

Financial Statements

**Kahana Falls Interval
Owners Association**

**For the Year Ended
December 31, 2011**

Kahana Falls Interval Owners Association

Contents

December 31, 2011

(Summarized Totals for 2010)

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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, 2011 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, 2010 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 February 23, 2011.

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, 2011 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 25, 2012

Kahana Falls Interval Owners Association

Balance Sheet December 31, 2011 (Summarized Totals for 2010)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2011 Total</u>	<u>2010 Total</u>
Assets				
Cash, including interest-bearing deposits (Note 4)	\$ 1,341,066	\$ 421,992	\$ 1,763,058	\$ 1,351,348
Accounts receivable-net (Note 5)	39,904	-	39,904	48,696
Prepaid expenses (Note 6)	6,504	-	6,504	9,523
Property and equipment-net (Note 7)	-	-	-	3,109
Total assets	<u>\$ 1,387,474</u>	<u>\$ 421,992</u>	<u>\$ 1,809,466</u>	<u>\$ 1,412,676</u>
Liabilities and Fund Balances				
Accounts payable	\$ 22,570	\$ -	\$ 22,570	\$ 22,335
Due to Kahana Falls AOA	70,697	-	70,697	44,998
Accrued expenses (Note 8)	175,838	-	175,838	93,424
Income tax payable	1,331	-	1,331	-
Note payable (Note 9)	533	-	533	3,683
Prepaid assessments	1,118,702	-	1,118,702	952,617
Total liabilities	<u>1,389,671</u>	<u>-</u>	<u>1,389,671</u>	<u>1,117,057</u>
Fund balances (deficits)	<u>(2,197)</u>	<u>421,992</u>	<u>419,795</u>	<u>295,619</u>
Total liabilities and fund balances	<u>\$ 1,387,474</u>	<u>\$ 421,992</u>	<u>\$ 1,809,466</u>	<u>\$ 1,412,676</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, 2011 (Summarized Totals for 2010)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2011 Total</u>	<u>2010 Total</u>
Revenue				
Member assessments- net of discounts	\$ 1,560,326	\$ 301,943	\$ 1,862,269	\$ 1,785,685
Rental income	131,260	-	131,260	80,571
Interest income	2,786	1,914	4,700	4,941
Other income	19,209	-	19,209	42,352
Total revenue	<u>1,713,581</u>	<u>303,857</u>	<u>2,017,438</u>	<u>1,913,549</u>
Expenses				
Salaries and related	712,481	-	712,481	683,971
Employee benefits	205,581	-	205,581	193,738
Bad debt expense	184,615	-	184,615	129,125
Depreciation expense	3,109	-	3,109	3,110
General excise tax	131,936	-	131,936	60,496
Income tax expense	1,331	-	1,331	653
Legal and professional	6,541	-	6,541	20,162
General and administrative Services (Schedule)	244,084	-	244,084	247,472
Management fees	88,200	-	88,200	88,200
Supplies	42,080	-	42,080	32,442
Repairs and replacements	-	90,003	90,003	154,373
Utilities	183,301	-	183,301	129,992
Total expenses	<u>1,803,259</u>	<u>90,003</u>	<u>1,893,262</u>	<u>1,743,734</u>
Excess revenue (expense)	(89,678)	213,854	124,176	169,815
Fund balances-beginning	56,005	239,614	295,619	125,804
Fund transfers	<u>31,476</u>	<u>(31,476)</u>	<u>-</u>	<u>-</u>
Fund balances (deficits)-ending	<u>\$ (2,197)</u>	<u>\$ 421,992</u>	<u>\$ 419,795</u>	<u>\$ 295,619</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, 2011 (Summarized Totals for 2010)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2011 Total</u>	<u>2010 Total</u>
Cash Flows From Operating Activities				
Excess revenue (expenses)	\$ (89,678)	\$ 213,854	\$ 124,176	\$ 169,815
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:				
Depreciation	3,109	-	3,109	\$ 3,110
Changes in:				
Accounts receivable	8,792	-	8,792	(5,836)
Prepaid expenses	3,018	-	3,018	(920)
Accounts payable	235	-	235	(27,404)
Due to Kahana Falls AOA	25,699	-	25,699	14,479
Accrued expenses	82,414	-	82,414	19,508
Income tax payable	1,332	-	1,332	(399)
Prepaid assessments	166,085	-	166,085	130,447
Net cash provided (used) by operating activities	<u>201,006</u>	<u>213,854</u>	<u>414,860</u>	<u>302,800</u>
Cash Flows From Financing Activities				
Principal payments on note payable	(3,150)	-	(3,150)	(2,866)
Fund transfers	<u>31,476</u>	<u>(31,476)</u>	<u>-</u>	<u>-</u>
Net cash provided (used) by financing activities	<u>28,326</u>	<u>(31,476)</u>	<u>(3,150)</u>	<u>(2,866)</u>
Net increase (decrease) in cash	229,332	182,378	411,710	299,934
Cash - beginning of year	<u>1,111,734</u>	<u>239,614</u>	<u>1,351,348</u>	<u>1,051,414</u>
Cash - end of year	<u>\$ 1,341,066</u>	<u>\$ 421,992</u>	<u>\$ 1,763,058</u>	<u>\$ 1,351,348</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, 2011 (Summarized Totals for 2010)

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	<u>2011</u> <u>Total</u>	<u>2010</u> <u>Total</u>
General and Administrative Services		
Audit, tax and accounting fees	\$ 35,480	\$ 34,800
Bank and credit card charges	16,287	36,446
Building maintenance	19,574	16,479
Guest relations	48,673	47,706
Insurance	11,596	8,371
Interest	165	435
Meeting and education	7,474	8,302
Postage and freight	6,595	6,029
Printing	10,135	10,440
Reservation fees	55,000	55,000
Taxes and licenses	3,125	600
Other general and administrative	<u>29,980</u>	<u>22,864</u>
Total general and administrative services	<u>\$ 244,084</u>	<u>\$ 247,472</u>

The accompanying notes are an integral part of these financial statements

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2011 (Summarized Totals for 2010)

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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 2010 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, 2010 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, 2011 (Summarized Totals for 2010)

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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.

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 timeshare association for the years ended December 31, 2011 and 2010. 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 Hawaii net operating losses of approximately \$36,000 which expire between 2025 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 2008 through 2010. For the years ended December 31, 2011 and 2010, the Association paid no income tax interest or penalties.

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2011 (Summarized Totals for 2010)

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4. Cash and Cash Equivalents

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

	<u>2011</u>	<u>2010</u>
Operating Fund		
US Bank – checking	\$963,294	\$587,233
Bank of Hawaii – checking	13,002	14,092
Bank of Hawaii – checking	150,026	145,623
American Security Bank – money market account	1,363	30,997
Wells Fargo Bank – money market account	11,377	131,789
Wells Fargo Bank – certificate of deposit	200,004	200,000
Petty cash	<u>2,000</u>	<u>2,000</u>
Total Operating Fund	<u>\$1,341,066</u>	<u>\$1,111,734</u>
Replacement Fund		
Wells Fargo Bank – money market account	\$20,257	\$246
Wells Fargo Bank – certificate of deposit	350,000	-0-
American Security Bank – money market account	<u>51,735</u>	<u>239,368</u>
Total Replacement Fund	<u>\$421,992</u>	<u>\$239,614</u>

5. Accounts Receivable

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

	<u>2011</u>	<u>2010</u>
Regular assessments	\$471,151	\$312,334
Due from Trading Places International	4,716	3,635
Other receivables	24,749	30,037
Allowance for doubtful accounts	<u>(460,712)</u>	<u>(297,310)</u>
Accounts receivable - net	<u>\$39,904</u>	<u>\$48,696</u>

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2011 (Summarized Totals for 2010)

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6. Prepaid Expenses

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

	<u>2011</u>	<u>2010</u>
Insurance	\$5,634	\$8,562
Income taxes	-0-	867
Other prepaid expenses	<u>871</u>	<u>94</u>
Total prepaid expenses	<u>\$6,505</u>	<u>\$9,523</u>

7. Property and Equipment

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

	<u>2011</u>	<u>2010</u>
Laundry equipment	\$47,612	\$47,612
Vehicle	15,549	15,549
Accumulated depreciation	<u>(63,161)</u>	<u>(60,052)</u>
Net property and equipment	<u>\$-0-</u>	<u>\$3,109</u>

8. Accrued Expenses

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

	<u>2011</u>	<u>2010</u>
State Excise tax payable	\$12,168	\$13,388
Accrued excise tax settlement	67,895	-0-
Accrued vacation	40,916	44,591
Accrued other	<u>54,859</u>	<u>35,445</u>
Total accrued expenses	<u>\$175,838</u>	<u>\$93,424</u>

The Association reached a settlement agreement with the Hawaii Department of Taxation (DOT) during 2011, in which the Association agreed to pay \$67,895 in excise taxes pursuant to an audit of the Association. The DOT took 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 AOA) that all of the maintenance fees received by the IOA on behalf of the AOA be subject to excise tax. The Association paid the settlement amount in full subsequent to December 31, 2011.

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2011 (Summarized Totals for 2010)

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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 2012

\$533

The following is a schedule of future principal payments under the terms of the note as of December 31, 2011:

December 31, 2012	\$533
Thereafter	<u>-0-</u>
Total principal payments	<u>\$533</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 \$421,992, 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.

Kahana Falls Interval Owners Association

Notes to Financial Statements December 31, 2011 (Summarized Totals for 2010)

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11. Related Party Transactions

The Association reimbursed Kahana Falls Association of Apartment Owners (AOAO), a related Association 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 \$507,926 and \$396,131 at December 31, 2011 and 2010 respectively. At the reporting dates, the Association owed the AOAO \$70,697 and \$44,998 and was due \$727 and \$575 from the AOAO respectively.

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.

In December 2010, the Association's management company was bought by Interval International, Inc. The Association is provided collection services by one of Interval International, Inc.'s subsidiary companies. During the year ended December 31, 2011, \$237 was paid to this Company for collection services and \$-0- was due to or due from this Company at December 31, 2011.

12. Supplemental Cash Flow Disclosures

Supplemental cash flows at the reporting dates consist of:

	<u>2011</u>	<u>2010</u>
Federal and state income tax payments	\$-0-	\$1,919
Interest paid	<u>165</u>	<u>435</u>
Total supplemental cash flows	<u>\$165</u>	<u>\$2,354</u>

13. Commitments and Contingencies

The Association entered into a three-year management agreement with Trading Places International (TPI) beginning May 1, 2008 that automatically renewed on May 1, 2011 and now expires on May 1, 2014. 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.

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 \$21,290 and \$371,113 at December 31, 2011 and 2010 respectively.

**Kahana Falls Interval
Owners Association**

**Notes to Financial Statements
December 31, 2011
(Summarized Totals for 2010)**

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15. Subsequent Events

Management has evaluated subsequent events through February 25, 2012, the date which the financial statements were available for issue.

Supplemental Information

Kahana Falls Interval Owners Association

Supplemental Information on Future Major Repairs and Replacements

December 31, 2011 (Unaudited)

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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 January 2009 Replacement Cost	Estimated 2012 Funding Requirement	Reserve Expenditures For the Year Ended 12/31/11	Replacement Cash Balance at 12/31/11
Appliances	9-17	\$ 62,160	\$ 8,527	\$ (30,121)	\$ 44,107
Bedrooms	5-21	406,100	55,707	-	288,157
Buildings	5-17	219,400	30,096	(36,143)	155,680
Cabinets	7-12	129,500	17,764	-	91,890
Carpets	2-8	258,600	35,474	-	183,495
Case goods	3	10,540	1,446	-	7,479
Electronics	5-12	125,200	17,174	(18,750)	88,838
Furniture	2-12	361,080	49,532	(385)	256,212
Miscellaneous	3-17	127,120	17,438	(271)	90,201
Plumbing	7-22	251,200	34,459	(4,333)	178,245
Soft goods	2-6	125,050	17,154	-	88,733
Cash deficit		-	-	-	(1,051,045)
Totals		<u>\$ 2,075,950</u>	<u>\$ 284,771</u>	<u>\$ (90,003)</u>	<u>\$ 421,992</u>

See auditors' report.