

**Financial Statements**

**Kahana Falls Association  
of Apartment Owners**

**For the Year Ended  
December 31, 2014**

# Kahana Falls Association of Apartment Owners

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December 31, 2014

(Summarized Totals for 2013)

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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, 2014, 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 2013 financial statements and, in our report dated February 19, 2014 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  
March 9, 2015  
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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, 2014, 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 9, 2015

# Kahana Falls Association of Apartment Owners

## Balance Sheet December 31, 2014 (Summarized Totals for 2013)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2014 Total</u>	<u>2013 Total</u>
<b>Assets</b>				
Cash, including interest-bearing deposits (Note 4)	\$ 1,044,344	\$ 523,416	\$ 1,567,760	\$ 1,541,051
Assessments receivable, net (Note 5)	-	-	-	-
Due from Kahana Falls IOA	50,364	-	50,364	14,906
Prepaid expenses (Note 6)	10,406	-	10,406	14,655
Total assets	<u>\$ 1,105,114</u>	<u>\$ 523,416</u>	<u>\$ 1,628,530</u>	<u>\$ 1,570,612</u>
<b>Liabilities and Fund Balances</b>				
Accounts payable	\$ 38,222	\$ -	\$ 38,222	\$ 39,953
Accrued expenses (Note 7)	40,231	-	40,231	36,371
Income taxes payable	72	-	72	1,061
Due to Kahana Falls IOA	6,756	-	6,756	532
Prepaid assessments	990,336	-	990,336	947,085
Total liabilities	<u>1,075,617</u>	<u>-</u>	<u>1,075,617</u>	<u>1,025,002</u>
Fund balances	<u>29,497</u>	<u>523,416</u>	<u>552,913</u>	<u>545,610</u>
Total liabilities and fund balances	<u>\$ 1,105,114</u>	<u>\$ 523,416</u>	<u>\$ 1,628,530</u>	<u>\$ 1,570,612</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, 2014 (Summarized Totals for 2013)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2014 Total</u>	<u>2013 Total</u>
<b>Revenue</b>				
Member assessments	\$ 1,359,040	\$ 198,063	\$ 1,557,103	\$ 1,551,274
Commercial assessments	42,978	-	42,978	1,375
Rental income	31,976	-	31,976	31,473
Interest income	2,306	764	3,070	1,421
Other income (Schedule)	4,816	-	4,816	11,817
Total revenue	<u>1,441,116</u>	<u>198,827</u>	<u>1,639,943</u>	<u>1,597,360</u>
<b>Expenses</b>				
Payroll and related	381,375	-	381,375	386,103
Bad debt expense	223,870	-	223,870	200,080
Income tax expense	3,172	-	3,172	3,061
Facilities				
Maintenance	67,979	-	67,979	51,871
Utilities	233,678	-	233,678	226,374
General and administrative				
Services (Schedule)	145,820	-	145,820	141,195
Supplies	7,176	-	7,176	5,430
Landscape maintenance	74,235	-	74,235	70,837
Property taxes	326,372	-	326,372	259,358
Repairs and replacements	-	168,963	168,963	239,029
Total expenses	<u>1,463,677</u>	<u>168,963</u>	<u>1,632,640</u>	<u>1,583,338</u>
Excess revenue (expenses)	(22,561)	29,864	7,303	14,022
Fund balances, beginning of year	51,294	494,316	545,610	531,588
Fund transfers	<u>764</u>	<u>(764)</u>	<u>-</u>	<u>-</u>
Fund balances, end of year	<u>\$ 29,497</u>	<u>\$ 523,416</u>	<u>\$ 552,913</u>	<u>\$ 545,610</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, 2014 (Summarized Totals for 2013)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2014 Total</u>	<u>2013 Total</u>
<b>Cash Flows From</b>				
<b>Operating Activities</b>				
Excess revenue (expenses)	\$ (22,561)	\$ 29,864	\$ 7,303	\$ 14,022
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:				
Changes in:				
Interest receivable	-	-	-	255
Due from Kahana Falls IOA	(35,458)	-	(35,458)	120,971
Prepaid expenses	4,249	-	4,249	10,927
Accounts payable	(1,731)	-	(1,731)	(12,633)
Accrued expenses	3,860	-	3,860	1,611
Income taxes payable	(989)	-	(989)	265
Due to Kahana Falls IOA	6,224	-	6,224	(6,841)
Prepaid assessments	43,251	-	43,251	61,386
Net cash provided (used) by operating activities	<u>(3,155)</u>	<u>29,864</u>	<u>26,709</u>	<u>189,963</u>
<b>Cash Flows From</b>				
<b>Financing Activities</b>				
Fund transfers	<u>764</u>	<u>(764)</u>	<u>-</u>	<u>-</u>
Net cash provided (used) by financing activities	<u>764</u>	<u>(764)</u>	<u>-</u>	<u>-</u>
Net increase (decrease) in cash	(2,391)	29,100	26,709	189,963
Cash, beginning of year	<u>1,046,735</u>	<u>494,316</u>	<u>1,541,051</u>	<u>1,351,088</u>
Cash, end of year	<u>\$ 1,044,344</u>	<u>\$ 523,416</u>	<u>\$ 1,567,760</u>	<u>\$ 1,541,051</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, 2014 (Summarized Totals for 2013)

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	<u>2014</u> <u>Total</u>	<u>2013</u> <u>Total</u>
<b>Other Income</b>		
Late fees	\$ 400	\$ 900
Other	4,416	10,917
Total other income	<u>\$ 4,816</u>	<u>\$ 11,817</u>
<b>General and Administrative Services</b>		
Audit, tax and accounting fees	\$ 36,454	\$ 36,004
Insurance	35,413	37,276
Legal fees	-	384
Management fees	8,880	8,880
Other general and administrative	55,561	49,332
Postage and freight	1,305	3,598
Printing	4,983	3,178
Taxes and licenses	3,224	2,543
Total general and administrative services	<u>\$ 145,820</u>	<u>\$ 141,195</u>

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

# Kahana Falls Association of Apartment Owners

## Notes to Financial Statements December 31, 2014 (Summarized Totals for 2013)

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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**

#### *Comparative Information*

The financial statements include certain 2013 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, 2013 from which the summarized information was derived.

#### *Use of Estimates*

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.

#### *Fund Accounting*

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.

#### *Major Repairs and Replacements*

A portion of Association dues are paid for reserve expenses, generally major repairs and replacements. They deposit these funds in separate interest-bearing bank accounts. For a further discussion of reserves, see Note 8.

# Kahana Falls Association of Apartment Owners

## Notes to Financial Statements December 31, 2014 (Summarized Totals for 2013)

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### **2. Significant Accounting Policies** (concluded)

#### *Cash and Cash Equivalents*

For financial statement purposes, the Association considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

#### *Member Assessments*

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. 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.

#### *Property and Equipment*

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*

Prepaid assessments include amounts received in advance from owners. The Association bills the monthly assessments in advance and some members pay the amount due in advance. These amounts are deferred at year-end, and then recognized into income when they are earned during the next assessment period.

# Kahana Falls Association of Apartment Owners

## Notes to Financial Statements December 31, 2014 (Summarized Totals for 2013)

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### 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, 2014 and 2013. 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 2011 through 2014. For the years ended December 31, 2014 and 2013, the Association paid no income tax interest or penalties.

The Association has federal and state net operating losses of approximately \$87,218 and \$61,017 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.

### 4. Cash and Cash Equivalents

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

	<u>2014</u>	<u>2013</u>
Operating Fund		
US Bank, checking	\$384,447	\$481,346
Citizens Business Bank, checking	225,024	137,395
Wells Fargo Advisors, money market account	31,902	61,592
Wells Fargo Advisors, certificates of deposit	300,000	200,000
Bank of Hawaii, checking	100,063	163,712
Managers checking account	<u>2,908</u>	<u>2,690</u>
Total Operating Fund Cash	<u>\$1,044,344</u>	<u>\$1,046,735</u>
Replacement Fund		
Wells Fargo Advisors, money market account	\$317,082	\$194,668
Wells Fargo Advisors, certificates of deposit	200,000	200,000
Citizens Business Bank, money market account	<u>6,334</u>	<u>99,648</u>
Total Replacement Fund Cash	<u>\$523,416</u>	<u>\$494,316</u>

# Kahana Falls Association of Apartment Owners

## Notes to Financial Statements December 31, 2014 (Summarized Totals for 2013)

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### 5. Assessments Receivable

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

	<u>2014</u>	<u>2013</u>
Regular assessments	\$932,787	\$814,493
Allowance for doubtful accounts	<u>(932,787)</u>	<u>(814,493)</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>2014</u>	<u>2013</u>
Insurance	\$6,416	\$10,784
Other prepaid expenses	<u>3,990</u>	<u>3,871</u>
Total prepaid expenses	<u>\$10,406</u>	<u>\$14,655</u>

### 7. Accrued Expenses

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

	<u>2014</u>	<u>2013</u>
State Excise and TAT taxes	\$417	\$315
Payroll and vacation	36,135	32,377
Other	<u>3,679</u>	<u>3,679</u>
Total accrued expenses	<u>\$40,231</u>	<u>\$36,371</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.

# Kahana Falls Association of Apartment Owners

## Notes to Financial Statements December 31, 2014 (Summarized Totals for 2013)

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

Association Reserves, Inc. conducted a study in March 2015 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 3 percent and interest of 0.5 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 \$193,063, based on 97 percent of the full funding plan, was included in the 2014 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.

### **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 periods the related party transactions are as follows:

	<u>2014</u>	<u>2013</u>
Reimbursed to the Association from IOA	<u>\$53,138</u>	<u>\$226,853</u>
Due to IOA from the Association	<u>\$6,756</u>	<u>\$532</u>
Due to the Association from IOA	<u>\$50,365</u>	<u>\$14,906</u>

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.

# Kahana Falls Association of Apartment Owners

## Notes to Financial Statements December 31, 2014 (Summarized Totals for 2013)

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### **9. Related Party Transactions** (concluded)

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, 2014 and 2013 is \$5,961 and \$-0- 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 \$4,161 and \$2,000 for the years ended December 31, 2014 and 2013, respectively.

### **11. Commitments and Contingencies**

The Association renewed its management agreement with Trading Places International (TPI) beginning May 1, 2014 and expiring on April 30, 2017. 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 March 9, 2015, the date which the financial statements were available for issue. Management has determined there are no subsequent events that require recognition or disclosure in these financial statements.

## **Supplemental Information**

# Kahana Falls Association of Apartment Owners

## Supplemental Information on Future Major Repairs and Replacements (Unaudited) December 31, 2014

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Association Reserves, Inc. conducted a study in March 2015 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 3% and interest of 0.5%, 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 March 2015 Replacement Cost</b>	<b>Estimated 2015 Funding Requirement</b>	<b>Reserve Expenditures For the Year Ended 12/31/14</b>	<b>Replacement Cash Balance at 12/31/14</b>
General common area	0-26	\$ 750,700	\$ 59,081	\$ (23,783)	\$ 551,138
Clubhouse interiors	0-21	142,100	11,184	(45,878)	104,325
Building exteriors	0-16	1,458,400	114,779	(10,718)	1,070,706
Mechanical	0-14	1,035,000	81,456	(85,463)	759,861
Reserve study	0	-	-	(3,120)	-
Cash deficit	-	-	-	-	(1,962,614)
Totals		<u>\$ 3,386,200</u>	<u>\$ 266,500</u>	<u>\$ (168,962)</u>	<u>\$ 523,416</u>

See report of independent auditor.