519
Accrued expenses (Note 8)	93,424	-	93,424	73,916
Income tax payable	-	-	-	399
Note payable (Note 9)	3,683	-	3,683	6,549
Prepaid assessments	952,617	-	952,617	822,170
Total liabilities	<u>1,117,057</u>	<u>-</u>	<u>1,117,057</u>	<u>983,292</u>
Fund balances	<u>56,005</u>	<u>239,614</u>	<u>295,619</u>	<u>125,804</u>
Total liabilities and fund balances	<u>\$ 1,173,062</u>	<u>\$ 239,614</u>	<u>\$ 1,412,676</u>	<u>\$ 1,109,096</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, 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>
<b>Revenue</b>				
Member assessments	\$ 1,512,022	\$ 273,663	\$ 1,785,685	\$ 1,649,105
Rental income	80,571	-	80,571	78,288
Interest income	2,980	1,961	4,941	11,668
Other income	42,352	-	42,352	32,556
Total revenue	<u>1,637,925</u>	<u>275,624</u>	<u>1,913,549</u>	<u>1,771,617</u>
<b>Expenses</b>				
Salaries and related	683,971	-	683,971	647,436
Employee benefits	193,738	-	193,738	268,973
Bad debt expense	129,125	-	129,125	68,054
Depreciation expense	3,110	-	3,110	3,110
General excise and tot tax	60,496	-	60,496	21,342
Income tax expense	653	-	653	1,519
Legal and professional	20,162	-	20,162	17,001
General and administrative Services (Schedule)	247,472	-	247,472	239,801
Management fees	88,200	-	88,200	88,200
Supplies	32,442	-	32,442	52,699
Repairs and replacements	-	154,373	154,373	306,804
Utilities	129,992	-	129,992	-
Total expenses	<u>1,589,361</u>	<u>154,373</u>	<u>1,743,734</u>	<u>1,714,939</u>
Excess revenue	48,564	121,251	169,815	56,678
Fund balances - beginning	8,025	117,779	125,804	69,126
Fund transfers	<u>(584)</u>	<u>584</u>	<u>-</u>	<u>-</u>
Fund balances - ending	<u>\$ 56,005</u>	<u>\$ 239,614</u>	<u>\$ 295,619</u>	<u>\$ 125,804</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, 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>
<b>Cash Flows From Operating Activities</b>				
Excess revenue (expenses)	\$ 48,564	\$ 121,251	\$ 169,815	\$ 56,678
Noncash items included in excess revenue (expenses) -				
Depreciation	3,110	-	3,110	\$ 3,110
Changes in:				
Accounts receivable	(5,836)	-	(5,836)	10,133
Prepaid expenses	(920)	-	(920)	(5,370)
Accounts payable	(27,404)	-	(27,404)	35,220
Due to Kahana Falls AOAO	14,479	-	14,479	9,524
Accrued expenses	19,508	-	19,508	(249)
Income tax payable	(399)	-	(399)	(1,087)
Prepaid assessments	130,447	-	130,447	232,322
	<u>181,549</u>	<u>121,251</u>	<u>302,800</u>	<u>340,281</u>
Net cash provided (used) by operating activities				
<b>Cash Flows From Financing Activities</b>				
Payments on note payable	(2,866)	-	(2,866)	(2,822)
Fund transfers	(584)	584	-	-
	<u>(3,450)</u>	<u>584</u>	<u>(2,866)</u>	<u>(2,822)</u>
Net cash provided (used) by financing activities				
Net increase (decrease) in cash	178,099	121,835	299,934	337,459
Cash - beginning of year	933,635	117,779	1,051,414	713,955
Cash - end of year	<u>\$ 1,111,734</u>	<u>\$ 239,614</u>	<u>\$ 1,351,348</u>	<u>\$ 1,051,414</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, 2010 (Summarized Totals for 2009)

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	<u>2010</u> <u>Total</u>	<u>2009</u> <u>Total</u>
<b>General and Administrative Services</b>		
Insurance	\$ 8,371	\$ 4,662
Interest	435	466
Postage and freight	6,029	6,061
Printing	10,440	11,243
Audit, tax and accounting fees	34,800	34,800
Reservation fees	55,000	55,000
Taxes and licenses	600	2,476
Bank and credit card charges	36,446	35,194
Guest relations	47,706	49,130
Meeting and education	8,302	9,473
Other general and administrative	<u>39,343</u>	<u>31,296</u>
Total general and administrative services	<u>\$ 247,472</u>	<u>\$ 239,801</u>

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

# Kahana Falls Interval Owners Association

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

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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 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 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 monthly assessments to provide funds for operating expenses and future major repairs and replacements. Assessments receivable at the reporting dates represent amounts due from unit owners. The Association establishes an allowance for all unpaid accounts with delinquent balances outstanding for more than 90 days. The Association's policy is to accrue interest on all amounts due, including delinquent assessment, reasonable collection costs and late charges commencing 30 days after assessment becomes due.



# Kahana Falls Interval Owners Association

## Notes to Financial Statements December 31, 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, which include filing liens, foreclosing on the unit owner, and obtaining judgment on other assets of the owner. Any excess assessments at year-end are retained by the Association for use in the succeeding year. See Note 5 for additional details on assessments receivable amounts.

The Association conforms to industry practice in recognizing real property and common areas as assets. Based on this practice, the Association only capitalizes property to which it has title and to which the board of directors has discretion to dispose of 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, 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.

# Kahana Falls Interval Owners Association

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

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### 3. *Income Taxes* (concluded)

The Association has state net operating losses of approximately \$37,000 which expire between 2011 and 2026.

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.

### 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	\$587,233	\$330,235
Bank of Hawaii – checking	14,092	13,382
Bank of Hawaii – checking	145,623	100
American Security Bank – money market account	30,997	203,092
Wells Fargo Bank – money market account	131,789	153,638
Wells Fargo Bank – certificate of deposit	200,000	200,000
Petty cash	<u>2,000</u>	<u>2,000</u>
Total Operating Fund	<u>\$1,111,734</u>	<u>\$902,447</u>
Replacement Fund		
Wells Fargo Bank – money market account	\$246	\$758
Wells Fargo Bank – certificate of deposit	-0-	148,000
American Security Bank – money market account	<u>239,368</u>	<u>209</u>
Total Replacement Fund	<u>\$239,614</u>	<u>\$148,967</u>

### 5. *Accounts Receivable*

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

	<u>2010</u>	<u>2009</u>
Regular assessments	\$312,334	\$176,927
Other receivables	33,672	42,860
Allowance for doubtful accounts	<u>(297,310)</u>	<u>(176,927)</u>
Accounts receivable - net	<u>\$48,696</u>	<u>\$42,860</u>

# Kahana Falls Interval Owners Association

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

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### 6. Prepaid Expenses

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

	<u>2010</u>	<u>2009</u>
Insurance	\$8,562	\$8,308
Income taxes	867	-0-
Other prepaid expenses	<u>94</u>	<u>295</u>
Total prepaid expenses	<u>\$9,523</u>	<u>\$8,603</u>

### 7. Property and Equipment

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

	<u>2010</u>	<u>2009</u>
Laundry equipment	\$47,612	\$47,612
Vehicle	15,549	15,549
Accumulated depreciation	<u>(60,052)</u>	<u>(56,942)</u>
Net property and equipment	<u>\$3,109</u>	<u>\$6,219</u>

### 8. 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	\$13,388	\$5,866
Accrued vacation	44,591	34,634
Accrued other	<u>35,445</u>	<u>33,416</u>
Total accrued expenses	<u>\$93,424</u>	<u>\$73,916</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 7.75% per annum, maturing March 2, 2012

\$3,683

# Kahana Falls Interval Owners Association

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

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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, 2010:

December 31, 2011	\$3,098
2012	585
Thereafter	<u>-0-</u>
Total principal payments	<u>\$3,683</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 \$239,614, are held in separate bank and brokerage 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 13 for additional details.

The Association is funding for such repairs and replacements 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 additional replacement funds are needed, the Board may elect to increase yearly assessments, levy special assessments, or delay replacements until funds are available.

### **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 \$396,131 and \$254,566 at December 31, 2010 and 2009, owed the AOAO \$44,998 and \$21,655.

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.

# Kahana Falls Interval Owners Association

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

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### **12. Supplemental Cash Flow Disclosures**

Supplemental cash flows at the reporting dates consist of:

	<u>2010</u>	<u>2009</u>
Federal and state tax payments	\$1,919	\$1,120
Interest expense	<u>435</u>	<u>466</u>
Total supplemental cash flows	<u>\$2,354</u>	<u>\$1,586</u>

### **13. 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, rental 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 was 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. As of December 31, 2010, the appeal is still pending.

### **14. 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 \$371,113 and \$109,088 at December 31, 2010 and 2009 respectively.

### **15. 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.

**Kahana Falls Interval  
Owners Association**

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

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***16. Date of Management's Review***

In preparing the financial statements, the Association has evaluated events and transactions for potential recognition or disclosure through February 23, 2011, 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, 2010 (unaudited)

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.

<b>Component</b>	<b>Estimated Remaining Useful Life (Years)</b>	<b>Estimated Current Replacement Cost</b>	<b>Estimated 2011 Funding Requirement</b>	<b>Reserve Expenditures For the Year Ended 12/31/10</b>	<b>Replacement Cash Balance at 12/31/10</b>
Appliances	10-18	\$ 62,160	\$ 8,360	\$ (18,330)	\$ 38,150
Bedrooms	6-22	406,100	54,615	(80,018)	249,237
Buildings	6-18	219,400	29,506	(43,481)	134,653
Cabinets	8-13	129,500	17,416	-	79,478
Carpets	3-9	258,600	34,778	(3,090)	158,711
Case goods	4	10,540	1,417	-	6,469
Electronics	6-13	125,200	16,838	(6,281)	76,839
Furniture	3-13	361,080	48,561	-	221,607
Miscellaneous	4-18	127,120	17,096	-	78,018
Plumbing	8-23	251,200	33,783	(3,173)	154,170
Soft goods	3-7	125,050	16,818	-	76,747
Cash deficit		-	-	-	(1,034,465)
<b>Totals</b>		<b>\$ 2,075,950</b>	<b>\$ 279,188</b>	<b>\$ (154,373)</b>	<b>\$ 239,614</b>

See auditors' report.