

April 2020

Dear Marriott's Maui Ocean Club Owner,

The audited 2019 Financial Statements reports for Association of Apartment Owners of Maui Ocean Club and Maui Ocean Club Vacation Owners Association and the Owners Participation Rules for Board of Directors Meetings are enclosed for your review. These reports are provided to you as outlined in the Associations' governing documents and Hawaii State Statutes.

If you have any questions, please contact Elton Sambrano, Director of Finance, at 808-667-8230 or via email at elton.sambrano@vacationclub.com.

Sincerely,

John Draeger

Secretary -Treasurer

Association of Apartment Owners of Maui Ocean Club

Maui Ocean Club Vacation Owners Association

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**Association of Apartment
Owners of Maui Ocean Club**
Financial Statements
December 31, 2019



Association of Apartment Owners of Maui Ocean Club

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December 31, 2019

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Report of Independent Auditors

The Board of Directors of
Association of Apartment Owners of Maui Ocean Club

We have audited the accompanying financial statements of Association of Apartment Owners of Maui Ocean Club (the "Association"), which comprise the balance sheet as of December 31, 2019, and the related statements of revenues, expenses and changes in fund balance - operating fund, revenues, expenditures and changes in fund balance - reserve for replacement fund and cash flows 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.

Auditors' 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 our 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 Association'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 Association'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 Association of Apartment Owners of Maui Ocean Club at December 31, 2019, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Board of Directors of
Association of Apartment Owners of Maui Ocean Club

Disclaimer of Opinion on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the supplementary information on future major repairs and replacements on page 16 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Financial Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



MYERS, BRETT HOLTZ & COMPANY, PA

Fort Myers, Florida

April 1, 2020

Association of Apartment Owners of Maui Ocean Club
Balance Sheet
December 31, 2019

	<u>Operating Fund</u>	<u>Reserve for Replacement Fund</u>	<u>Total</u>
Assets			
Cash and cash equivalents	\$ 8,756,305	\$ 2,563,338	\$ 11,319,643
Investments	-	3,567,172	3,567,172
Maintenance fees receivable due from MRHC	677,219	125,817	803,036
Accrued interest receivable	-	35,435	35,435
Prepaid expenses and other assets	917,828	-	917,828
Fixed assets, net	64,131	-	64,131
Due to Operating Fund	-	(484,917)	(484,917)
Due from Reserve for Replacement Fund	484,917	-	484,917
Total assets	<u>\$ 10,900,400</u>	<u>\$ 5,806,845</u>	<u>\$ 16,707,245</u>
Liabilities and Fund Balances			
Liabilities			
Accrued expenses	\$ 580,924	\$ 81,285	\$ 662,209
Unearned maintenance fees	10,008,170	1,877,373	11,885,543
Income tax payable	13,429	36,905	50,334
General excise tax payable	6,809	601	7,410
Due to Marriott Vacations Worldwide Corporation	93,947	-	93,947
Due to Maui Ocean Club Vacation Owners			
Association	53,031	-	53,031
Contract liability	-	3,810,681	3,810,681
Total liabilities	<u>10,756,310</u>	<u>5,806,845</u>	<u>16,563,155</u>
Fund balances	144,090	-	144,090
Total liabilities and fund balances	<u>\$ 10,900,400</u>	<u>\$ 5,806,845</u>	<u>\$ 16,707,245</u>

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

Association of Apartment Owners of Maui Ocean Club
Statement of Revenues, Expenses and Changes in Fund Balance – Operating
Fund
Year Ended December 31, 2019

Revenues	
Maintenance fees, net	\$ 16,931,957
Operating finance charges	45,687
Acquisition revenue	122,719
Interest income	148,804
Total revenues	<u>17,249,167</u>
Expenses	
Accounting and administration	427,175
Association dues	295,876
Audit fees	11,100
Board of directors' expense	3,761
Credit card fees	285,996
Electricity	2,834,330
Gas	374,557
Housekeeping	1,286,143
Income tax	49,388
Insurance	1,729,959
Landscaping/grounds	1,764,029
Loss prevention	1,562,250
Maintenance	2,686,369
Recreation/activities	1,527,951
Management fee	1,861,009
Parking license expense	85,007
Pest control	100,715
Refuse collection	221,656
Water and sewer	1,090,546
Total expenses	<u>18,197,817</u>
Deficiency of revenues over expenses	(948,650)
Fund balance	
Beginning of year after adoption of ASC 606 (Note 10)	<u>1,092,740</u>
End of year	<u><u>\$ 144,090</u></u>

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

Association of Apartment Owners of Maui Ocean Club
Statement of Revenues, Expenditures and Changes in Fund Balance – Reserve
for Replacement Fund
Year Ended December 31, 2019

Revenues	
Reserve for replacement assessment, net	\$ 3,174,501
Late fee income	8,143
Bank interest income	101,522
Unrealized gain on fair value investments	76,875
Total revenues	<u>3,361,041</u>
Expenditures	
External building maintenance	25,914
Common area rehabilitation	2,174,482
Building painting	1,123,748
Income tax expense	36,897
Total expenditures	<u>3,361,041</u>
Excess of revenues over expenditures	-
Fund balance	
Beginning of year after adoption of ASC 606 (Note 10)	<u>-</u>
End of year	<u><u>\$ -</u></u>

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

Association of Apartment Owners of Maui Ocean Club
Statement of Cash Flows
For the Year Ended December 31, 2019

	Operating Fund	Reserve for Replacement Fund	Total
Cash flows from operating activities			
Deficiency of revenues over expenses/expenditures	\$ (948,650)	\$ -	\$ (948,650)
Adjustments to reconcile deficiency of revenues over expenses/expenditures to net cash provided by operating activities			
Depreciation expense	48,847	-	48,847
Loss on disposal of fixed assets	384	-	384
Unrealized gain on fair value investments	-	(76,875)	(76,875)
Changes in operating assets and liabilities			
Decrease in maintenance fees receivable	-	34,500	34,500
Decrease in maintenance fees receivable due from MRHC	149,139	41,414	190,553
Increase in accrued interest receivable	-	(18,559)	(18,559)
Increase in prepaid expenses and other assets	(216,957)	-	(216,957)
Decrease in due from Marriott Vacations Worldwide Corporation	11,364	-	11,364
Increase (decrease) in accrued expenses	235,752	(209,763)	25,989
Increase in unearned maintenance fees	1,091,596	54,378	1,145,974
Increase in income tax payable	5,290	32,296	37,586
Increase in general excise tax payable	737	560	1,297
Increase in due to Marriott Vacations Worldwide Corporation	93,947	-	93,947
Decrease in due to Maui Ocean Club Vacation Owners Association	(1,684)	-	(1,684)
Increase in contract liability	-	246,187	246,187
(Decrease) increase in due from/to Operating/Reserve for Replacement Funds	(388,051)	388,051	-
Net cash provided by operating activities	<u>81,714</u>	<u>492,189</u>	<u>573,903</u>
Cash flows from investing activities			
Purchases of investments	(2,695,000)	(3,002,952)	(5,697,952)
Proceeds from maturity of investments	<u>2,695,000</u>	<u>736,805</u>	<u>3,431,805</u>
Net cash provided by (used in) investing activities	<u>-</u>	<u>(2,266,147)</u>	<u>(2,266,147)</u>
Net increase (decrease) in cash and cash equivalents	81,714	(1,773,958)	(1,692,244)
Cash and cash equivalents			
Beginning of year	8,674,591	4,337,296	13,011,887
End of year	<u>\$ 8,756,305</u>	<u>\$ 2,563,338</u>	<u>\$ 11,319,643</u>
Supplemental disclosure information			
Cash paid during the year for income taxes	<u>\$ 44,098</u>	<u>\$ 4,601</u>	<u>\$ 48,699</u>

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

Association of Apartment Owners of Maui Ocean Club

Notes to Financial Statements

December 31, 2019

1. Summary of Significant Accounting Policies

The Association of Apartment Owners of Maui Ocean Club (the "Association") was incorporated on May 6, 1999 in the State of Hawaii, and commenced operations on December 20, 2000. The purpose of the Association is to administer and manage the condominium project created and established as Maui Ocean Club condominium project. The Association is managed under an agreement with Marriott Resorts Hospitality Corporation ("MRHC").

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 that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amount of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Operating Fund

The Association's fees and earnings from operations, which are restricted for the use and benefit of Association members, are recorded in the Operating Fund.

Reserve for Replacement Fund

The Association's governing documents require funds to be accumulated for future major repairs and replacements. Accumulated funds, which aggregate \$3,810,681, and are presented on the accompanying balance sheet as a contract liability as of December 31, 2019, are held in separate accounts and are generally not available for operating purposes. The Association's policy is to retain income earned on such funds in the reserve for replacement fund.

MRHC, on behalf of the Association's Board of Directors, engages a third-party vendor to conduct ongoing studies to estimate the remaining useful lives and the replacement costs of the components of common property. The table included in the Supplementary Information on Future Major Repairs and Replacements (Unaudited) is based on those studies.

The Association is funding for major repairs and replacements over the remaining estimated useful lives of the components based on the study's estimates of current replacement costs and considering amounts previously accumulated in the Reserve for Replacement Fund. Accordingly, a funding requirement of \$3,655,364 has been included in the 2020 budget.

Funds are being accumulated in the Reserve for Replacement Fund based on estimates of future needs for repairs and replacements of common property components. Actual expenditures may vary from the estimated future expenditures, and the variations may be material. Therefore, amounts accumulated in the Reserve for 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 the Board of Directors' approval, to increase regular assessments, pass special assessments, or delay major repairs and replacements until funds are available.

Association of Apartment Owners of Maui Ocean Club

Notes to Financial Statements

December 31, 2019

Cash and Cash Equivalents

The Association considers money in checking accounts, money market funds, and certificates of deposit with an original maturity of three months or less, at date of purchase, to be cash equivalents. The Association places its cash and cash equivalents with financial institutions in the United States of America. The Federal Deposit Insurance Corporation ("FDIC") provides for deposits at FDIC-insured institutions to be insured up to \$250,000.

Investments

Investments consist of certificates of deposit and equity-linked certificates of deposit.

The Association's certificates of deposit are carried at amortized cost, as the Association has both the intent and ability to hold them until maturity. Certain certificates of deposit are considered depository accounts and are insured by the FDIC.

The Association's equity-linked certificates of deposit are principal protected structured products. At maturity, the Association will receive their principal plus a "supplemental payment" or minimum interest, if any, that is based on the performance of an underlying index or market measure.

The Association's U.S. treasury securities are debt securities carried at amortized cost, as the Association has both the intent and ability to hold them until maturity. At maturity, the Association is guaranteed by the U.S. Department of the Treasury to receive the greater of the adjusted principal balance or the original principal.

The equity-linked certificates of deposit are adjusted to fair value at the end of each period, with unrealized gains or losses shown as a component of revenues (the "Fair Value Option"). Gains or losses on securities sold are based on the specific identification method. The Fair Value Option selected by the Association is considered to provide a more transparent presentation to users of the financial statements.

Fair Value Measurements

The Association measures certain assets at fair value in accordance with current accounting standards on fair value measurements. The standard defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) as opposed to the price that would be paid to acquire the asset or received to assume the liability (an entry price). A fair value measure should reflect the assumptions that market participants would use in pricing the asset or liability, including the assumptions about the risk inherent in a particular valuation technique, the effect of a restriction on the sale or use of an asset and the risk of nonperformance. A fair value hierarchy is utilized which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Three levels may be used to measure fair value:

- Level 1 – Quoted prices in active markets for identical assets or liabilities.
- Level 2 – Quoted prices for similar assets and liabilities in active markets or inputs that are observable.
- Level 3 – Inputs that are unobservable (for example, cash flow modeling inputs based on assumptions).

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

Association of Apartment Owners of Maui Ocean Club
Notes to Financial Statements
December 31, 2019

The following table summarizes the Association's investments recorded at fair value on a recurring basis at December 31, 2019:

	Fair Value Measurements Using			Total
	Level 1	Level 2	Level 3	
Equity-linked certificates of deposit	\$ -	\$ 566,025	\$ -	\$ 566,025

Fixed Assets

Fixed assets, net are stated at cost. Upon disposition or retirement, the cost and related accumulated depreciation are eliminated and any resulting gain or loss is reflected in operations. Maintenance and repairs are charged to expense when incurred; expenditures for renewals and betterments are capitalized. Depreciation is provided utilizing the straight-line method using estimated useful lives between 3 and 10 years.

Revenue Recognition

Association members are subject to annual assessments to provide funds for the Association's operating expenses and major repairs and replacements. Assessment revenue is recognized as the related performance obligations are satisfied at transaction amounts expected to be collected. The Association's performance obligations related to its operating assessments are satisfied over time on a daily pro-rata basis using the input method. The performance obligations related to the replacement fund assessments are satisfied when these funds are expended for their designated purpose. Any excess assessments at year-end are retained by the Association for use in the succeeding year.

The following is a reconciliation of net revenues as recorded in the accompanying financial statements to the amount of assessments approved by the Board of Directors on the annual budget:

	Operating Fund	Reserve for Replacement Fund
Net revenue recorded per the financial statements	\$ 16,931,957	\$ 3,174,501
Plus: amounts not deemed collectible	90,687	27,769
Plus: amounts reclassified to contract liability during the year	-	246,187
Annual assessments per the Board approved budget	<u>\$ 17,022,644</u>	<u>\$ 3,448,457</u>

Association of Apartment Owners of Maui Ocean Club

Notes to Financial Statements

December 31, 2019

Maintenance Fees Receivable

Maintenance fees receivable at the balance sheet date are stated at the amounts expected to be collected from outstanding assessments from members. The Association has a Foreclosed Inventory Purchase Agreement with Marriott Ownership Resorts, Inc. ("MORI") that automatically renews for any number of additional one (1) year terms, unless either party terminates the agreement with a 45 day written notice. The agreement provides that MORI shall purchase the Association's foreclosed inventory subject to the terms of the agreement, shown as acquisition revenue. Accounts receivable are generally considered delinquent when the payment is not received on or before the due date. At December 31, 2019, the Association had delinquent assessments of \$194,488. The Association treats uncollectible assessments as variable consideration. Methods, inputs, and assumptions used to evaluate whether an estimate of variable consideration is constrained include consideration of past experience and susceptibility to factors outside the Association's control. The balances of assessments receivable as of the beginning and end of the year are \$256,969 and \$194,488, respectively, which are allowed for 100%.

Unearned Maintenance Fees

Maintenance fees for all unit weeks are receivables as of the beginning of each timeshare year. Unearned maintenance fees represent prepayment of the next year's maintenance fees. The fees for the unit weeks prior to the Association's year-end are classified as revenues; the remainder is considered unearned maintenance fees.

Contract Liability

The Association recognizes revenue from members as the related performance obligations are satisfied. A contract liability is recorded when the Association has the right to receive payment in advance of the satisfaction of performance obligations related to the replacement fund assessments. The balance of contract liability as of the beginning and end of the year are \$3,564,494 and \$3,810,681, respectively.

Income Taxes

The Association accounts for income taxes in accordance with Accounting Standards Codification ("ASC") 740, *Income Taxes*. ASC 740 utilizes the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax impact attributable to differences between the financial statement carrying amounts and tax basis of existing assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply in the years in which the temporary differences are expected to be recovered.

Condominium associations may elect to be taxed as exempt homeowners associations pursuant to Internal Revenue Code Section 528 ("Section 528") if they meet certain income, expenditure, and organizational requirements. Section 528 allows electing condominium associations to be taxed at a 32% rate on their "homeowners association taxable income," which is the excess of the association's gross income, excluding "exempt function income," over related deductions. "Exempt function income" includes membership dues, fees and assessments (less related expenses) from owners of condominium rights to use, or condominium ownership interests in, real property.

The Association plans on making this election for 2019; accordingly, deferred taxes have not been provided for temporary differences related to exempt function income. Should the Association elect not to be taxed as an exempt homeowners association in the future, deferred tax assets and liabilities may be recognized for existing temporary differences at that time, with a corresponding impact on income tax expense.

Association of Apartment Owners of Maui Ocean Club
Notes to Financial Statements
December 31, 2019

The Association has evaluated the effects of the guidance provided by generally accepted accounting principles related to accounting for uncertainty in income taxes. The Association has determined that it had no uncertain income tax positions that could have a significant effect on the financial statements for the year ended December 31, 2019. The Association's federal income tax returns for 2016, 2017, and 2018 are subject to examination by the Internal Revenue Service, generally for a period of three years after the federal income tax returns were filed.

Cost Allocation Methodology

In the beginning of 2005, the complex was comprised of a hotel, Maui Ocean Club Vacation Owners Association (the "VOA") and the Association. During 2005, the complex underwent a process converting its hotel units to timeshare units. On April 22, 2005, the hotel ceased operating and the property was converted completely to timeshare operations. In 2006, the complex was comprised of the Timeshare Association, the Association, MRHC commercial units and Marriott Ownership Resorts, Inc. ("MORI") Marketing and Sales offices. All expenses are recorded by the Association or the Timeshare Association. At the end of each accounting period, the Association expenses are allocated based on different methodologies to the Timeshare Association, MRHC, and MORI.

Accounting Pronouncement

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2016-02 – *Leases* (Topic 842) ("ASU 2016-02") to increase transparency and comparability of information regarding an entity's leasing activities by providing additional information to users of financial statements. ASU 2016-02 amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. The new standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. This update is effective for annual periods beginning after December 15, 2020, based on a one-year deferral of the effective date approved in July 2019 by the FASB. The Association continues to evaluate the impact that adoption of this accounting standard update will have on its financial statements and disclosures. In addition, the Association will adopt ASU 2016-02 commencing in fiscal year 2021.

2. Investments

Investments are classified as follows at December 31, 2019:

	<u>Amortized Cost/Principal</u>	<u>Fair Market Value</u>
Equity-linked certificates of deposit	<u>\$ 500,000</u>	<u>\$ 566,025</u>
U.S. Treasury Securities (held to maturity)	<u>\$ 1,043,668</u>	<u>\$ 1,043,838</u>
Certificates of deposit (held-to-maturity)	<u>\$ 1,957,479</u>	<u>\$ 1,960,887</u>

* Investments on the Balance Sheet is the sum of the fair market value of the equity-linked certificate of deposit and the amortized cost of the U.S. Treasury Securities and certificates of deposit.

Association of Apartment Owners of Maui Ocean Club
Notes to Financial Statements
December 31, 2019

The contractual maturities of investments at December 31, 2019 are as follows:

	<u>Amortized Cost/Principal</u>	<u>Fair Market Value</u>
Due within one year	\$ 1,543,573	\$ 1,544,197
Due after one year through five years	1,957,574	2,026,553
	<u>\$ 3,501,147</u>	<u>\$ 3,570,750</u>

The equity-linked certificates of deposit had unrealized gains of \$76,875 for the year ended December 31, 2019, which are included in the Statement of Revenues, Expenditures and Changes in Fund Balance – Reserve for Replacement Fund.

3. Fixed Assets

Fixed assets, net at December 31, 2019:

Guest shuttles	\$ 21,812
Electric carts	21,403
Utility trucks	22,435
Store sweeper	42,709
Lawnmower	31,529
Patrol vehicle	10,937
Utility carts - grounds	31,038
Point of Sale	20,968
Vehicles	75,794
Accumulated depreciation	<u>(214,494)</u>
	<u>\$ 64,131</u>

Depreciation expense of \$48,847 was recorded in the Statement of Revenues, Expenses, and Changes in Fund Balance - Operating Fund for the year ended December 31, 2019.

4. Income Taxes

The expense for income taxes consisted of the following for the years ended December 31, 2019:

	<u>Total</u>	<u>Operating Fund</u>	<u>Reserve for Replacement Fund</u>
Federal	\$ 72,192	\$ 41,792	\$ 30,400
State	14,094	7,597	6,497
	<u>\$ 86,286</u>	<u>\$ 49,388</u>	<u>\$ 36,897</u>

The Association is taxed only on interest and investment income, net of related expenses, in the Statement of Revenues, Expenditures and Changes in Fund Balance - Reserve for Replacement Fund.

Association of Apartment Owners of Maui Ocean Club

Notes to Financial Statements

December 31, 2019

The difference between the provision for income taxes as presented, and the provision calculated by applying the statutory federal rate to the (deficiency) excess of revenues over expenses/expenditures, primarily relates to state income taxes and the exclusion of exempt function income.

5. Management Agreement

In February 2010, Marriott Hotel Services, Inc. assigned the entire management agreement to MRHC who, at that point, became responsible for the on and off-site management of the Association. For the year ended December 31, 2019, MRHC is responsible for the management, maintenance and operations of the facilities, in exchange for an annual fee of 10% of the annual budget of the Association, exclusive of the management fee. For the year ended December 31, 2019, the management fee was \$1,861,009, and is recorded in the Statement of Revenues, Expenses and Changes in Fund Balance - Operating Fund.

6. Related Party Transactions

Marriott Vacations Worldwide Corporation ("MVWC"), the indirect parent company of MRHC, pays all invoices on behalf of the Association, subject to reimbursement by the Association. The amount due to MVWC at December 31, 2019, was \$93,947.

The net amount due to Maui Ocean Club Vacation Owners Association at December 31, 2019, was \$53,031.

MRHC collects annual maintenance fees on behalf of the Association. The amount of maintenance fees receivable due from MRHC at December 31, 2019, was \$803,036.

7. Association Dues

The Association is a member of the Kaanapali Operators Association ("KOA") and the Kaanapali Beach Resort Association ("KBRA"). The fees paid to KOA are utilized for the maintenance of the community, security and lighting. The fees paid to KBRA are utilized for the promotion and enhancement of Kaanapali as a resort destination. For the year ended December 31, 2019, the Association incurred fees of \$295,876, which are included in the Statement of Revenues, Expenses and Changes in Fund Balance - Operating Fund.

8. Concentrations of Credit Risk

Financial instruments which potentially subject the Association to concentrations of credit risk consist principally of cash and cash equivalents and investments. The Association maintains its cash and cash equivalents and investments with what the Board of Directors believes to be high credit quality financial institutions. In addition, the Board of Directors maintains its investments in a portfolio that it believes limits the amount of market exposure.

In an effort to fulfill their fiduciary responsibility to protect and maintain assets for the Association, the Board of Directors for the Association has implemented a formal investment policy statement in reference to all cash, cash equivalents and investable funds for the reserve for replacement and operating funds. The investment policy statement stipulates that all funds shall be invested in federally insured or guaranteed vehicles with no risk to principal as long as these investments are held-to-maturity.

Association of Apartment Owners of Maui Ocean Club
Notes to Financial Statements
December 31, 2019

Since the Board of Directors has incorporated an analysis that identifies the use of these funds at specific times and the investments are structured with maturity dates to coincide with these anticipated expenditures, notwithstanding emergencies not under the control of the Board of Directors, the Association is able to and prepared to hold to these investments to their stated maturity dates.

9. Subsequent Events

The Association has performed an evaluation of subsequent events through April 1, 2020 which is the date the financial statements were available to be issued.

In December 2019, a novel strain of coronavirus surfaced and has spread around the world resulting in business and social disruption. The coronavirus was declared a Public Health Emergency of International Concern by the World Health Organization on January 30, 2020. The effect of the virus on the financial position or operations of the Association is unknown at this time.

10. New Accounting Guidance Implementation

The Financial Accounting Standards Board (FASB) issued new guidance that created Topic 606, *Revenue from Contracts with Customers*, in the Accounting Standards Codification (ASC). Topic 606 supersedes the revenue recognition requirements in FASB ASC 972-605, *Real Estate - Common Interest Realty Associations, Revenue Recognition*, and requires the recognition of revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which a CIRA expects to be entitled in exchange for those goods or services.

The Association adopted the requirements of new guidance as of January 1, 2019, using the modified retrospective method of transition, which requires that the cumulative effect of the changes related to the adoption be charged to beginning fund balance. The Association applied the new guidance using the practical expedient provided in Topic 606 that allows the guidance to be applied only to contracts that were not complete as of January 1, 2019. Adoption of the new guidance resulted in changes to the accounting policies for assessment revenue and contract liabilities related to the replacement fund, as previously described.

The adoption of the new guidance for both revenue recognition and financial instruments resulted in the following change to fund balance as of January 1, 2019:

	Operating Fund	Reserve for Replacement Fund
	<u> </u>	<u> </u>
Fund balance, as previously reported, at January 1, 2019	\$ 1,226,370	\$ 3,564,494
Adjustment for effects of Topic 606	(133,630)	(3,564,494)
Fund balance, as adjusted, at January 1, 2019	<u>\$ 1,092,740</u>	<u>\$ -</u>

The effect of the adoption on the operating fund is a decrease in 2019 assessments by \$90,687 for uncollectible assessments.

The effect of the adoption on the reserve for replacement fund is a decrease in 2019 assessments by \$273,956 and a recording of a contract liability as of December 31, 2019, of \$3,810,681. The Association has no customer contract modifications that had an effect on the Association's transition to the new guidance.

Association of Apartment Owners of Maui Ocean Club
Notes to Financial Statements
December 31, 2019

The modified retrospective method of transition requires the effect of applying the new guidance on each item included in the 2019 financial statements be disclosed.

Following are the line items from the balance sheet as of December 31, 2019, that were affected, the amounts that would have been reported under the former guidance, the effects of applying the new guidance, and the balances reported under the new guidance:

	Amounts That Would Have Been Reported	Effects of Applying Topic 606 Guidance	As Reported
<u>Liabilities</u>			
Contract liability	\$ -	\$ 3,810,681	\$ 3,810,681
<u>Fund balance</u>			
Ending fund balance	\$ 3,954,771	\$ (3,810,681)	\$ 144,090

The following are the line items from the statement of revenue, expenses/expenditures, and changes in fund balance and the statement of cash flows for the year ended December 31, 2019, that were affected, the amounts that would have been reported under the former guidance, the effects of applying the new guidance, and the amounts reported under the new guidance:

	Amounts That Would Have Been Reported	Effects of Applying Topic 606 Guidance	As Reported
Operating Fund			
<u>Revenue</u>			
Maintenance fees	\$ 17,022,644	\$ (90,687)	\$ 16,931,957
Acquisition revenue	\$ -	\$ 122,719	\$ 122,719
Deficiency of revenue over expenses	\$ (980,682)	\$ 32,032	\$ (948,650)
<u>Cash Flows</u>			
Deficiency of revenue over expenses	\$ (980,682)	\$ 32,032	\$ (948,650)
Reserve for Replacement Fund			
<u>Revenue</u>			
Maintenance fees	\$ 3,448,457	\$ (273,956)	\$ 3,174,501
Excess of revenue over expenses	246,187	\$ (246,187)	\$ -
<u>Cash Flows</u>			
Excess of revenue over expenses	\$ 246,187	\$ (246,187)	\$ -
Increase in contract liability	\$ -	\$ 246,187	\$ 246,187

Association of Apartment Owners of Maui Ocean Club
Supplementary Information on Future Major Repairs and Replacements
(Unaudited)
Year Ended December 31, 2019

On behalf of the Board of Directors, a reserve study was completed during 2019 to estimate the remaining useful lives and the replacement costs of the components of common property.

The following table is based on the study with subsequent review by the Board of Directors and presents significant information about the components of common property.

	Estimated Remaining Useful Lives (Years)	Estimated Current Replacement Costs	2020 Funding Requirement	Balance at December 31, 2019
Roof replacement	17	\$ 6,528,726	\$ 206,460	\$ 420,265
Building painting	3	2,795,120	272,544	2,114,960
External building maintenance	13	37,261,474	1,612,026	899,222
Pavement resurfacing	4	222,340	26,797	36,195
Common area rehabilitation	8	21,728,568	1,537,537	340,039
		<u>\$ 68,536,228</u>	<u>\$ 3,655,364</u>	<u>\$ 3,810,681</u>

Maui Ocean Club Vacation Owners Association

Financial Statements
December 31, 2019



Maui Ocean Club Vacation Owners Association

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December 31, 2019

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Report of Independent Auditors

The Board of Directors of
Maui Ocean Club Vacation Owners Association

We have audited the accompanying financial statements of Maui Ocean Club Vacation Owners Association (the "Association"), which comprise the balance sheet as of December 31, 2019, and the related statements of revenues, expenses and changes in fund balance - operating fund, revenues, expenditures and changes in fund balance - reserve for replacement fund and cash flows for the year 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.

Auditors' 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 our 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 Association'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 Association'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 Maui Ocean Club Vacation Owners Association as of December 31, 2019, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

To the Board of Directors of
Maui Ocean Club Vacation Owners Association

Disclaimer of Opinion on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the supplementary information on future major repairs and replacements on page 16 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Financial Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



MYERS, BRETT HOLTZ & COMPANY, PA
Fort Myers, Florida
April 2, 2020

Maui Ocean Club Vacation Owners Association
Balance Sheet
December 31, 2019

	<u>Operating Fund</u>	<u>Reserve for Replacement Fund</u>	<u>Total</u>
Assets			
Cash and cash equivalents	\$ 15,467,160	\$ 8,973,717	\$ 24,440,877
Investments	-	5,539,592	5,539,592
Maintenance fees receivable due from MRHC	1,073,160	277,717	1,350,877
Accrued interest receivable	-	18,763	18,763
Prepaid expenses and other assets	253,414	-	253,414
Fixed assets, net	21,274	-	21,274
Due from Association of Apartment Owners of Maui Ocean Club	53,031	-	53,031
Due from Reserve for Replacement Fund	63,900	-	63,900
Due to Operating Fund	-	(63,900)	(63,900)
Total assets	<u>\$ 16,931,939</u>	<u>\$ 14,745,889</u>	<u>\$ 31,677,828</u>
Liabilities and Fund Balances			
Liabilities			
Accrued expenses	\$ 323,712	\$ 6,421	\$ 330,133
Unearned maintenance fees	15,871,205	4,170,699	20,041,904
General excise tax payable	100,499	-	100,499
Income tax payable	1,678	93,698	95,376
Due to Marriott Vacations Worldwide Corporation	139,666	-	139,666
Contract liability	-	10,475,071	10,475,071
Total liabilities	<u>16,436,760</u>	<u>14,745,889</u>	<u>31,182,649</u>
Fund balances	495,179	-	495,179
Total liabilities and fund balances	<u>\$ 16,931,939</u>	<u>\$ 14,745,889</u>	<u>\$ 31,677,828</u>

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

Maui Ocean Club Vacation Owners Association
Statement of Revenues, Expenses and Changes in Fund Balance – Operating
Fund
Year Ended December 31, 2019

Revenues	
Maintenance fees, net	\$ 29,765,961
Late fee income	82,997
Operating finance charges	74,879
Acquisition revenue	226,709
Bank interest income	273,312
Miscellaneous income	210
Total revenues	<u>30,424,068</u>
Expenses	
Accounting and administration	2,441,536
Audit fees	12,747
Board of Directors	5,725
Cable television	129,822
Credit card fees	472,243
Front desk	4,237,104
General excise tax	1,520,984
High-speed internet	103,907
Housekeeping, net	7,133,506
Income taxes	87,723
Insurance	187,616
Maintenance	1,632,791
Management fee	3,394,208
Owner services	1,063,354
Property taxes	7,359,321
Telephone	129,571
Total expenses	<u>29,912,158</u>
Excess of revenues over expenses	511,910
Fund balance	
Beginning of year after adoption of ASC 606 (Note 9)	<u>(16,731)</u>
End of year	<u><u>\$ 495,179</u></u>

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

Maui Ocean Club Vacation Owners Association
Statement of Revenues, Expenditures and Changes in Fund Balance – Reserve
for Replacement Fund
Year Ended December 31, 2019

Revenues	
Reserve for replacement assessment, net	\$ 251,357
Bank interest income	218,109
Late fee income	17,034
Realized gain on fair value investments	39,645
Unrealized gain on fair value investments	42,800
Total revenues	<u>568,945</u>
Expenditures	
Furniture and fixtures	475,267
Income taxes	93,678
Total expenditures	<u>568,945</u>
Excess of revenues over expenditures	-
Fund balance	
Beginning of year after adoption of ASC 606 (Note 9)	<u>-</u>
End of year	<u><u>\$ -</u></u>

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

Maui Ocean Club Vacation Owners Association
Statement of Cash Flows
For the Year Ended December 31, 2019

	Operating Fund	Reserve for Replacement Fund	Total
Cash flows from operating activities			
Excess of revenues over expenses/expenditures	\$ 511,910	\$ -	\$ 511,910
Adjustments to reconcile excess of revenues over expenses/expenditures to net cash provided by operating activities			
Depreciation expense	14,144	-	14,144
Unrealized gain on fair value investments	-	(42,800)	(42,800)
Bad debt (benefit) expense	(90,884)	57,849	(33,035)
Changes in operating assets and liabilities			
Decrease in maintenance fees receivable	90,884	14,571	105,455
Decrease in maintenance fees receivable due from MRHC	387,209	78,280	465,489
Increase in accrued interest receivable	-	(6,804)	(6,804)
Decrease in prepaid expenses and other assets	14,763	-	14,763
Decrease in due from Marriott Vacations Worldwide Corporation	122,118	-	122,118
Decrease in due from Association of Apartment Owners of Maui Ocean Club	1,684	-	1,684
Increase in accrued expenses	152,883	6,421	159,304
Increase in unearned maintenance fees	46,641	287,710	334,351
Increase (decrease) in general excise tax payable	69,319	-	69,319
(Decrease) increase in income tax payable	(21,626)	44,499	22,873
Increase in due to Marriott Vacations Worldwide Corporation	139,666	-	139,666
Increase in contract liability	-	7,018,279	7,018,279
(Decrease) increase in due from/to Operating/ Reserve for Replacement Funds	(326,059)	326,059	-
Net cash provided by operating activities	<u>1,112,652</u>	<u>7,784,064</u>	<u>8,896,716</u>
Cash flows from investing activities			
Purchases of investments	-	(6,483,320)	(6,483,320)
Proceeds from maturities of investments	-	3,616,812	3,616,812
Net cash used in investing activities	<u>-</u>	<u>(2,866,508)</u>	<u>(2,866,508)</u>
Net increase in cash and cash equivalents	1,112,652	4,917,556	6,030,208
Cash and cash equivalents			
Beginning of year	14,354,508	4,056,161	18,410,669
End of year	<u>\$ 15,467,160</u>	<u>\$ 8,973,717</u>	<u>\$ 24,440,877</u>
Supplemental disclosure information			
Cash paid during the year for income taxes	<u>\$ 109,349</u>	<u>\$ 49,179</u>	<u>\$ 158,528</u>

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

Maui Ocean Club Vacation Owners Association

Notes to Financial Statements

December 31, 2019

1. Summary of Significant Accounting Policies

Maui Ocean Club Vacation Owners Association (the "Association") was incorporated on May 6, 1999 in the State of Hawaii, and commenced operations on December 20, 2000. The purpose of the Association is to administer and manage the vacation ownership program created and established as Maui Ocean Club Vacation Ownership Program at the Marriott's Maui Ocean Club condominium project (the "Ownership Condominium"). As of December 31, 2019, the Ownership Condominium consisted of 23,688 unit weeks. The Association's declaration of interval ownership provides that each unit week owner has an undivided interest in the facilities, and, accordingly, the Association assets are not recorded in the financial statements. The Association is managed under an agreement with Marriott Resorts Hospitality Corporation ("MRHC").

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 that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Operating Fund

The Association's fees and earnings from operations, which are restricted for the use and benefit of Association members, are recorded in the Operating Fund.

Reserve for Replacement Fund

The Association's governing documents require funds to be accumulated for future major repairs and replacements. Accumulated funds, which aggregate \$10,475,071, and are presented on the accompanying balance sheet as a contract liability as of December 31, 2019, are held in separate accounts and are generally not available for operating purposes. The Association's policy is to retain the income earned on such funds in the Reserve for Replacement Fund.

MRHC, on behalf of the Association's Board of Directors, engages a third-party vendor to conduct ongoing studies to estimate the remaining useful lives and the replacement costs of the components of common property. The table included in the Supplementary Information on Future Major Repairs and Replacements (Unaudited) is based on these studies.

The Association will provide funding for major repairs and replacements over the remaining estimated useful lives of the components based on the study's estimates of current replacement costs and considering amounts previously accumulated in the Reserve for Replacement Fund. Accordingly, a funding requirement of \$8,098,878 has been included in the 2020 budget.

Funds are being accumulated in the Reserve for Replacement Fund based on estimates of future needs for repairs and replacements of common property components. Actual expenditures may vary from the estimated future expenditures, and the variations may be material. Therefore, amounts accumulated in the Reserve for 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 the Board of Directors' approval, to increase regular assessments, pass special assessments, or delay major repairs and replacements until funds are available.

Maui Ocean Club Vacation Owners Association

Notes to Financial Statements

December 31, 2019

Cash and Cash Equivalents

The Association considers money in checking accounts, money market funds, and certificates of deposit with an original maturity of three months or less, at date of purchase, to be cash equivalents. The Association places its cash and cash equivalents with financial institutions in the United States of America. The Federal Deposit Insurance Corporation (“FDIC”) provides for deposits at FDIC-insured institutions to be insured up to \$250,000.

Investments

Investments consist of certificates of deposit and equity-linked certificates of deposit.

The Association’s certificates of deposit are carried at amortized cost, as the Association has both the intent and ability to hold them until maturity. Certain certificates of deposit are considered depository accounts and are insured by the FDIC.

The Association’s equity-linked certificates of deposit are principal-protected structured products. At maturity, the Association will receive their principal plus a “supplemental payment” or minimum interest, if any, that is based on the performance of an underlying index or market measure.

The equity-linked certificates of deposit are adjusted to fair value at the end of each period, with unrealized gains or losses shown as a component of revenues (the “Fair Value Option”). Gains or losses on securities sold are based on the specific identification method. The Fair Value Option selected by the Association is considered to provide a more transparent presentation to users of the financial statements.

Fair Value Measurements

The Association measures certain assets at fair value in accordance with current accounting standards on fair value measurements. The standard defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) as opposed to the price that would be paid to acquire the asset or received to assume the liability (an entry price). A fair value measure should reflect the assumptions that market participants would use in pricing the asset or liability, including the assumptions about the risk inherent in a particular valuation technique, the effect of a restriction on the sale or use of an asset and the risk of nonperformance. A fair value hierarchy is utilized which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Three levels may be used to measure fair value:

- Level 1 – Quoted prices in active markets for identical assets or liabilities.
- Level 2 – Quoted prices for similar assets and liabilities in active markets or inputs that are observable.
- Level 3 – Inputs that are unobservable (for example cash flow modeling inputs based on assumptions).

A financial instrument’s level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

Maui Ocean Club Vacation Owners Association
Notes to Financial Statements
December 31, 2019

The following table summarizes the Association's investments recorded at fair value on a recurring basis at December 31, 2019:

	Fair Value Measurements Using			Total
	Level 1	Level 2	Level 3	
Equity-linked certificates of deposit	\$ -	\$ 326,375	\$ -	\$ 326,375

Maintenance Fees Receivable

Assessments receivable at the balance sheet date are stated at the amounts expected to be collected from outstanding assessments from members. The Association has a Foreclosed Inventory Purchase Agreement with Marriott Ownership Resorts, Inc. ("MORI") that automatically renews for any number of additional one (1) year terms, unless either party terminates the agreement with a 45 day written notice. The agreement provides that MORI shall purchase the Association's foreclosed inventory subject to the terms of the agreement, shown as acquisition revenue. Accounts receivable are generally considered delinquent when the payment is not received on or before the due date. At December 31, 2019, the Association had delinquent assessments of \$343,094. The Association treats uncollectible assessments as variable consideration. Methods, inputs, and assumptions used to evaluate whether an estimate of variable consideration is constrained include consideration of past experience and susceptibility to factors outside the Association's control. The balances of assessments receivable as of the beginning and end of the year are \$448,549 and \$343,094, respectively, allowed for 100%.

Fixed Assets

Fixed assets, net are stated at cost. Upon disposition or retirement, the cost and related accumulated depreciation are eliminated and any resulting gain or loss is reflected in operations. Maintenance and repairs are charged to expense when incurred; expenditures for renewals and betterments are capitalized. Depreciation is provided utilizing the straight-line method using estimated useful lives between 1 and 4 years.

Unearned Maintenance Fees

Maintenance fees for all unit weeks are receivables as of the beginning of each timeshare year. Unearned maintenance fees represent prepayment of the next year's maintenance fees. The fees for the unit weeks prior to the Association's year-end are classified as revenues; the remainder is considered unearned maintenance fees.

Contract Liability

The Association recognizes revenue from members as the related performance obligations are satisfied. A contract liability is recorded when the Association has the right to receive payment in advance of the satisfaction of performance obligations related to the replacement fund assessments. The balance of contract liability as of the beginning and end of the year are \$3,456,792 and \$10,475,071, respectively.

Maui Ocean Club Vacation Owners Association

Notes to Financial Statements

December 31, 2019

Income Taxes

The Association accounts for income taxes in accordance with Accounting Standards Codification (“ASC”) 740, *Income Taxes*. ASC 740 utilizes the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax impact attributable to differences between the financial statement carrying amounts and tax basis of existing assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply in the years in which the temporary differences are expected to be recovered.

In 2019, the Association satisfied the requirements to file as an exempt organization under Section 528 and provided for taxes under the provisions of Section 528. However, in 2016, the Association did not satisfy the requirements to file as an exempt organization under Section 528 and provided for taxes under the provisions of Section 277. As a result, the Association carried deferred tax assets on its books related to taxes provided for under Section 277 in prior years. Refer to Note 3 - Income Taxes for further information.

Under Section 277, the Association is taxed on any excess of “membership income” over “member expenses”, and net income from non-membership activities using the corporate tax rate. An Association is also permitted to carryforward net losses from membership activities which may be used to offset net membership income in future years as provided in Rev. Rul. 70-604.

Associations taxed pursuant to Section 528 are not required to report deferred taxes for temporary differences related to exempt function income. Associations not eligible or electing to be taxed as a corporation under Section 277 are required to account for deferred tax assets and liabilities for existing temporary differences, with a corresponding impact on income tax expense.

The Association has evaluated the effects of the guidance provided by generally accepted accounting principles related to accounting for uncertainty in income taxes. Under this guidance the Association has determined that it has no uncertain income tax positions that could have a significant effect on the financial statements for the year ended December 31, 2019.

The Association’s federal income tax returns for 2016, 2017 and 2018 are subject to examination by the Internal Revenue Service, generally for a period of three years after the federal income tax returns were filed.

Revenue Recognition

Association members are subject to assessments to provide funds for the Association’s operating expenses and major repairs and replacements. Assessment revenue is recognized as the related performance obligations are satisfied at transaction amounts expected to be collected. The Association’s performance obligations related to its operating assessments are satisfied over time on a daily pro-rata basis using the input method. The performance obligations related to the replacement fund assessments are satisfied when these funds are expended for their designated purpose. Any excess assessments at year-end are retained by the Association for use in the succeeding year.

Maui Ocean Club Vacation Owners Association
Notes to Financial Statements
December 31, 2019

The following is a reconciliation of net revenues as recorded in the accompanying financial statements to the amount of assessments approved by the Board of Directors on the annual budget:

	Operating Fund	Reserve for Replacement Fund
Net revenue recorded per the financial statements	\$29,765,961	\$ 251,357
Plus: amounts not deemed collectible	242,847	57,849
Plus: Association of Apartment Owners of Maui Ocean Club	20,464,096	-
Plus: amounts reclassified to contract liability during year	<u>-</u>	<u>7,018,279</u>
Annual assessments per the Board approved budget	<u><u>\$50,472,904</u></u>	<u><u>\$ 7,327,485</u></u>

Cost Allocation Methodology

In 2019, the complex was comprised of the Association, the Condominium Association, MRHC commercial units and MORI Marketing and Sales offices. All expenses are recorded by the Association or Condominium Association. At the end of each accounting period, the Condominium Association expenses are allocated based on different methodologies to the Association, MRHC and MORI.

Accounting Pronouncement

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2016-02 - Leases (Topic 842) (“ASU 2016-02”) to increase transparency and comparability of information regarding an entity’s leasing activities by providing additional information to users of financial statements. ASU 2016-02 amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. The new standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. This update is effective for annual periods beginning after December 15, 2020, based on a one-year deferral of the effective date approved in July 2019 by the FASB. The Association continues to evaluate the impact that adoption of this accounting standard update will have on its financial statements and disclosures. In addition, the Association will adopt ASU 2016-02 commencing in fiscal year 2021.

2. Investments

Investments are classified as follows at December 31, 2019:

	Amortized Cost/Principal	Fair Market Value
Equity-linked certificates of deposit	<u>\$ 250,000</u>	<u>\$ 326,375</u>
Certificates of deposit (held-to-maturity)	<u><u>\$ 5,213,217</u></u>	<u><u>\$ 5,254,336</u></u>

* Investments on the Balance Sheet is the sum of the fair market value of the equity-linked certificates of deposit and the amortized cost/principal of the certificates of deposit.

Maui Ocean Club Vacation Owners Association
Notes to Financial Statements
December 31, 2019

The contractual maturities of investments held-to-maturity and equity-linked certificates of deposit at December 31, 2019, are as follows:

	<u>Amortized Cost/Principal</u>	<u>Fair Market Value</u>
Due between one to five years	<u>\$ 5,463,217</u>	<u>\$ 5,580,711</u>

The equity-linked certificates of deposit had unrealized gains of \$42,800 for the year ended December 31, 2019, which are included in the Statement of Revenues, Expenditures and Changes in Fund Balance - Reserve for Replacement Fund.

3. Fixed Assets

Fixed assets, net at December 31, 2019, consist of the following:

Electric carts	\$ 46,531
Computers - business center	24,980
Accumulated depreciation	<u>(50,237)</u>
	<u>\$ 21,274</u>

Depreciation expense of \$14,144 was recorded in the Statement of Revenues, Expenses, and Changes in Fund Balance - Operating Fund for the year ended December 31, 2019.

4. Income Taxes

The provision for income taxes consisted of the following for the year ended December 31, 2019:

	<u>Total</u>	<u>Operating Fund</u>	<u>Reserve for Replacement Fund</u>
Federal	\$ 30,843	\$ 14,347	\$ 16,496
State	<u>150,558</u>	<u>73,376</u>	<u>77,182</u>
	<u>\$ 181,401</u>	<u>\$ 87,723</u>	<u>\$ 93,678</u>

The difference between the provision for income taxes as presented, and the provision calculated by applying the statutory federal rate to the excess of revenues over expenses/expenditures, primarily related to state income taxes and the exclusion exempt function income.

At December 31, 2019, the Association had the following deferred tax asset:

Deferred tax asset	\$ 1,679,429
Valuation allowance	<u>(1,679,429)</u>
Net deferred tax asset	<u>\$ -</u>

Maui Ocean Club Vacation Owners Association

Notes to Financial Statements

December 31, 2019

The deferred tax asset is a result of a net operating loss generated in prior years when the Association was taxed pursuant to the provisions of Section 277, and is allowable as a carryforward under Rev. Rule 70-604. A valuation allowance was recorded for this deferred tax asset as it was more likely than not that the related tax benefits would not be realized. This deferred tax asset could be utilized to offset certain taxable income in the event the association files its income tax return under the provisions of Section 277 in a future year.

5. Management Agreement

In February 2010, Marriott Hotel Services, Inc. assigned the entire management agreement to MRHC who, at that point, became responsible for the on and off-site management of the Association. For the year ended December 31, 2019, MRHC was responsible for the management, maintenance and operations of the facilities, in exchange for an annual fee of 10% of the annual budget of the Association, exclusive of the management fee. For the year ended December 31, 2019, the management fee was \$3,394,208, and is recorded in the Statement of Revenues, Expenses and Changes in Fund Balance - Operating Fund.

6. Related Party Transactions

Certain services, including off-site accounting and administration, and reservations, are provided by MRHC and allocated to the Association based on the number of unit weeks, as a percentage of total unit weeks the respective service covers. Marriott Vacations Worldwide Corporation ("MVWC"), the indirect parent company of MRHC, pays all invoices on behalf of the Association, subject to reimbursement by the Association. The net amount due to MVWC at December 31, 2019, was \$139,666.

The net amount due from Association of Apartment Owners of Maui Ocean Club at December 31, 2019, was \$53,031.

MRHC collects annual maintenance fees on behalf of the Association. The amount of maintenance fees receivable due from MRHC at December 31, 2019, was \$1,350,877.

7. Concentrations of Credit Risk

Financial instruments which potentially subject the Association to concentrations of credit risk consist principally of cash and cash equivalents and investments. The Association maintains its cash and cash equivalents and investments with what the Board of Directors believes to be high credit quality financial institutions. In addition, the Board of Directors maintains its investments in a portfolio that it believes limits the amount of market exposure.

In an effort to fulfill their fiduciary responsibility to protect and maintain assets for the Association, the Board of Directors for the Association has implemented a formal investment policy statement in reference to all cash, cash equivalents and investable funds for the reserve for replacement and operating funds. The investment policy statement stipulates that all funds shall be invested in federally insured or guaranteed vehicles with no risk to principal as long as these investments are held-to-maturity.

Maui Ocean Club Vacation Owners Association
Notes to Financial Statements
December 31, 2019

Since the Board of Directors has incorporated an analysis that identifies the use of these funds at specific times and the investments are structured with maturity dates to coincide with these anticipated expenditures, notwithstanding emergencies not under the control of the Board of Directors, the Association is able to and prepared to hold to these investments to their stated maturity dates.

The MVC Trust is a Florida land trust established to hold certain real property, including timeshare interests, utilized as part of the Marriott Vacation Club Destinations vacation ownership plan. As of December 31, 2019, the MVC Trust held 4,958 (21%) of the timeshare interests in the Association.

8. Subsequent Events

The Association has performed an evaluation of subsequent events through April 2, 2020, which is the date the financial statements were available to be issued.

In December 2019, a novel strain of coronavirus surfaced and has spread around the world resulting in business and social disruption. The coronavirus was declared a Public Health Emergency of International Concern by the World Health Organization on January 30, 2020. The effect of the virus on the financial position or operations of the Association is unknown at this time.

9. New Accounting Guidance Implementation

The Financial Accounting Standards Board (FASB) issued new guidance that created Topic 606, *Revenue from Contracts with Customers*, in the Accounting Standards Codification (ASC). Topic 606 supersedes the revenue recognition requirements in FASB ASC 972-605, *Real Estate - Common Interest Realty Associations, Revenue Recognition*, and requires the recognition of revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which a CIRA expects to be entitled in exchange for those goods or services.

The Association adopted the requirements of new guidance as of January 1, 2019, using the modified retrospective method of transition, which requires that the cumulative effect of the changes related to the adoption be charged to beginning fund balance. The Association applied the new guidance using the practical expedient provided in Topic 606 that allows the guidance to be applied only to contracts that were not complete as of January 1, 2019. Adoption of the new guidance resulted in changes to the accounting policies for assessment revenue and contract liabilities related to the replacement fund, as previously described.

The adoption of the new revenue recognition guidance resulted in the following change to fund balance as of January 1, 2019:

	Operating Fund	Reserve for Replacement Fund
Fund balance, as previously reported, at January 1, 2019	\$ 204,328	\$ 3,456,792
Adjustment for effects of Topic 606	(221,059)	(3,456,792)
Fund balance, as adjusted, at January 1, 2019	<u>\$ (16,731)</u>	<u>\$ -</u>

The effect of the adoption on the operating fund is a decrease in assessments by \$242,847 for uncollectible assessments.

Maui Ocean Club Vacation Owners Association
Notes to Financial Statements
December 31, 2019

The effect of the adoption on the reserve for replacement fund is a decrease in 2019 assessments by \$7,076,128 and a recording of a contract liability as of December 31, 2019, of \$10,475,071. The Association has no customer contract modifications that had an effect on the Association's transition to the new guidance.

The modified retrospective method of transition requires the effect of applying the new guidance on each item included in the 2019 financial statements be disclosed.

Following are the line items from the balance sheet as of December 31, 2019, that were affected, the amounts that would have been reported under the former guidance, the effects of applying the new guidance, and the balances reported under the new guidance:

	Amounts That Would Have Been Reported	Effects of Applying Topic 606 Guidance	As Reported
<u>Liabilities</u>			
Contract liability	\$ -	\$ 10,475,071	\$ 10,475,071
<u>Fund balance</u>			
Ending fund balance	\$ 10,970,250	\$ (10,475,071)	\$ 495,179

The following are the line items from the statement of revenue, expenses/expenditures, and changes in fund balance and the statement of cash flows for the year ended December 31, 2019, that were affected, the amounts that would have been reported under the former guidance, the effects of applying the new guidance, and the amounts reported under the new guidance:

	Amounts That Would Have Been Reported	Effects of Applying Topic 606 Guidance	As Reported
Operating Fund			
<u>Revenue</u>			
Maintenance fees	\$ 30,008,808	\$ (242,847)	\$ 29,765,961
Acquisition revenue	\$ -	\$ 226,709	\$ 226,709
Excess of revenue over expenses	\$ 528,048	\$ (16,138)	\$ 511,910
<u>Cash Flows</u>			
Excess of revenue over expenses	\$ 528,048	\$ (16,138)	\$ 511,910
Reserve for Replacement Fund			
<u>Revenue</u>			
Maintenance fees	\$ 7,327,485	\$ (7,076,128)	\$ 251,357
Excess of revenue over expenses	\$ 7,018,279	\$ (7,018,279)	\$ -
<u>Cash Flows</u>			
Excess of revenue over expenses	\$ 7,018,279	\$ (7,018,279)	\$ -
Increase in contract liability	\$ -	\$ 7,018,279	\$ 7,018,279

Maui Ocean Club Vacation Owners Association
Supplementary Information on Future Major Repairs and Replacements
(Unaudited)
Year Ended December 31, 2019

On behalf of the Board of Directors, a reserve study was completed during 2019, to estimate the remaining useful lives and the replacement costs of the components of common property.

The following table is based on the study with subsequent review by the Board of Directors and presents significant information about the components of common property.

	Estimated Remaining Useful Lives (Years)	Estimated Current Replacement Costs	2020 Funding Requirement	Balance at December 31, 2019
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Furniture and fixtures	5	<u>\$ 74,336,844</u>	<u>\$ 8,098,878</u>	<u>\$ 10,475,071</u>

**Association of Apartment Owners of Maui Ocean Club
Maui Ocean Club Vacation Owners Association
Board of Directors**

Name/Address	Phone/Fax/Email	Office	Term
<p style="text-align: center;">Larry Wolfe c/o Marriott's Maui Ocean Club Executive Offices 100 Nohea Kai Drive Lahaina, HI 96761</p>	<p style="text-align: center;">Ph: 808-667-8203 F: 808-667-8141 ownerboard.maui@vacationclub.com</p>	<p style="text-align: center;">President</p>	<p style="text-align: center;">2018-2021</p>
<p style="text-align: center;">Mark Neumann c/o Marriott's Maui Ocean Club Executive Offices 100 Nohea Kai Drive Lahaina, HI 96761</p>	<p style="text-align: center;">Ph: 808-667-8203 F: 808-667-8141 ownerboard.maui@vacationclub.com</p>	<p style="text-align: center;">Vice President</p>	<p style="text-align: center;">2017-2020</p>
<p style="text-align: center;">John Draeger c/o Marriott's Maui Ocean Club Executive Offices 100 Nohea Kai Drive Lahaina, HI 96761</p>	<p style="text-align: center;">Ph: 808-667-8203 F: 808-667-8141 ownerboard.maui@vacationclub.com</p>	<p style="text-align: center;">Secretary- Treasurer</p>	<p style="text-align: center;">2017-2020</p>
<p style="text-align: center;">Nathan Guikema c/o Marriott's Maui Ocean Club Executive Offices 100 Nohea Kai Drive Lahaina, HI 96761</p>	<p style="text-align: center;">Ph: 808-667-8203 F: 808-667-8141 ownerboard.maui@vacationclub.com</p>	<p style="text-align: center;">Director</p>	<p style="text-align: center;">2018-2021</p>
<p style="text-align: center;">Andrew McGovern c/o Marriott's Maui Ocean Club Executive Offices 100 Nohea Kai Drive Lahaina, HI 96761</p>	<p style="text-align: center;">Ph: 808-667-8203 F: 808-667-8141 ownerboard.maui@vacationclub.com</p>	<p style="text-align: center;">Director</p>	<p style="text-align: center;">2019-2022</p>

**Association of Apartment Owners of Maui Ocean Club
Maui Ocean Club Vacation Owners Association**

Owner Participation Rules for Board of Directors Meetings

1) Attendance

- a) Attendance at Board of Directors meetings is open to all Owners of the Association, representatives of the management company, and such other persons who have been specifically invited by the Board.
- b) All meeting attendees must sign-in or otherwise announce themselves as being present at the meeting.

2) Owners Recognized by Chair/Rights to the Floor

- a) Once each agenda item has been discussed by the Board (and before a vote is taken), the Chair of the meeting will ask if there are any Owners that would like to discuss or deliberate with respect to the agenda item.
- b) Any Owner wishing to speak shall call out "Mr./Ms. Chairperson" and wait to be recognized by the Chair.
- c) Such participating Owner will first identify him/herself by stating his/her name and unit/interest owned before speaking.
- d) If there are multiple calls for the Chair, the Chair will call on Owners present at the meeting location one at a time and then will call on Owners on the phone one at a time.
- e) Before discussion is concluded on a given agenda item, the Chair will call again for any further discussion; if none, the Chair will call the discussion closed.
- f) After the discussion (and vote, where applicable) on all agenda items, the Chair will ask if there are any Owners that would like to discuss or deliberate with respect to any additional items that are not on the agenda.
- g) Any owners wishing to speak on items not on the agenda shall follow the procedures set forth above in Sections 2(b)-(e) above

3) Owner Deliberation/Discussion

- a) An Owner who wishes, and is entitled, to speak may not speak until recognized by the Chair.
- b) Once recognized, the Owner may speak for no more than three (3) minutes on a given agenda item or non-agenda item.
- c) An Owner shall not speak a second time on any matter until all Owners who wish to speak a first time on such matter are recognized by the Chair.
- d) No Owner shall speak more than twice on the same matter, or longer than three (3) minutes per speech, without permission of the Chair.

4) Amendment of Owner Participation Rules for Board of Directors Meetings

These Owner Participation Rules for Board of Directors Meetings may be amended or otherwise modified at any regular or duly noticed special meeting of the Board, provided that all Owners shall be notified of any changes to these Owner Participation Rules.

5) Electronic Devices

Mobile phones and pagers shall be silenced during all Board Meetings. Video cameras and recording equipment, other than those approved in advance by the Chair, shall not be permitted and no recordings shall be made of the meeting.