

Financial Statements

**Kahana Falls Association
of Apartment Owners**

**For the Year Ended
December 31, 2017**

Kahana Falls Association of Apartment Owners

Contents December 31, 2017 (Summarized Totals for 2016)

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Independent Auditor's Report

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, 2017, and the related statements of revenue, expenses, and changes in fund balances, cash flows and other operating income and expenses for the year then ended, and the related notes to the 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.

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, 2017, 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.

Other Matters

The prior year summarized comparative information has been derived from the Association's 2016 financial statements and, in our report dated March 7, 2017, we expressed an unqualified opinion on those financial statements.

FITZGERALD & ASSOCIATES, INC. CPAs

Redlands, California
March 11, 2018

Kahana Falls Association of Apartment Owners

Balance Sheet December 31, 2017 (Summarized Totals for 2016)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2017 Total</u>	<u>2016 Total</u>
Assets				
Cash, including interest-bearing deposits (Note 4)	\$ 878,973	\$ 767,016	\$ 1,645,989	\$ 1,514,994
Assessments receivable, net (Note 5)	-	-	-	-
Due from Kahana Falls IOA	-	-	-	23,280
Interest receivable	-	577	577	206
Prepaid expenses (Note 6)	225,717	-	225,717	227,568
Total assets	<u>\$ 1,104,690</u>	<u>\$ 767,593</u>	<u>\$ 1,872,283</u>	<u>\$ 1,766,048</u>
Liabilities and Fund Balances				
Accounts payable	\$ 59,544	\$ -	\$ 59,544	\$ 68,045
Accrued expenses (Note 7)	27,681	-	27,681	33,554
Income taxes payable	-	-	-	886
Due to Kahana Falls IOA	10,830	-	10,830	21,281
Prepaid assessments	966,730	-	966,730	965,763
Total liabilities	<u>1,064,785</u>	<u>-</u>	<u>1,064,785</u>	<u>1,089,529</u>
Fund balances	<u>39,905</u>	<u>767,593</u>	<u>807,498</u>	<u>676,519</u>
Total liabilities and fund balances	<u>\$ 1,104,690</u>	<u>\$ 767,593</u>	<u>\$ 1,872,283</u>	<u>\$ 1,766,048</u>

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

Kahana Falls Association of Apartment Owners

Statement of Revenue, Expenses, and Changes in Fund Balances For the Year Ended December 31, 2017 (Summarized Totals for 2016)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2017 Total</u>	<u>2016 Total</u>
Revenue				
Member assessments net of discounts	\$ 1,470,478	\$ 263,214	\$ 1,733,692	\$ 1,599,156
Revenue from Kahana Falls IOA	-	-	-	150,000
Commercial assessments	2,802	-	2,802	24,665
Rental income	38,481	-	38,481	35,026
Interest income	2,374	3,636	6,010	6,121
Other income (Schedule)	5,575	-	5,575	6,048
Total revenue	<u>1,519,710</u>	<u>266,850</u>	<u>1,786,560</u>	<u>1,821,016</u>
Expenses				
Bad debt expense	275,381	-	275,381	236,863
Income tax expense	4,208	-	4,208	4,926
Facilities				
Maintenance	63,731	-	63,731	55,135
Utilities	225,775	-	225,775	201,843
General and administrative				
Services (Schedule)	131,687	-	131,687	131,755
Supplies	6,246	-	6,246	6,611
Landscape maintenance	80,623	-	80,623	73,944
Payroll and related	348,144	-	348,144	400,132
Property taxes	435,078	-	435,078	322,646
Repairs and replacements	-	84,708	84,708	541,888
Total expenses	<u>1,570,873</u>	<u>84,708</u>	<u>1,655,581</u>	<u>1,975,743</u>
Excess revenue (expenses)	(51,163)	182,142	130,979	(154,727)
Fund balances, beginning of year	92,244	584,275	676,519	831,246
Fund transfers	(1,176)	1,176	-	-
Fund balances, end of year	<u>\$ 39,905</u>	<u>\$ 767,593</u>	<u>\$ 807,498</u>	<u>\$ 676,519</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, 2017 (Summarized Totals for 2016)

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	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>2017 Total</u>	<u>2016 Total</u>
Cash Flows From Operating Activities				
Excess revenue (expenses)	\$ (51,163)	\$ 182,142	\$ 130,979	\$ (154,727)
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:				
Changes in:				
Due from Kahana Falls IOA	23,280	-	23,280	(3,365)
Interest receivable	-	(371)	(371)	(206)
Prepaid expenses	1,851	-	1,851	(213,629)
Accounts payable	(8,501)	-	(8,501)	23,487
Accrued expenses	(5,873)	-	(5,873)	3,060
Income taxes payable	(886)	-	(886)	72
Due to Kahana Falls IOA	(10,451)	-	(10,451)	18,476
Prepaid assessments	967	-	967	38,178
	<u>(50,776)</u>	<u>181,771</u>	<u>130,995</u>	<u>(288,654)</u>
Net cash provided (used) by operating activities				
Cash Flows From Financing Activities				
Fund transfers	(1,176)	1,176	-	-
	<u>(1,176)</u>	<u>1,176</u>	<u>-</u>	<u>-</u>
Net cash provided (used) by financing activities				
Net increase (decrease) in cash	(51,952)	182,947	130,995	(288,654)
Cash, beginning of year	930,925	584,069	1,514,994	1,803,648
Cash, end of year	<u>\$ 878,973</u>	<u>\$ 767,016</u>	<u>\$ 1,645,989</u>	<u>\$ 1,514,994</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, 2017 (Summarized Totals for 2016)

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	<u>2017</u> <u>Total</u>	<u>2016</u> <u>Total</u>
Other Income		
Late fees	\$ 330	\$ 525
Other	5,245	5,523
Total other income	<u>\$ 5,575</u>	<u>\$ 6,048</u>
General and Administrative Services		
Audit, tax and accounting fees	\$ 36,454	\$ 36,454
Bank and credit card fees	17,862	16,703
Insurance	34,276	30,132
Legal fees	108	166
Management fees	8,880	8,880
Other general and administrative	25,011	24,937
Postage and freight	6,974	8,142
Printing	-	4,471
Taxes and licenses	2,122	1,870
Total general and administrative services	<u>\$ 131,687</u>	<u>\$ 131,755</u>

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

Kahana Falls Association of Apartment Owners

Notes to Financial Statements December 31, 2017 (Summarized Totals for 2016)

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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 2016 comparative information. With respect to the balance sheet, the statement of revenue, expenses, and changes in 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, 2016 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, 2017 (Summarized Totals for 2016)

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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 annual 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. 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. Interest and related charges are recorded as income when billed to the owner. 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 against 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 annual 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.

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Notes to Financial Statements December 31, 2017 (Summarized Totals for 2016)

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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, 2017 and 2016. 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 for federal purposes at the rate of 30% and taxed for state purposes at a rate of 4.4% on its nonexempt function income such as interest.

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 2014 through 2017.

The Association has federal and state net operating losses of approximately \$46,543 and \$16,988 respectively, which expire between 2018 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>2017</u>	<u>2016</u>
Operating Fund		
US Bank, checking	\$610,359	\$614,610
Citizens Business Bank, checking	42,823	125,845
Wells Fargo Advisors, money market account	51,721	72,907
Bank of Hawaii, checking	169,551	114,152
Managers checking account	<u>4,519</u>	<u>3,411</u>
Total Operating Fund Cash	<u>\$878,973</u>	<u>\$930,925</u>
Replacement Fund		
Wells Fargo Advisors, money market account	\$57,178	\$200,858
Wells Fargo Advisors, certificates of deposit	500,000	300,000
Citizens Business Bank, money market account	<u>209,838</u>	<u>83,211</u>
Total Replacement Fund Cash	<u>\$767,016</u>	<u>\$584,069</u>
Total Cash	<u>\$1,645,989</u>	<u>\$1,514,994</u>

Kahana Falls Association of Apartment Owners

Notes to Financial Statements December 31, 2017 (Summarized Totals for 2016)

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5. Assessments Receivable

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

	<u>2017</u>	<u>2016</u>
Regular assessments	\$1,165,949	\$1,199,229
Allowance for doubtful accounts	<u>(1,165,949)</u>	<u>(1,199,229)</u>
Assessments receivable, net	<u>\$-0-</u>	<u>\$-0-</u>

6. Prepaid Expenses

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

	<u>2017</u>	<u>2016</u>
Income tax	\$792	\$-0-
Insurance	10,592	10,395
Property tax	213,382	216,288
Other prepaid expenses	<u>951</u>	<u>885</u>
Total prepaid expenses	<u>\$225,717</u>	<u>\$227,568</u>

7. Accrued Expenses

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

	<u>2017</u>	<u>2016</u>
State Excise tax	\$423	\$448
Payroll and related	23,579	27,776
Other	<u>3,679</u>	<u>5,330</u>
Total accrued expenses	<u>\$27,681</u>	<u>\$33,554</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, 2017 (Summarized Totals for 2016)

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8. Future Major Repairs and Replacements (concluded)

Association Reserves, Inc. conducted a study in September 2017 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 2.5 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.

In 2017, the board of directors decided to fund 100 percent of the amount recommended by the study. Accordingly, \$263,214 was included in the 2017 budget. Because actual expenditures may vary from estimated future expenditures and the variations may be material, amounts accumulated in the replacement 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>2017</u>	<u>2016</u>
Reimbursed to the Association from IOA	\$ <u>152,145</u>	\$ <u>87,349</u>
Due to IOA from the Association	\$ <u>10,830</u>	\$ <u>21,281</u>
Due to the Association from IOA	\$ <u>-0-</u>	\$ <u>23,280</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.

10. Supplemental Cash Flow Disclosures

For the reporting periods, cash flows from operating activities include state and federal income tax payments of \$5,000 and \$4,854 for the years ended December 31, 2017 and 2016, respectively.

Kahana Falls Association of Apartment Owners

Notes to Financial Statements December 31, 2017 (Summarized Totals for 2016)

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11. Commitments and Contingencies

The Association entered into a management agreement with Trading Places International (TPI) beginning May 1, 2017 and expiring on April 30, 2018. The contract automatically renews for successive additional one-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. Subsequent Events

Management has evaluated subsequent events through March 1, 2018, the date that 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, 2017

Association Reserves, Inc. conducted a study in September 2017 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 2.5% 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.

Component	Estimated Remaining Useful Life (Years)	Estimated March 2015 Replacement Cost	Estimated 2018 Funding Requirement	Reserve Expenditures For the Year Ended 12/31/17	Replacement Fund Balance at 12/31/17
General common area	0-23	\$ 750,700	\$ 60,395	\$ (18,151)	\$ 407,397
Clubhouse interiors	0-18	142,100	11,432	(24,471)	77,116
Building exteriors	0-13	1,458,400	117,331	(28,495)	791,458
Mechanical	0-11	1,035,000	83,268	(13,591)	561,684
Fund deficit	-	-	-	-	(1,070,062)
Totals		<u>\$ 3,386,200</u>	<u>\$ 272,426</u>	<u>\$ (84,708)</u>	<u>\$ 767,593</u>

See report of independent auditor.