

Financial Statements

**Hanalei Bay Resort
Vacation Owners Association**

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

Hanalei Bay Resort Vacation Owners Association

Contents

December 31, 2014

(Summarized Totals for 2013)

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Report of Independent Auditor

Board of Directors
Hanalei Bay Resort Vacation
Owners Association
Kauai, Hawaii

We have audited the accompanying financial statements of Hanalei Bay Resort Vacation

Owners Association, 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 April 17, 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Hanalei Bay Resort Vacation Owners Association 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 on Future Major Repairs and Replacements, 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
April 22, 2015

Hanalei Bay Resort Vacation Owners Association

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>
Assets				
Cash, including interest-bearing deposits	\$ 1,717,040	\$ 964,655	\$ 2,681,695	\$ 2,430,396
Interest receivable	-	-	-	684
Accounts receivable, net	68,414	-	68,414	21,408
Due from Hanalei Bay AOA	-	-	-	118,333
Prepaid expenses	15,507	-	15,507	3,415
Interfund balances	231,819	(231,819)	-	-
Intangible asset, developer rights	675,000	-	675,000	675,000
Total assets	<u>\$ 2,707,780</u>	<u>\$ 732,836</u>	<u>\$ 3,440,616</u>	<u>\$ 3,249,236</u>
Liabilities and Fund Balances				
Accounts payable	\$ 111,175	\$ -	\$ 111,175	497,154
Accrued expenses	20,049	848	20,897	45,226
Deposits	94,302	-	94,302	56,266
Due to Hanalei Bay AOA	202,769	-	202,769	-
General excise tax settlement payable	-	-	-	75,664
Deferred special assessments	-	-	-	666,469
Prepaid assessments	1,799,347	-	1,799,347	806,153
Total liabilities	<u>2,227,642</u>	<u>848</u>	<u>2,228,490</u>	<u>2,146,932</u>
Fund balances	<u>480,138</u>	<u>731,988</u>	<u>1,212,126</u>	<u>1,102,304</u>
Total liabilities and fund balances	<u>\$ 2,707,780</u>	<u>\$ 732,836</u>	<u>\$ 3,440,616</u>	<u>\$ 3,249,236</u>

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

Hanalei Bay Resort Vacation Owners Association

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>
Revenue				
Regular assessments	\$ 3,916,529	\$ 451,945	\$ 4,368,474	\$ 4,427,784
Special assessment	-	3,423,869	3,423,869	3,513,088
Interval sales, net	4,586	-	4,586	4,874
Interest income	1,989	406	2,395	1,549
Other income (Schedule)	966,268	-	966,268	825,887
Total revenue	<u>4,889,372</u>	<u>3,876,220</u>	<u>8,765,592</u>	<u>8,773,182</u>
Expenses				
Bad debt expense	133,383	97,452	230,835	809,899
Front desk	55,152	-	55,152	79,510
General and administrative (Schedule)	1,010,990	-	1,010,990	1,023,477
Housekeeping	957,440	-	957,440	819,236
Income tax expense	5,046	-	5,046	11,841
Insurance	6,081	-	6,081	6,047
Maintenance	269,122	-	269,122	260,679
Master association dues	1,554,036	-	1,554,036	1,480,033
Management fees	324,996	-	324,996	324,996
Property taxes	178,809	-	178,809	140,663
Repairs and replacements	-	-	-	-
Renovation expense	-	3,897,366	3,897,366	3,199,825
Reservation services	94,008	-	94,008	75,034
Utilities	71,889	-	71,889	64,427
Total expenses	<u>4,660,952</u>	<u>3,994,818</u>	<u>8,655,770</u>	<u>8,295,667</u>
Excess revenue (expenses)	228,420	(118,598)	109,822	477,515
Fund balances, beginning	567,543	534,761	1,102,304	624,789
Fund transfers	(315,825)	315,825	-	-
Fund balances, ending	<u>\$ 480,138</u>	<u>\$ 731,988</u>	<u>\$ 1,212,126</u>	<u>\$ 1,102,304</u>

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

Hanalei Bay Resort Vacation Owners Association

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>
Cash Flows From Operating Activities				
Excess revenue (expenses)	\$ 228,420	\$ (118,598)	\$ 109,822	\$ 477,515
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:				
Changes in:				
Interest receivable	227	457	684	1,485
Accounts receivable	(47,006)	-	(47,006)	81,804
Due from Hanalei Bay AOA	118,333	-	118,333	(118,333)
Prepaid expenses	(12,092)	-	(12,092)	(2,308)
Accounts payable	15,804	(401,783)	(385,979)	472,870
Accrued expenses	(477)	(23,852)	(24,329)	(1,863)
Deposits	38,036	-	38,036	(1,646)
Due to Hanalei Bay AOA	202,769	-	202,769	(18,535)
General excise tax payable	(75,664)	-	(75,664)	(259,370)
Income tax payable	-	-	-	(4,596)
Deferred special assessments	-	(666,469)	(666,469)	(1,217,188)
Prepaid assessments	993,194	-	993,194	339,794
Net cash provided (used) by operating activities	<u>1,461,544</u>	<u>(1,210,245)</u>	<u>251,299</u>	<u>(250,371)</u>
Cash Flows From Financing Activities				
Fund transfers	(319,549)	319,549	-	-
Interfund balances	(392,200)	392,200	-	-
Net cash provided (used) by financing activities	<u>(711,749)</u>	<u>711,749</u>	<u>-</u>	<u>-</u>
Net increase (decrease) in cash	749,795	(498,496)	251,299	(250,371)
Cash, beginning of year	<u>967,245</u>	<u>1,463,151</u>	<u>2,430,396</u>	<u>2,680,767</u>
Cash, end of year	<u>\$ 1,717,040</u>	<u>\$ 964,655</u>	<u>\$ 2,681,695</u>	<u>\$ 2,430,396</u>

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

Hanalei Bay Resort Vacation Owners Association

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>
Other Income		
Bonus time	\$ 62,436	\$ 82,227
Front desk	277,102	203,099
Late fees	26,049	49,316
Rental income	438,934	474,652
ResorTime rental income	145,130	-
Other	16,617	16,593
Total other income	<u>\$ 966,268</u>	<u>\$ 825,887</u>
General and Administrative Services		
Audit, tax and accounting fees	\$ 84,500	\$ 80,290
Travel agent commissions	37,473	11,620
Computer services	32,240	21,691
Credit card fees	134,046	105,589
Foreclosure expense	1,652	64,625
Front desk reimbursement to AOA	192,417	170,135
General excise tax	176,325	190,330
Legal and collection expenses	7,976	43,815
Reservation and owner services fees	75,000	75,000
Printing and postage	30,170	45,646
Salaries, wages and related	170,071	149,787
Travel	32,798	36,558
Other general and administrative	36,322	28,391
Total general and administrative services	<u>\$ 1,010,990</u>	<u>\$ 1,023,477</u>

The accompanying notes are an integral part of these financial statements

Hanalei Bay Resort Vacation Owners Association

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

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1. Organization and Other Matters

Hanalei Bay Resort Vacation Owners Association (the Association) is a nonprofit mutual benefit corporation organized in Hawaii in 1995 and is governed by a member-elected Board of Directors. The Association consists of 3,927 weekly interval units and is responsible for the interiors of the Association units at the Hanalei Bay Resort. The property is located in Princeville, Hawaii on the island of Kauai.

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 7.

Hanalei Bay Resort Vacation Owners Association

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

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2. Significant Accounting Policies (continued)

Cash and Cash Equivalents

The Association considers all temporary cash investments with 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. Assessments receivable at the reporting date represent amounts due from members. 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. After one year of collection efforts on delinquent accounts, the Association directly writes-off the uncollected balance through the allowance for doubtful accounts and no longer bills the delinquent owner. Any excess assessments at year-end are retained by the Association for use in the succeeding year. See Note 4 for additional details on assessments receivable amounts.

Property and Equipment

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 the Association has title and to which the board of directors has discretion to dispose of the property and retain the proceeds for the Association use. Other real property and common areas are owned by the members in common and not by the Association and therefore are not capitalized as assets. Repairs, replacements, and improvements of common property are expensed as incurred.

Impairment of Long-lived Assets

The Association capitalized the cost of the purchase of developer rights, an intangible asset, from the previous developer. The developer rights give the Association the right, among other things, to collect rental income on unused weeks. The Association reviews its intangible assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. When recovery is reviewed, if the undiscounted cash flows estimated to be generated by the assets are less than its carrying amount, management compares the carrying amount of the property to its fair value to determine whether an impairment loss has occurred. The amount of the impairment loss is equal to the excess of the asset's carrying value over its estimated fair value. No impairment loss has been recognized during the year ended December 31, 2014 and 2013.

Hanalei Bay Resort Vacation Owners Association

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

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2. Significant Accounting Policies (concluded)

Prepaid Assessments

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 ended 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 32% 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.

4. Accounts Receivable

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

	<u>2014</u>	<u>2013</u>
Regular assessments	\$-0-	\$1,828,357
Special assessments	-0-	895,627
Other accounts receivable	68,414	21,408
Allowance for doubtful accounts	<u>(-0-)</u>	<u>(2,723,984)</u>
Accounts receivable, net	<u>\$68,414</u>	<u>\$21,408</u>

5. Prepaid Expenses

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

	<u>2014</u>	<u>2013</u>
Insurance	\$1,141	\$1,141
Income taxes	7,439	2,274
Software License fees	<u>6,927</u>	<u>-0-</u>
Total prepaid expenses	<u>\$15,507</u>	<u>\$3,415</u>

Hanalei Bay Resort Vacation Owners Association

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

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6. *Accrued Expenses*

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

	<u>2014</u>	<u>2013</u>
State Excise and TAT taxes payable	\$12,746	\$17,291
Payroll and related	8,150	-0-
Due to Grand Pacific Resort Services	-0-	3,235
Reserve expenditures	-0-	<u>24,700</u>
Total accrued expenses	<u>\$20,896</u>	<u>\$45,226</u>

7. *Future Major Repairs and Replacements*

The Association's governing documents require that funds be accumulated for future major repairs and replacements. These funds, which amount to \$964,655, are held in separate bank and brokerage accounts and are generally not available for operating purposes. The Association's policy is to allocate interest earned on such funds to the replacement fund.

Advanced Reserves, Inc. conducted a study in September 2014 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 1 percent, net of taxes, on amounts funded for future major repairs and replacements. The table included in the compiled 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, \$451,945 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.

Hanalei Bay Resort Vacation Owners Association

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

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8. Special Assessment

In September 2012, the Board of Directors voted in favor of a three-year special assessment of \$600 per year per interval totaling \$2,340,348 annually and \$7,068,600 in total for the three-year period. The assessment will be used for a full renovation of units.

In December 2013, the Board of Directors voted in favor of an additional special assessment of \$800 per interval totaling \$2,735,200 to be paid in total in 2014. The assessment will be used to complete the full renovation of the units. For the years ended 2014 and 2013, the Association spent \$3,897,366 and \$3,199,825 for these renovations, respectively.

9. Interval Sales

The Association periodically acquires intervals by deed-backs, foreclosures, purchases and other methods. The Association resells these intervals and retains the proceeds after sales commissions and other related costs.

10. Related Party Transactions

Each interval owner of the Association is a member of the Association of Apartment Owners of Hanalei Bay Resort (the "Master Association"). As such, the weekly interval owners are assessed dues by the Master Association for the purpose of paying certain common expenses of the Association. The Association serves as the collection agent for the Master Association. The Master Association dues are recorded as income and expense in the accompanying financial statements. For the years ended December 31, 2014 and 2013, the Association billed the weekly interval owners \$1,554,036 and \$1,480,033, respectively, on behalf of the Master Association.

For the years ended December 31, 2014 and 2013, the Association reimbursed the Master Association \$3,753,519 and \$3,801,937 respectively for shared costs. At December 31, 2014 the Association owed the Master Association \$202,769 for shared costs and at December 31, 2013, the Master Association owed the Association \$118,333.

11. Supplemental Cash Flow Disclosures

Cash flows from operating activities include state and federal income tax payments of \$10,789 and \$13,794 for the years ended December 31, 2014 and 2013, respectively.

12. Commitments and Contingencies

Effective January 1, 2013, Grand Pacific Resort Services, L.P. was engaged to manage the Association for a two year term for a management fee of \$325,000 per year payable in equal monthly installments of \$27,083. This agreement may be renewed for a succeeding two year term by the written agreement of the parties. Either party may terminate this agreement for cause if such cause is not cured within thirty days after receipt of written notice from the non-defaulting party.

Hanalei Bay Resort Vacation Owners Association

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

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12. Commitments and Contingencies (concluded)

The Hawaii State Department of Taxation (DOT) conducted an audit of Hanalei Bay Resort VOA for the years 2000 through 2008 and concluded that the Association owed \$400,200 in General Excise Tax (GET) due to the method that the assessments were billed and collected. The DOT accepted a payment plan of monthly payments of \$5,000 over 5 years at an interest rate of 8% with a one-time down payment of \$100,000 due in February 2010. The Association paid the balance due on the agreement in full in December 2014.

13. 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.

14. Subsequent Events

Management has evaluated subsequent events through April 22, 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

**Hanalei Bay Resort
Vacation Owners Association**

**Supplemental Information on Future Major
Repairs and Replacements
December 31, 2014**

Association Reserves, Inc., conducted a study in September of 2014 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 1%, net of taxes, on amounts funded for future major repairs and replacements.

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

<i>Component</i>	<i>Estimated Remaining Useful Life (Years)</i>	<i>Current Replacement Cost</i>	<i>Estimated 2015 Funding Requirement</i>	<i>Reserve Expenditures For the Year Ended 12/31/14</i>	<i>Replacement Fund Balance at 12/31/14</i>
General	2	\$ 48,000	\$ 3,799	\$ -	\$ 5,551
Unit interiors	0-29	9,200,000	728,201	(3,897,366)	1,063,999
Fund deficit		-	-	-	(104,895)
Totals		<u>\$ 9,248,000</u>	<u>\$ 732,000</u>	<u>\$ (3,897,366)</u>	<u>\$ 964,655</u>

See accountants' report.