

**Financial Statements**

**Kahana Falls Interval  
Owners Association**

**For the Year Ended  
December 31, 2012**

# Kahana Falls Interval Owners Association

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December 31, 2012

(Summarized Totals for 2011)

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***Report of Independent Auditor***

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

We have audited the accompanying financial statements of Kahana Falls Interval Owners Association, which comprise the balance sheet as of December 31, 2012, and the related statements of income, expenses, fund balances, cash flows, and other operating expenses for the years then ended, and the related notes to the financial statements. The prior year summarized comparative information has been derived from the Association's 2011 financial statements and, in our report dated February 25, 2012, we expressed an unqualified opinion on those financial statements.

***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Kahana Falls  
Interval Owners Association  
March 11, 2013  
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***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, 2012, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Report on Supplementary Information***

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The supplemental information, which is the responsibility of the Association's management, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

*FITZGERALD & ASSOCIATES, INC. CPAs*

Redlands, California  
March 11, 2013

# Kahana Falls Interval Owners Association

## Balance Sheet

December 31, 2012

(Summarized Totals for 2011)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2012 Total</u>	<u>2011 Total</u>
<b>Assets</b>				
Cash, including interest-bearing deposits (Note 4)	\$ 1,583,254	\$ 536,376	\$ 2,119,630	\$ 1,763,058
Accounts receivable, net (Note 5)	57,685	-	57,685	39,177
Due from Kahana Falls AOAO	7,373	-	7,373	727
Interest receivable	909	549	1,458	-
Prepaid expenses (Note 6)	6,144	-	6,144	6,504
Property and equipment, net (Note 7)	-	-	-	-
Total assets	<u>\$ 1,655,365</u>	<u>\$ 536,925</u>	<u>\$ 2,192,290</u>	<u>\$ 1,809,466</u>
<b>Liabilities and Fund Balances</b>				
Accounts payable	\$ 76,918	\$ -	\$ 76,918	\$ 22,570
Due to Kahana Falls AOAO	135,877	-	135,877	70,697
Accrued expenses (Note 8)	130,302	-	130,302	175,838
Income tax payable	5,719	-	5,719	1,331
Note payable	-	-	-	533
Prepaid assessments	1,236,223	-	1,236,223	1,118,702
Total liabilities	<u>1,585,039</u>	<u>-</u>	<u>1,585,039</u>	<u>1,389,671</u>
Fund balances	<u>70,326</u>	<u>536,925</u>	<u>607,251</u>	<u>419,795</u>
Total liabilities and fund balances	<u>\$ 1,655,365</u>	<u>\$ 536,925</u>	<u>\$ 2,192,290</u>	<u>\$ 1,809,466</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, 2012 (Summarized Totals for 2011)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2012 Total</u>	<u>2011 Total</u>
<b>Revenue</b>				
Member assessments, net of discounts	\$ 1,752,051	\$ 311,001	\$ 2,063,052	\$ 1,862,269
Rental income	210,817	-	210,817	131,260
Interest income	2,053	3,390	5,443	4,700
Other income	18,506	-	18,506	19,209
Total revenue	<u>1,983,427</u>	<u>314,391</u>	<u>2,297,818</u>	<u>2,017,438</u>
<b>Expenses</b>				
Salaries and related	752,944	-	752,944	712,481
Employee benefits	230,477	-	230,477	205,581
Bad debt expense	259,398	-	259,398	184,615
Depreciation expense	-	-	-	3,109
General excise tax	81,350	-	81,350	131,936
Income tax expense	7,019	-	7,019	1,331
Legal and professional	18,092	-	18,092	6,541
General and administrative Services (Schedule)	258,010	-	258,010	244,084
Management fees	88,200	-	88,200	88,200
Supplies	48,529	-	48,529	42,080
Repairs and replacements	-	196,237	196,237	90,003
Utilities	170,106	-	170,106	183,301
Total expenses	<u>1,914,125</u>	<u>196,237</u>	<u>2,110,362</u>	<u>1,893,262</u>
Excess revenue (expense)	69,302	118,154	187,456	124,176
Fund balances (deficits), beginning	(2,197)	421,992	419,795	295,619
Fund transfers	<u>3,221</u>	<u>(3,221)</u>	<u>-</u>	<u>-</u>
Fund balances, ending	<u>\$ 70,326</u>	<u>\$ 536,925</u>	<u>\$ 607,251</u>	<u>\$ 419,795</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, 2012  
(Summarized Totals for 2011)**

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2012 Total</u>	<u>2011 Total</u>
<b>Cash Flows From Operating Activities</b>				
Excess revenue (expenses)	\$ 69,302	\$ 118,154	\$ 187,456	\$ 124,176
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:				
Depreciation	-	-	-	\$ 3,109
Changes in:				
Accounts receivable	(25,154)	-	(25,154)	8,792
Interest receivable	(909)	(549)	(1,458)	-
Prepaid expenses	360	-	360	3,018
Accounts payable	54,348	-	54,348	235
Due to Kahana Falls AOA	65,180	-	65,180	25,699
Accrued expenses	(45,536)	-	(45,536)	82,414
Income tax payable	4,388	-	4,388	1,332
Prepaid assessments	117,521	-	117,521	166,085
Net cash provided (used) by operating activities	<u>239,500</u>	<u>117,605</u>	<u>357,105</u>	<u>414,860</u>
<b>Cash Flows From Financing Activities</b>				
Principal payments on note payable	(533)	-	(533)	(3,150)
Fund transfers	<u>3,221</u>	<u>(3,221)</u>	<u>-</u>	<u>-</u>
Net cash provided (used) by financing activities	<u>2,688</u>	<u>(3,221)</u>	<u>(533)</u>	<u>(3,150)</u>
Net increase (decrease) in cash	242,188	114,384	356,572	411,710
Cash, beginning of year	<u>1,341,066</u>	<u>421,992</u>	<u>1,763,058</u>	<u>1,351,348</u>
Cash, end of year	<u>\$ 1,583,254</u>	<u>\$ 536,376</u>	<u>\$ 2,119,630</u>	<u>\$ 1,763,058</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, 2012  
(Summarized Totals for 2011)**

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	<u>2012</u> <u>Total</u>	<u>2011</u> <u>Total</u>
<b>General and Administrative Services</b>		
Audit, tax and accounting fees	\$ 36,467	\$ 35,480
Bank and credit card charges	21,300	16,287
Building maintenance	13,827	19,574
Director expense	7,552	-
Guest relations	54,017	48,673
Insurance	10,988	11,596
Interest	14	165
Meetings and education	1,416	7,474
Postage and freight	9,288	6,595
Printing	9,774	10,135
Reservation fees	55,000	55,000
Taxes and licenses	375	3,125
Other general and administrative	37,992	29,980
Total general and administrative services	<u>\$ 258,010</u>	<u>\$ 244,084</u>

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



# **Kahana Falls Interval Owners Association**

## **Notes to Financial Statements December 31, 2012 (Summarized Totals for 2011)**

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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 2011 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, 2011 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 9 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, 2012 (Summarized Totals for 2011)

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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**

Timeshare associations may elect to be taxed either as a timeshare association or as a regular corporation. The Association elected to be taxed as a timeshare association in accordance with Internal Revenue Code Section 528 for the years ending December 31, 2012 and 2011. Under that Section, the Association is not taxed on assessments to members and other income received from association members solely as a function of their membership in the Association. The Association is taxed at the rate of 32% on its nonexempt function income such as interest.

The Association has Hawaii net operating losses of approximately \$10,700 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 2009 through 2011. For the years ended December 31, 2012 and 2011, the Association paid no income tax interest or penalties.

# Kahana Falls Interval Owners Association

## Notes to Financial Statements December 31, 2012 (Summarized Totals for 2011)

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### 4. Cash and Cash Equivalents

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

	2012	2011
Operating Fund		
US Bank, checking	\$328,846	\$963,294
Bank of Hawaii, checking	17,685	13,002
Bank of Hawaii, checking	208,938	150,026
American Security Bank, money market account	3,369	1,363
Wells Fargo Bank, money market account	22,416	11,377
Wells Fargo Bank, certificate of deposit	1,000,000	200,004
Petty cash	<u>2,000</u>	<u>2,000</u>
Total Operating Fund	<u>\$1,583,254</u>	<u>\$1,341,066</u>
Replacement Fund		
Wells Fargo Bank, money market account	\$85,240	\$20,257
Wells Fargo Bank, certificate of deposit	150,000	350,000
American Security Bank, money market account	<u>301,136</u>	<u>51,735</u>
Total Replacement Fund	<u>\$536,376</u>	<u>\$421,992</u>

### 5. Accounts Receivable

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

	2012	2011
Regular assessments	\$681,384	\$471,151
Due from Trading Places International	10,788	4,716
Other receivables	24,207	24,022
Allowance for doubtful accounts	<u>(658,694)</u>	<u>(460,712)</u>
Accounts receivable, net	<u>\$57,685</u>	<u>\$39,177</u>

### 6. Prepaid Expenses

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

	2012	2011
Insurance	\$5,932	\$5,633
Other prepaid expenses	<u>212</u>	<u>871</u>
Total prepaid expenses	<u>\$6,144</u>	<u>\$6,504</u>

# Kahana Falls Interval Owners Association

## Notes to Financial Statements December 31, 2012 (Summarized Totals for 2011)

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### 7. Property and Equipment

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

	<u>2012</u>	<u>2011</u>
Laundry equipment	\$47,612	\$47,612
Vehicle	15,549	15,549
Accumulated depreciation	<u>(63,161)</u>	<u>(63,161)</u>
Net property and equipment	<u>\$-0-</u>	<u>\$-0-</u>

### 8. Accrued Expenses

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

	<u>2012</u>	<u>2011</u>
State Excise tax payable	\$28,496	\$12,168
Accrued excise tax settlement	-0-	67,895
Accrued vacation	42,587	40,916
Accrued other	<u>59,219</u>	<u>54,859</u>
Total accrued expenses	<u>\$130,302</u>	<u>\$175,838</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 AOAO) that all of the maintenance fees received by the IOA on behalf of the AOAO be subject to excise tax. The Association paid the settlement amount in full during the year ended December 31, 2012.

### 9. Future Major Repairs and Replacements

The association's governing documents require that funds be accumulated for future major repairs and replacements. Accumulated funds are held in separate savings accounts and are generally not available for expenditures for normal operations.

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. Funding requirements consider an annual inflation rate of 2.25 percent and interest of 3.5 percent, net of taxes, on amounts funded for future major repairs and replacements. The table included in the unaudited supplementary information on Future Major Repairs and Replacements is based on the study.

# Kahana Falls Interval Owners Association

## Notes to Financial Statements December 31, 2012 (Summarized Totals for 2011)

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### **9. Future Major Repairs and Replacements** (concluded)

The board is funding for major repairs and replacements over the remaining useful lives of the components based on the study's estimates of future replacement costs and considering amounts previously accumulated in the replacement fund. Accordingly, the funding requirement of \$311,001, based on a full funding plan, had been included in the 2012 budget.

Funds are being accumulated in the replacement fund based on estimated future costs for repairs and replacements of common property components. Actual expenditures and investment income may vary from the estimated amounts, and the variations may be material. Therefore, amounts accumulated in the replacements fund may not be adequate to meet all future needs for major repairs and replacements. If additional funds are needed, the association has the right, subject to membership approval, to increase regular assessments, pass special assessments, or delay major repairs and replacements until funds are available.

### **10. Related Party Transactions**

The Association 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 years ended December 31, 2012 and 2011, the Association reimbursed the AOAO \$103,072 and \$507,926 respectively. At December 31, 2012 and 2011, the Association owed the AOAO \$135,877 and \$70,697 respectively, and the AOAO owed the Association \$7,373 and \$727 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 years ended December 31, 2012 and 2011, \$1,144 and \$237 were paid to this Company for collection services and \$-0- was due to or due from this Company at December 31, 2012 and 2011.

### **11. Supplemental Cash Flow Disclosures**

Supplemental cash flows at the reporting dates consist of:

	<u>2012</u>	<u>2011</u>
Federal and state income tax payments	\$2,599	\$-0-
Interest paid	14	165
Total supplemental cash flows	<u>\$2,613</u>	<u>\$165</u>

# **Kahana Falls Interval Owners Association**

**Notes to Financial Statements  
December 31, 2012  
(Summarized Totals for 2011)**

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## ***12. 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.

## ***13. 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 \$47,762 and \$21,290 at December 31, 2012 and 2011 respectively.

## ***14. Subsequent Events***

Management has evaluated subsequent events through March 11, 2013, 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, 2012 (Unaudited)

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The Association conducted a study in January 2009 to estimate the remaining useful lives and replacement costs of the components of common property. The estimates were based on future estimated replacement costs. Funding requirements consider an annual inflation rate of 2.25% and interest of 3.5%, net of taxes, on amounts funded for future major repairs and replacements.

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

<b>Component</b>	<b>Estimated Remaining Useful Life (Years)</b>	<b>Estimated January 2009 Replacement Cost</b>	<b>Estimated 2013 Funding Requirement</b>	<b>Reserve Expenditures For the Year Ended 12/31/12</b>	<b>Replacement Cash Balance at 12/31/12</b>
Appliances	8-16	\$ 62,160	\$ 9,581	\$ (30,142)	\$ 48,168
Bedrooms	4-20	406,100	62,592	(16,303)	314,685
Buildings	4-16	219,400	33,816	(35,990)	170,012
Cabinets	6-11	129,500	19,960	-	100,349
Carpets	1-7	258,600	39,858	-	200,388
Case goods	2	10,540	1,625	-	8,167
Electronics	4-11	125,200	19,297	(14,564)	97,017
Furniture	1-11	361,080	55,653	(90,727)	279,799
Miscellaneous	2-16	127,120	19,593	(6,460)	98,505
Plumbing	6-21	251,200	38,717	(2,051)	194,654
Soft goods	1-5	125,050	19,274	-	96,901
Cash deficit		-	-	-	(1,072,269)
<b>Totals</b>		<b>\$ 2,075,950</b>	<b>\$ 319,966</b>	<b>\$ (196,237)</b>	<b>\$ 536,376</b>

See auditors' report.