

Financial Statements

**Kahana Falls Association
of Apartment Owners**

**For the Year Ended
December 31, 2013**

Kahana Falls Association of Apartment Owners

Contents

December 31, 2013

(Summarized Totals for 2012)

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Report of Independent Auditor

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

We have audited the accompanying financial statements of Kahana Falls Association of Apartment Owners, which comprise the balance sheet as of December 31, 2013, and the related statements of income, expenses, fund balances, cash flows and other operating income and expenses for the year then ended, and the related notes to the financial statements. The prior year summarized comparative information has been derived from the Association's 2012 financial statements and, in our report dated March 11, 2013 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 Association
Of Apartment Owners
February 19, 2014
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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 Association of Apartment Owners as of December 31, 2013, 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
February 19, 2014

Kahana Falls Association of Apartment Owners

Balance Sheet December 31, 2013 (Summarized Totals for 2012)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2013 Total</u>	<u>2012 Total</u>
Assets				
Cash, including interest-bearing deposits (Note 4)	\$ 1,046,735	\$ 494,316	\$ 1,541,051	\$ 1,351,088
Assessments receivable, net (Note 5)	-	-	-	-
Interest receivable	-	-	-	255
Due from Kahana Falls IOA	14,906	-	14,906	135,877
Prepaid expenses (Note 6)	14,655	-	14,655	25,582
Total assets	<u>\$ 1,076,296</u>	<u>\$ 494,316</u>	<u>\$ 1,570,612</u>	<u>\$ 1,512,802</u>
Liabilities and Fund Balances				
Accounts payable	\$ 39,953	\$ -	\$ 39,953	\$ 52,586
Accrued expenses (Note 7)	36,371	-	36,371	34,760
Income taxes payable	1,061	-	1,061	796
Due to Kahana Falls IOA	532	-	532	7,373
Prepaid assessments	947,085	-	947,085	885,699
Total liabilities	<u>1,025,002</u>	<u>-</u>	<u>1,025,002</u>	<u>981,214</u>
Fund balances	<u>51,294</u>	<u>494,316</u>	<u>545,610</u>	<u>531,588</u>
Total liabilities and fund balances	<u>\$ 1,076,296</u>	<u>\$ 494,316</u>	<u>\$ 1,570,612</u>	<u>\$ 1,512,802</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, 2013 (Summarized Totals for 2012)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2013 Total</u>	<u>2012 Total</u>
Revenue				
Member assessments	\$ 1,357,094	\$ 194,180	\$ 1,551,274	\$ 1,572,408
Rental income	31,473	-	31,473	39,373
Interest income	569	852	1,421	2,267
Other income (Schedule)	13,192	-	13,192	12,297
Total revenue	<u>1,402,328</u>	<u>195,032</u>	<u>1,597,360</u>	<u>1,626,345</u>
Expenses				
Payroll and related	386,103	-	386,103	377,203
Bad debt expense	200,080	-	200,080	180,714
Income tax expense	3,061	-	3,061	1,996
Facilities				
Maintenance	51,871	-	51,871	51,167
Utilities	226,374	-	226,374	216,762
General and administrative				
Services (Schedule)	141,195	-	141,195	143,211
Supplies	5,430	-	5,430	7,152
Landscape maintenance	70,837	-	70,837	72,224
Property taxes	259,358	-	259,358	250,552
Repairs and replacements	-	239,029	239,029	137,281
Total expenses	<u>1,344,309</u>	<u>239,029</u>	<u>1,583,338</u>	<u>1,438,262</u>
Excess revenue (expenses)	58,019	(43,997)	14,022	188,083
Fund balances (deficit), beginning	(7,832)	539,420	531,588	343,505
Fund transfers	<u>1,107</u>	<u>(1,107)</u>	<u>-</u>	<u>-</u>
Fund balances, ending	<u>\$ 51,294</u>	<u>\$ 494,316</u>	<u>\$ 545,610</u>	<u>\$ 531,588</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, 2013 (Summarized Totals for 2012)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2013 Total</u>	<u>2012 Total</u>
Cash Flows From				
Operating Activities				
Excess revenue (expenses)	\$ 58,019	\$ (43,997)	\$ 14,022	\$ 188,083
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:				
Changes in:				
Assessments receivable	-	-	-	9,301
Interest receivable	-	255	255	1,011
Due from Kahana Falls IOA	120,971	-	120,971	(65,180)
Prepaid expenses	10,927	-	10,927	8,631
Accounts payable	(12,633)	-	(12,633)	(36,453)
Accrued expenses	1,611	-	1,611	12,861
Income taxes payable	265	-	265	(386)
Due to Kahana Falls IOA	(6,841)	-	(6,841)	(6,646)
Prepaid assessments	61,386	-	61,386	54,514
	<u>233,705</u>	<u>(43,742)</u>	<u>189,963</u>	<u>165,736</u>
Net cash provided (used) by operating activities				
Cash Flows From				
Financing Activities				
Fund transfers	<u>1,107</u>	<u>(1,107)</u>	<u>-</u>	<u>-</u>
Net cash provided (used) by financing activities	<u>1,107</u>	<u>(1,107)</u>	<u>-</u>	<u>-</u>
Net increase (decrease) in cash	234,812	(44,849)	189,963	165,736
Cash, beginning of year	<u>811,923</u>	<u>539,165</u>	<u>1,351,088</u>	<u>1,185,352</u>
Cash, end of year	<u>\$ 1,046,735</u>	<u>\$ 494,316</u>	<u>\$ 1,541,051</u>	<u>\$ 1,351,088</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, 2013 (Summarized Totals for 2012)

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	<u>2013</u> <u>Total</u>	<u>2012</u> <u>Total</u>
Other Income		
Late fees	\$ 900	\$ 7,927
Other	12,292	4,370
Total other income	<u>\$ 13,192</u>	<u>\$ 12,297</u>
General and Administrative Services		
Audit, tax and accounting fees	\$ 36,004	\$ 35,169
Insurance	37,276	42,073
Legal fees	384	246
Management fees	8,880	8,886
Other general and administrative	49,332	45,180
Postage and freight	3,598	1,700
Printing	3,178	4,353
Taxes and licenses	2,543	5,604
Total general and administrative services	<u>\$ 141,195</u>	<u>\$ 143,211</u>

The accompanying notes are an integral part of these financial statements

Kahana Falls Association of Apartment Owners

Notes to Financial Statements December 31, 2013 (Summarized Totals for 2012)

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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 2 commercial units. The property is located in Kahana, Hawaii on the island of Maui.

2. Significant Accounting Policies

The financial statements include certain 2012 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, 2012 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 bank and brokerage accounts. 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 monthly 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 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 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, 2013 (Summarized Totals for 2012)

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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 information on assessments receivable.

The Association conforms to industry practice in recognizing real property and common areas as assets. Based on this practice, the Association would only capitalize property to which it has title and to which the board of directors has discretion to dispose of and retain the proceeds for the Association's use. Since the real property and common areas are owned in common by the individual unit owners and not by the Association, they are not capitalized and presented in the financial statements of the Association. The acquisition costs and improvements to such properties are charged directly to current period replacements.

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

Homeowner associations may elect to be taxed as regular corporations or as homeowner associations. The Association elected to be taxed as a homeowners' association in accordance with Internal Revenue Code Section 528 for the years ending December 31, 2013 and 2012. 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 30% on its nonexempt function income 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 2010 through 2012. For the years ended December 31, 2013 and 2012, the Association paid no income tax interest or penalties.

The Association has federal and state net operating losses of approximately \$87,218 and \$71,691 respectively, which expire between 2015 and 2026. Federal net operating losses can only be used if the Association files in accordance with the IRS Code 277.

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Notes to Financial Statements December 31, 2013 (Summarized Totals for 2012)

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4. Cash and Cash Equivalents

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

	<u>2013</u>	<u>2012</u>
Operating Fund		
US Bank, checking	\$481,346	\$212,709
American Security Bank, checking	137,395	26,629
Wells Fargo Advisors, money market account	61,592	934
Wells Fargo Advisors, certificates of deposit	200,000	400,000
Bank of Hawaii, checking	163,712	167,768
Managers checking account	<u>2,690</u>	<u>3,883</u>
Total Operating Fund Cash	<u>\$1,046,735</u>	<u>\$811,923</u>
Replacement Fund		
Wells Fargo Advisors, money market account	\$194,668	\$134,243
Wells Fargo Advisors, certificates of deposit	200,000	150,000
American Security Bank, money market account	<u>99,648</u>	<u>254,922</u>
Total Replacement Fund Cash	<u>\$494,316</u>	<u>\$539,165</u>

5. Assessments Receivable

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

	<u>2013</u>	<u>2012</u>
Regular assessments	\$814,493	\$654,663
Allowance for doubtful accounts	<u>(814,493)</u>	<u>(654,663)</u>
Accounts receivable, net	<u>\$-0-</u>	<u>\$-0-</u>

6. Prepaid Expenses

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

	<u>2013</u>	<u>2012</u>
Insurance	\$10,784	\$21,718
Other prepaid expenses	<u>3,870</u>	<u>3,864</u>
Total prepaid expenses	<u>\$14,655</u>	<u>\$25,582</u>

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Notes to Financial Statements December 31, 2013 (Summarized Totals for 2012)

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7. *Accrued Expenses*

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

	<u>2013</u>	<u>2012</u>
State Excise and TAT taxes	\$315	\$529
Payroll and vacation	32,377	30,552
Other	<u>3,679</u>	<u>3,679</u>
Total accrued expenses	<u>\$36,371</u>	<u>\$34,760</u>

8. *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.

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 \$194,180, based on a full funding plan, had been included in the 2013 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.

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Notes to Financial Statements December 31, 2013 (Summarized Totals for 2012)

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9. Related Party Transactions

The Association incurs certain shared costs with Kahana Falls Interval Owners Association (IOA), a related Association, which is responsible for the maintenance and operation of the owners' units. For the reporting period, December 31, 2013, the IOA reimbursed the Association \$226,853 and \$187,572 in 2012, in shared costs. At December 31, 2013 and 2012 the Association owed the IOA \$532 and \$7,373 respectively. At December 31, 2013 and 2012, \$-0- and \$135,877 was due to the Association from the IOA respectively for these shared costs.

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.

The Association's management company, Trading Places International, is owned by Interval Leisure Group, Inc. The Association hired Meridian Financial Services, also a subsidiary of Interval Leisure Group, to provide collection services. Outstanding balances were collected with service fees attached so the Association recovered the balances owed in full by the member. The amount collected in fees by Meridian during the years ended December 31, 2013 and 2012 is \$-0- and \$1,369 respectively. No amounts were owed to Meridian by the Association at the reporting dates.

10. Supplemental Cash Flow Disclosures

For the reporting periods, cash flows from operating activities include state and federal income tax payments of \$2,000 and \$1,200 for the years ended December 31, 2013 and 2012, respectively.

11. Commitments and Contingencies

The Association renewed its management agreement with Trading Places International (TPI) beginning May 1, 2011 and expiring on April 30, 2014. The contract automatically renews for successive additional three-year terms unless terminated earlier by majority of the Association board members within a ninety-day window before the expiration of the then current term. TPI will provide administrative, financial, and accounting services for the Association.

12. Reclassification

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.

13. Subsequent Events

Management has evaluated subsequent events through February 19, 2014, 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, 2013

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.

Component	Estimated Remaining Useful Life (Years)	Estimated January 2009 Replacement Cost	Estimated 2014 Funding Requirement	Reserve Expenditures For the Year Ended 12/31/13	Replacement Cash Balance at 12/31/13
AC Units	10	\$ 719,000	\$ 91,635	\$ (41,058)	\$ 386,792
ADA Compliance	0	15,000	1,912	(9,111)	8,069
Walkways	2	5,000	637	-	2,690
Carpet	1	7,500	956	-	4,035
Decks	0	6,000	765	-	3,228
Elevators	5	60,000	7,647	(26,516)	32,277
Painting	1-5	170,000	21,666	(6,553)	91,453
Fitness Center	10	24,500	3,122	-	13,180
Gates and fences	15	15,000	1,912	-	8,069
Landscape	5	10,000	1,274	-	5,380
Lobby	0-13	21,500	2,740	(8,702)	11,566
Lock system	8	49,500	6,309	-	26,629
Parking	10-19	91,000	11,598	(27,740)	48,954
Pool and spa	0-7	115,000	14,657	(6,432)	61,865
Roofs	13	120,000	15,294	(61,618)	64,555
Sprinkler	20	60,000	7,647	-	32,277
Telephone system	11	55,000	7,010	(51,300)	29,588
Windows	10-22	49,560	6,316	-	26,661
Water heater	10	5,000	637	-	2,690
Cash deficit	-	-	-	-	(365,642)
Totals		\$ 1,598,560	\$ 203,733	\$ (239,029)	\$ 494,316

See report of independent auditor.