April 2018

Dear Marriott’s Kauai Beach Club Owner,

Enclosed please find the 2017 Audit Reports for Association of Apartment Owners of Marriott’s Kauai Resort and Beach Club and Marriott’s Kauai Beach Club Owners Association. These reports are being provided to you as outlined in the Associations’ documents and Hawaii Statutes.

If you have questions, please contact your Board of Directors via email (email addresses provided on the enclosed Board of Directors list) or by phone at the business office of the Association at 808-246-5019.

Sincerely,

*Jan Yokota*
Secretary/Treasurer
Association of Apartment Owners of
Marriott’s Kauai Resort and Beach Club

*Henry Lum*
Secretary/Treasurer
Marriott’s Kauai Beach Club Owners Association

Enclosure

# Association of Apartment Owners of Marriott's Kaua'i Resort and Beach Club

**Financial Statements**
**December 31, 2017 and 2016**

# Association of Apartment Owners of Marriott’s Kaua’i Resort and Beach Club
## Index
## December 31, 2017 and 2016

Page(s)

## Report of Independent Auditors

The Board of Directors of
Association of Apartment Owners of Marriott's Kaua'i Resort and Beach Club

We have audited the accompanying financial statements of the Association of Apartment Owners of Marriott's Kaua'i Resort and Beach Club (the "Association"), which comprise the balance sheet as of December 31, 2017 and the related statements of revenues, expenses and changes in fund balance - operating fund and of revenues, expenditures and changes in fund balance - reserve for replacement fund for the years ended December 31, 2017 and 2016, and of cash flows for the year ended December 31, 2017.

**Management's Responsibility for the Financial Statements**
Management is responsible for the preparation and fair presentation of the 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 the 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, we consider 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 the Association of Apartment Owners of Marriott's Kaua'i Resort and Beach Club at December 31, 2017, and the results of its operations for the years ended December 31, 2017 and 2016 and its cash flows for the year ended December 31, 2017 in accordance with accounting principles generally accepted in the United States of America.

*PricewaterhouseCoopers LLP, 4040 West Boy Scout Boulevard, Suite 1000, Tampa, FL 33607-5745*
*T: (813) 229 0221, F: (813) 229 3646,* www.pwc.com/us

pwc

**Other Matters**
We previously audited the balance sheet as of December 31, 2016 and the related statements of revenues, expenses and changes in fund balance – operating fund, of revenues, expenditures and changes in fund balance – reserve for replacement fund and of cash flows for the year then ended (not presented herein), and in our report dated April 19, 2017, we expressed an unmodified opinion on those financial statements. In our opinion, the information set forth in the accompanying summarized financial information as of December 31, 2016 and for the year then ended is consistent, in all material respects, with the audited financial statements from which it has been derived.

Accounting principles generally accepted in the United States of America require that the Supplementary Information on Future Major Repairs and Replacements (Unaudited) on page 15 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 who 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.

PricewaterhouseCoopers LLP

Certified Public Accountants
Tampa, Florida
April 16, 2018

# Association of Apartment Owners of Marriott's Kaua'i Resort and Beach Club
## Balance Sheets
## December 31, 2017, with Summarized Comparative Totals for December 31, 2016

| | 2017 | | | |
|---|---|---|---|---|
| | **Operating Fund** | **Reserve for Replacement Fund** | **Total** | **2016** |
| **Assets** | | | | |
| Cash and cash equivalents | $ 3,490,657 | $ 5,420,674 | $ 8,911,331 | $ 11,025,807 |
| Investments | 490,000 | 10,154,032 | 10,644,032 | 8,588,452 |
| Maintenance fees receivable, less allowance for doubtful accounts of approximately $21,000 and $52,000 in 2017 and 2016, respectively | 92,601 | 25,540 | 118,141 | 208,057 |
| Maintenance fees receivable due from MRHC | 312,701 | 80,584 | 393,285 | 174,763 |
| Accrued interest receivable | 389 | 19,004 | 19,393 | 12,642 |
| Prepaid expenses and other assets | 345,423 | - | 345,423 | 380,599 |
| Income tax receivable | - | - | - | 13,309 |
| Due from Marriott Kaua'i Beach Club Owners Association, Inc. | - | - | - | 774 |
| Due from Marriott Vacations Worldwide Corporation | - | - | - | 64,342 |
| Due from Operating Fund | - | 9,273 | 9,273 | 3,866 |
| Due to Reserve for Replacement Fund | (9,273) | - | (9,273) | (3,866) |
| Total assets | $ 4,722,498 | $ 15,709,107 | $ 20,431,605 | $ 20,468,745 |
| **Liabilities and Fund Balances** | | | | |
| Liabilities | | | | |
| Accrued expenses | $ 28,311 | $ - | $ 28,311 | $ 16,270 |
| Unearned maintenance fees | 3,210,841 | 838,224 | 4,049,065 | 3,307,108 |
| Income tax payable | 2,123 | 10,945 | 13,068 | 21,962 |
| General excise tax payable | 770 | - | 770 | - |
| Due to Marriott Vacations Worldwide Corporation | 16,422 | - | 16,422 | - |
| Due to HPTMI Hawaii Inc. | 708,255 | | 708,255 | 821,754 |
| Total liabilities | 3,966,722 | 849,169 | 4,815,891 | 4,167,094 |
| Fund balances | 755,776 | 14,859,938 | 15,615,714 | 16,301,651 |
| Total liabilities and fund balances | $ 4,722,498 | $ 15,709,107 | $ 20,431,605 | $ 20,468,745 |

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

# Association of Apartment Owners of Marriott's Kaua'i Resort and Beach Club
## Statements of Revenues, Expenses and Changes in Fund Balance – Operating Fund
## Years Ended December 31, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| **Revenues** | | |
| Maintenance fees | $ 15,834,086 | $ 15,111,825 |
| Operating finance charges | 25,980 | 31,644 |
| Interest income | 23,101 | 17,141 |
| Total revenues | 15,883,167 | 15,160,610 |
| **Expenses** | | |
| Accounting and administration | 888,243 | 922,134 |
| Audit fees | 14,350 | 16,069 |
| Bad debt benefit | (2,361) | (30,436) |
| Business license and registration | 9,305 | 1,685 |
| Credit card fees | 118,863 | 122,124 |
| Electricity | 3,010,510 | 3,299,043 |
| Gas | 885,848 | 685,176 |
| General excise tax | 5,921 | 3,176 |
| Housekeeping | 1,308,305 | 1,288,228 |
| Income tax expense | 6,419 | 3,594 |
| Insurance | 1,229,126 | 1,278,812 |
| Management fee | 1,125,975 | 1,111,470 |
| Recreation and activities | 984,905 | 920,835 |
| Rent | 404,293 | 390,838 |
| Repairs and maintenance | 3,631,560 | 3,423,430 |
| Water and sewer | 2,685,144 | 2,638,216 |
| Total expenses | 16,306,406 | 16,074,394 |
| Deficit of revenues over expenses | (423,239) | (913,784) |
| **Fund balance** | | |
| Beginning of year | 1,179,015 | 2,092,799 |
| End of year | $ 755,776 | $ 1,179,015 |

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

# Association of Apartment Owners of Marriott's Kaua'i Resort and Beach Club

## Statements of Revenues, Expenditures and Changes in Fund Balance – Reserve for Replacement Fund

## Years Ended December 31, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| **Revenues** | | |
| Reserve for replacement assessment | $ 2,614,579 | $ 3,099,201 |
| Reserve finance charges | 5,468 | 6,986 |
| Interest income | 93,485 | 62,256 |
| Unrealized gain on fair value investments | 95,580 | 45,545 |
| Total revenues | 2,809,112 | 3,213,988 |
| **Expenditures** | | |
| Roof replacement | 547,837 | 2,429,523 |
| Furniture and fixtures | 2,279,359 | 1,126,339 |
| Pavement resurfacing | 120,900 | - |
| Common area rehabilitation | 90,618 | 30,000 |
| Income tax expense | 33,096 | 18,171 |
| Total expenditures | 3,071,810 | 3,604,033 |
| Deficit of revenues over expenditures | (262,698) | (390,045) |
| **Fund balance** | | |
| Beginning of year | 15,122,636 | 15,512,681 |
| End of year | $ 14,859,938 | $ 15,122,636 |

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

# Association of Apartment Owners of Marriott's Kaua'i Resort and Beach Club
## Statements of Cash Flows
## For the Year Ended December 31, 2017, with Summarized Comparative Totals for December 31, 2016

| | 2017 | | | |
|---|---|---|---|---|
| | Operating Fund | Reserve for Replacement Fund | Total | 2016 |
| **Cash flows from operating activities** | | | | |
| Deficit of revenues over expenses/expenditures | $ (423,239) | $ (262,698) | $ (685,937) | $ (1,303,829) |
| Adjustments to reconcile deficit of revenues over expenses/expenditures to net cash used in operating activities | | | | |
| Bad debt benefit | (2,361) | - | (2,361) | (30,436) |
| Unrealized gain on fair value investments | - | (95,580) | (95,580) | (45,545) |
| Changes in operating assets and liabilities | | | | |
| Decrease (increase) in maintenance fees receivable | 69,382 | 22,895 | 92,277 | (30,652) |
| (Increase) decrease in maintenance fees receivable due from MRHC | (168,048) | (50,474) | (218,522) | 163,523 |
| Decrease (increase) in accrued interest receivable | 184 | (6,935) | (6,751) | (2,934) |
| Decrease (increase) in prepaid expenses and other assets | 35,176 | - | 35,176 | (12,002) |
| Decrease (increase) in income tax receivable | 13,309 | - | 13,309 | (9,669) |
| Decrease in due from Marriott Kaua'i Beach Club Owners Association, Inc. | 774 | - | 774 | 4,249 |
| Decrease (increase) in due from Marriott Vacations Worldwide Corporation | 64,342 | - | 64,342 | (64,342) |
| Increase (decrease) in accrued expenses | 12,041 | - | 12,041 | (47,158) |
| Increase in unearned maintenance fees | 474,765 | 267,192 | 741,957 | 138,526 |
| Increase (decrease) in income tax payable | 2,123 | (11,017) | (8,894) | 5,235 |
| Increase (decrease) in general excise tax payable | 770 | - | 770 | (240) |
| Increase (decrease) in due to Marriott Vacations Worldwide Corporation | 16,422 | - | 16,422 | (14,321) |
| Decrease in due to HPTMI Hawaii Inc. | (113,499) | - | (113,499) | (140,369) |
| Decrease (increase) in due from/to Operating/ Reserve for Replacement Funds | 5,407 | (5,407) | - | - |
| Net cash used in operating activities | (12,452) | (142,024) | (154,476) | (1,389,964) |
| **Cash flows from investing activities** | | | | |
| Purchases of investments | (4,165,000) | (5,390,000) | (9,555,000) | (10,785,007) |
| Proceeds from maturity of investments | 4,900,000 | 2,695,000 | 7,595,000 | 9,310,000 |
| Net cash provided by (used in) investing activities | 735,000 | (2,695,000) | (1,960,000) | (1,475,007) |
| Net increase (decrease) in cash and cash equivalents | 722,548 | (2,837,024) | (2,114,476) | (2,864,971) |
| **Cash and cash equivalents** | | | | |
| Beginning of year | 2,768,109 | 8,257,698 | 11,025,807 | 13,890,778 |
| End of year | $ 3,490,657 | $ 5,420,674 | $ 8,911,331 | $ 11,025,807 |
| **Supplemental disclosure of cash flow information** | | | | |
| Cash (received) paid during the year for income taxes | $ (9,013) | $ 44,113 | $ 35,100 | $ 26,199 |

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

## 1. Summary of Significant Accounting Policies

Association of Apartment Owners of Marriott's Kaua'i Resort and Beach Club (the "Association") was incorporated on February 17, 1995 in the State of Hawaii. The purpose of the Association is to administer and manage the condominium project created and established as Marriott's Kaua'i Resort and Beach Club condominium project. The complex consists of Marriott's Kaua'i Beach Club Owners Association, Inc. ("VOA"), HPTMI Hawaii Inc. ("Hotel") and Marriott Kaua'i Ownership Resorts, Inc. ("MKORI") and on February 25, 2011, MKORI transferred its ownership interest in certain real property located in the Kilohana Tower to Essex House Condominium Corporation ("Essex", a subsidiary of Marriott International). On July 29, 2015, Essex sold its ownership interest in certain real property located in the Kilohana Tower to Marriott Ownership Resorts, Inc. (the "Developer"). The Association is managed under an agreement with Essex.

### Comparative Information

While comparative information is not required under accounting principles generally accepted in the United States of America, the Association believes that this information is useful and has included comparative financial information from the financial statements as of and for the year ended December 31, 2016. Within the Balance Sheets and Statements of Cash Flows, prior year balances, by fund, have been condensed for comparative purposes. This summarized information is not intended to be a full presentation in conformity with accounting principles generally accepted in the United States of America, which would require certain additional information. Accordingly, such information should be read in conjunction with the Association's audited financial statements as of and for the year ended December 31, 2016.

### 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 is accumulating funds for future major repairs and replacements. Accumulated funds are held in separate savings accounts and generally are not available for normal operations.

Essex, 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 $2,970,330 has been included in the 2018 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.

**Cash and Cash Equivalents**
The Association considers money in checking accounts, money market funds, U.S. treasury strips, 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, equity-linked certificates of deposit, and treasury inflation-protected securities.

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 deposits 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 treasury inflation-protected securities are inflation-indexed securities. The rate of return on such securities is adjusted periodically to compensate for inflation as measured by the U.S. Department of Labor's consumer price index. 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.

Equity-linked certificates of deposit and treasury inflation-protected securities 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"). 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.

The following table summarizes the Association's investments recorded at fair value on a recurring basis at December 31, 2017 and 2016:

| | 2017 | | | |
|---|---|---|---|---|
| | Fair Value Measurements Using | | | |
| | Level 1 | Level 2 | Level 3 | Total |
| Equity-linked certificates of deposit | $ - | $ 636,175 | $ - | $ 636,175 |
| Treasury inflation-protected securities | $ 252,857 | $ - | $ - | $ 252,857 |

| | 2016 | | | |
|---|---|---|---|---|
| | Fair Value Measurements Using | | | |
| | Level 1 | Level 2 | Level 3 | Total |
| Equity-linked certificates of deposit | $ - | $ 542,763 | $ - | $ 542,763 |
| Treasury inflation-protected securities | $ 250,689 | $ - | $ - | $ 250,689 |

**Maintenance Fees Receivable**
Maintenance fees receivable represents an amount due from owners.

Effective January 1, 2010, the Association entered into a Foreclosed Inventory Purchase Agreement with Marriott Ownership Resorts, Inc. ("MORI"). Effective December 31, 2017, the original Foreclosed Inventory Purchase Agreement was terminated.

Effective January 1, 2018, the Association entered into a new Foreclosed Inventory Purchase Agreement with MORI. The agreements automatically renew for any number of additional one (1) year terms, unless either party terminates the agreement with a 45 day written notice. The agreements provide that MORI shall purchase the Association's foreclosed inventory subject to the terms of the agreements. Should either party terminate the agreement, there could be potential exposure regarding the allowance for doubtful accounts and bad debt expense.

As of April 16, 2018, the new agreement is in full effect and neither party has opted to terminate the agreement.

**Unearned Maintenance Fees**
Maintenance fees for all unit weeks are receivables as of the beginning of each fiscal 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.

**Income Taxes**
The Association accounts for income taxes in accordance with 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 timeshare 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 timeshare rights to use, or timeshare ownership interests in, real property.

The Association made this election for 2016 and plans on making this election for 2017; accordingly, deferred taxes have not been provided for temporary differences related to exempt function income. Should the Association not elect 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.

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, 2017. The Association's federal income tax returns for 2014, 2015 and 2016 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**
The complex consists of the VOA, the Hotel, MKORI and the Developer. The hotel back office accounting system is utilized to record all expenses of these four entities. At the end of each month, allocations are made based on different methodologies to credit the hotel books and allocate costs to the timeshare and condominium operations.

The allocation methodology was developed by a private consultant in 1994 at the request of the Developer with the assistance of Marriott International. These methodologies were then used by the Developer to register the property as a condominium with a hotel and timeshare operation and as the basis for allocating cost since opening in 1995. The management company (currently Essex) continues to use these methodologies in allocating costs between the owners of the Condominium Association.

The various allocation methodologies are documented in the management company's standard operating procedures. Examples of the major allocation bases are: 1) check-ins, 2) bays cleaned, 3) guest mix, and 4) square footage ownership.

**Accounting Pronouncements**

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09 – *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-09"), as Amended. ASU 2014-09 supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, as well as most industry-specific guidance, and significantly enhances comparability of revenue recognition practices across entities and industries by providing a principle-based, comprehensive framework for addressing revenue recognition issues. In order for a provider of promised goods or services to recognize as revenue the consideration that it expects to receive in exchange for the promised goods or services, the provider should apply the following five steps: (1) identify the contract with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014-09, as amended, will be effective for annual reporting periods beginning after December 15, 2018. The new standard may be applied retrospectively or on a modified retrospective basis with the cumulative effect recognized on the date of adoption. Although the Association expects to adopt ASU 2014-09, as amended, commencing in fiscal year 2019, the Association continues to evaluate the impact that adoption of this accounting standards update will have on its financial statements and disclosures.

In February 2016, the 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, 2019, with early adoption permitted. Although the Association expects to adopt ASU 2016-02 commencing in fiscal year 2020, the Association continues to evaluate the impact that adoption of this accounting standards update will have on its financial statements and disclosures.

## 2. Investments

Investments are classified as follows at December 31, 2017 and 2016:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Amortized Cost/Principal | Fair Market Value | Amortized Cost/Principal | Fair Market Value |
| Equity-linked certificates of deposit | $ 500,000 | $ 636,175 | $ 500,000 | $ 542,763 |
| Treasury inflation-protected securities | $ 252,857 | $ 252,857 | $ 250,007 | $ 250,689 |
| Certificates of deposit (held-to-maturity) | $ 9,755,000 | $ 9,725,980 | $ 7,795,000 | $ 7,772,508 |

* Investments on the Balance Sheets is the sum of the fair market value of the equity-linked certificates of deposit and the treasury inflation-protected securities and the amortized cost of the certificates of deposit.

The contractual maturities of investments held-to-maturity at December 31, 2017 and 2016 are as follows:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Amortized Cost/Principal | Fair Market Value | Amortized Cost/Principal | Fair Market Value |
| Due within one year | $ 5,835,000 | $ 5,828,008 | $ 3,920,000 | $ 3,917,021 |
| Due between one to five years | 4,672,857 | 4,787,004 | 4,375,000 | 4,398,250 |
| Due after five years | - | - | 250,007 | 250,689 |
| Total | $ 10,507,857 | $ 10,615,012 | $ 8,545,007 | $ 8,565,960 |

The equity-linked certificates of deposit and treasury inflation-protected securities had unrealized gains of $95,580 and $45,545 for the years ended December 31, 2017 and 2016, respectively, which are included in the Statements of Revenues, Expenses and Changes in Fund Balance – Reserve for Replacement Fund.

## 3. Income Taxes

The provision for income taxes consisted of the following for the years ended December 31, 2017 and 2016:

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Total | Operating Fund | Reserve for Replacement Fund | Total | Operating Fund | Reserve for Replacement Fund |
| Federal | $ 33,920 | $ 5,510 | $ 28,410 | $ 18,172 | $ 3,001 | $ 15,171 |
| State | 5,595 | 909 | 4,686 | 3,593 | 593 | 3,000 |
| | $ 39,515 | $ 6,419 | $ 33,096 | $ 21,765 | $ 3,594 | $ 18,171 |

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

## 4. Management Agreement

The Association entered into a management agreement with Essex as the management company for a term consisting of automatic one-year renewals unless sooner terminated by written notice or applicable law. The management company is responsible for the management, maintenance and operations of the facilities, in exchange for an annual fee of 6 1/2% of the annual budget of the Association, including replacement reserves contributions but excluding the management company's compensation. For the years ended December 31, 2017 and 2016, the management fee was $1,125,975 and $1,111,470, respectively, and is recorded in the Statements of Revenues, Expenses and Changes in Fund Balance – Operating Fund. On December 1, 2016, the Association and Essex entered into a first amendment to the original management agreement to reflect a change in the frequency of the payment of the management fee effective January 1, 2017.

## 5. Leases

The Association leases land, buildings, vehicles and equipment under operating leases which range in expiration dates through 2060. The following is a schedule of future minimum rental payments under the operating leases having a remaining noncancelable term in excess of one year as of December 31, 2017:

| **Years Ending December 31,** | |
|---|---|
| 2018 | $ 261,166 |
| 2019 | 248,123 |
| 2020 | 248,123 |
| 2021 | 248,123 |
| 2022 | 248,123 |
| Thereafter | 9,428,690 |
| | $ 10,682,348 |

Rent expense under the operating leases for the years ended December 31, 2017 and 2016 was approximately $404,293 and $390,838, respectively, and is included in the Statements of Revenues, Expenses, and Changes in Fund Balance – Operating Fund.

## 6. Related Party Transactions

The Hotel pays certain expenses on behalf of the Association for which the Association will reimburse the Hotel. The amounts due to the Hotel at December 31, 2017 and 2016 were $708,255 and $821,754, respectively.

The net amounts due from the VOA at December 31, 2017 and 2016 were $0 and $774, respectively.

Certain services, including off-site accounting and administration, and reservations, are provided by Marriott Resorts Hospitality Corporation ("MRHC") and allocated to the Association based on the number of unit weeks, as a percentage of total unit weeks the respective service covers. In addition, Marriott Vacations Worldwide Corporation ("MVWC"), the indirect parent company of MRHC, pays certain expenses on behalf of the Association, subject to reimbursement by the Association. The net amount due (to) from MVWC at December 31, 2017 and 2016 was ($16,422) and $64,342, respectively.

MRHC collects annual maintenance fees on behalf of the Association. The amount of maintenance fees receivable due from MRHC at December 31, 2017 and 2016 was $393,285 and $174,763, respectively.

## 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.

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.

## 8. Subsequent Events

The Association has performed an evaluation of subsequent events through April 16, 2018, which is the date the financial statements were issued.

On behalf of the Board of Directors, a reserve study was completed during 2017 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 | 2018 Funding Requirement | Components of Fund Balance at December 31, 2017 |
|---|---|---|---|---|
| Roof replacement | 17 | $ 4,094,356 | $ 45,575 | $ 919,711 |
| Furniture and fixtures | 4 | 30,759,911 | 1,722,485 | 4,081,206 |
| Building painting | 1 | 3,680,568 | 443,402 | 1,777,099 |
| Pavement resurfacing | 9 | 2,046,540 | (1,705) | 2,096,961 |
| Common area rehabilitation | 2 | 12,602,430 | 760,573 | 5,984,961 |
| Total | | $ 53,183,805 | $ 2,970,330 | $ 14,859,938 |

# Marriott's Kaua'i Beach Club Owners Association, Inc.

**Financial Statements**
**December 31, 2017 and 2016**

# Marriott's Kaua'i Beach Club Owners Association, Inc.
## Index
## December 31, 2017 and 2016

pwc

## Report of Independent Auditors

The Board of Directors of
Marriott's Kaua'i Beach Club Owners Association, Inc.

We have audited the accompanying financial statements of Marriott's Kaua'i Beach Club Owners Association, Inc. (the "Association"), which comprise the balance sheet as of December 31, 2017 and the related statements of revenues, expenses and changes in fund balance - operating fund and of revenues, expenditures and changes in fund balance - reserve for replacement fund for the years ended December 31, 2017 and 2016, and of cash flows for the year ended December 31, 2017.

**Management's Responsibility for the Financial Statements**
Management is responsible for the preparation and fair presentation of the 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 the 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, we consider 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 Marriott's Kaua'i Beach Club Owners Association, Inc. at December 31, 2017, and the results of its operations for the years ended December 31, 2017 and 2016 and its cash flows for the year ended December 31, 2017 in accordance with accounting principles generally accepted in the United States of America.

**Other Matters**
We previously audited the balance sheet as of December 31, 2016 and the related statements of revenues, expenses and changes in fund balance – operating fund, of revenues, expenditures and changes in fund balance – reserve for replacement fund and of cash flows for the year then ended (not presented herein), and in our report dated April 19, 2017, we expressed an unmodified opinion on those financial statements. In our opinion, the information set forth in the accompanying summarized financial information as of December 31, 2016 and for the year then ended is consistent, in all material respects, with the audited financial statements from which it has been derived.

Accounting principles generally accepted in the United States of America require that the Supplementary Information on Future Major Repairs and Replacements (Unaudited) on page 15 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 who 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.

PricewaterhouseCoopers LLP

Certified Public Accountants
Tampa, Florida
April 16, 2018

# Marriott's Kaua'i Beach Club Owners Association, Inc.
## Balance Sheets
## December 31, 2017, with Summarized Comparative Totals for December 31, 2016

| | 2017 | | | |
|---|---|---|---|---|
| | **Operating Fund** | **Reserve for Replacement Fund** | **Total** | **2016** |
| **Assets** | | | | |
| Cash and cash equivalents | $ 5,550,583 | $ 4,916,057 | $ 10,466,640 | $ 8,076,442 |
| Investments | - | 4,768,062 | 4,768,062 | 5,792,308 |
| Maintenance fees receivable, less allowance for doubtful accounts of approximately $37,000 and $88,000 in 2017 and 2016, respectively | 171,218 | 38,297 | 209,515 | 347,835 |
| Maintenance fees receivable due from MRHC | 530,973 | 84,416 | 615,389 | 276,248 |
| Accrued interest receivable | - | 12,589 | 12,589 | 13,540 |
| Prepaid expenses and other assets | 101,568 | - | 101,568 | 88,980 |
| Income tax receivable | - | - | - | 4,254 |
| Due from Marriott Vacations Worldwide Corporation | 73,647 | - | 73,647 | 205,705 |
| Due from Marriott Resorts Hospitality Corporation | - | - | - | 16,651 |
| Due to Operating Fund | - | (60,517) | (60,517) | (15,730) |
| Due from Reserve for Replacement Fund | 60,517 | - | 60,517 | 15,730 |
| Total assets | $ 6,488,506 | $ 9,758,904 | $ 16,247,410 | $ 14,821,963 |
| **Liabilities and Fund Balances** | | | | |
| Liabilities | | | | |
| Accrued expenses | $ 47,235 | $ - | $ 47,235 | $ 15,865 |
| Unearned maintenance fees | 5,686,613 | 880,607 | 6,567,220 | 5,232,009 |
| Income tax payable | 5,813 | 18,809 | 24,622 | 2,054 |
| General excise tax payable | 18,411 | - | 18,411 | 37,424 |
| Due to Association of Apartment Owners of Marriott's Kaua'i Resort and Beach Club | - | - | - | 774 |
| Due to HPTMI Hawaii Inc. | 680,598 | - | 680,598 | 623,157 |
| Total liabilities | 6,438,670 | 899,416 | 7,338,086 | 5,911,283 |
| Fund balances | 49,836 | 8,859,488 | 8,909,324 | 8,910,680 |
| Total liabilities and fund balances | $ 6,488,506 | $ 9,758,904 | $ 16,247,410 | $ 14,821,963 |

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

## Marriott’s Kaua’i Beach Club Owners Association, Inc.
### Statements of Revenues, Expenses and Changes in Fund Balance – Operating Fund
### Years Ended December 31, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| **Revenues** | | |
| Maintenance fees | $ 18,384,443 | $ 17,380,190 |
| Association of Apartment Owners of Marriott Kaua'i Resort and Beach Club assessment | (7,999,823) | (7,667,515) |
| Maintenance fees, net | 10,384,620 | 9,712,675 |
| Interest | 28,988 | 15,285 |
| Miscellaneous income | 67,432 | 25,111 |
| Late fee income and finance charges | 156,462 | 152,673 |
| Total revenues | 10,637,502 | 9,905,744 |
| **Expenses** | | |
| Accounting and administration | 1,228,010 | 1,153,997 |
| Audit fees | 16,750 | 16,075 |
| Activities, net | 188,694 | 182,442 |
| Bad debt expense (benefit) | 26,620 | (37,716) |
| Billing and collection expense | 114,600 | 112,320 |
| Board of Directors' expense | 24,916 | 22,666 |
| Cable television | 148,700 | 104,732 |
| Credit card | 190,621 | 191,837 |
| Front desk | 1,565,728 | 1,471,099 |
| General excise tax | 514,408 | 484,863 |
| Housekeeping | 2,630,605 | 2,619,068 |
| Income tax expense | 10,465 | 2,261 |
| Insurance | 34,758 | 21,786 |
| Loss prevention | 14,141 | 7,136 |
| Maintenance | 1,197,680 | 1,106,541 |
| Management fee | 916,290 | 866,199 |
| Owner services | 493,320 | 465,360 |
| Postage and printing | 51,917 | 39,982 |
| Real estate and property taxes | 2,119,610 | 1,728,220 |
| Total expenses | 11,487,833 | 10,558,868 |
| Deficit of revenues over expenses | (850,331) | (653,124) |
| **Fund balance** | | |
| Beginning of year | 900,167 | 1,553,291 |
| End of year | $ 49,836 | $ 900,167 |

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

# Marriott's Kaua'i Beach Club Owners Association, Inc.
## Statements of Revenues, Expenditures and Changes in Fund Balance – Reserve for Replacement Fund
## Years Ended December 31, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| **Revenues** | | |
| Reserve for replacement assessment | $ 2,180,770 | $ 2,138,010 |
| Late fee income | 8,104 | 10,029 |
| Interest income | 66,850 | 45,320 |
| Realized gain on fair value investments | 10,232 | - |
| Unrealized gain on fair value investments | 61,825 | 67,550 |
| Total revenues | 2,327,781 | 2,260,909 |
| **Expenditures** | | |
| Furniture and fixtures | 1,444,948 | 376,342 |
| Income tax expense | 33,858 | 9,981 |
| Total expenditures | 1,478,806 | 386,323 |
| Excess of revenues over expenditures | 848,975 | 1,874,586 |
| **Fund balance** | | |
| Beginning of year | 8,010,513 | 6,135,927 |
| End of year | $ 8,859,488 | $ 8,010,513 |

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

## Marriott's Kaua'i Beach Club Owners Association, Inc.
### Statements of Cash Flows
### For the Year Ended December 31, 2017, with Summarized Comparative Totals for the Year Ended December 31, 2016

| | 2017 Operating Fund | 2017 Reserve for Replacement Fund | 2017 Total | 2016 |
|---|---|---|---|---|
| **Cash flows from operating activities** | | | | |
| (Deficit) excess of revenues over expenses/expenditures | $ (850,331) | $ 848,975 | $ (1,356) | $ 1,221,462 |
| Adjustments to reconcile (deficit) excess of revenues over expenses/expenditures to net cash provided by operating activities | | | | |
| Bad debt expense (benefit) | 26,620 | - | 26,620 | (37,716) |
| Realized gain on fair value investments | - | (10,232) | (10,232) | - |
| Unrealized gain on fair value investments | - | (61,825) | (61,825) | (67,550) |
| Changes in operating assets and liabilities | | | | |
| Decrease (increase) in maintenance fees receivable | 76,267 | 35,433 | 111,700 | (76,091) |
| (Increase) decrease in maintenance fees receivable due from MRHC | (302,526) | (36,615) | (339,141) | 265,254 |
| Decrease (increase) in accrued interest receivable | - | 951 | 951 | (12,376) |
| Increase in prepaid expenses and other assets | (12,588) | - | (12,588) | (769) |
| Decrease in income tax receivable | 4,254 | - | 4,254 | 19,237 |
| Decrease (increase) in due from Marriott Vacations Worldwide Corporation | 132,058 | - | 132,058 | (180,336) |
| Decrease (increase) in due from Marriott Resorts Hospitality Corporation | 16,651 | | 16,651 | (16,651) |
| Increase (decrease) in accrued expenses | 31,370 | - | 31,370 | (70,222) |
| Increase (decrease) in unearned maintenance fees | 1,368,434 | (33,223) | 1,335,211 | 259,166 |
| Increase (decrease) in income tax payable | 5,813 | 16,755 | 22,568 | (5,273) |
| (Decrease) increase in general excise tax payable | (19,013) | - | (19,013) | 16,435 |
| Decrease in due to Association of Apartment Owners of Marriott's Kaua'I Resort and Beach Club | (774) | - | (774) | (4,249) |
| Increase (decrease) in due to HPTMI Hawaii Inc. | 57,441 | - | 57,441 | (64,355) |
| (Decrease) increase in due from/to Operating/ Reserve for Replacement Funds | (44,787) | 44,787 | - | - |
| Net cash provided by operating activities | 488,889 | 805,006 | 1,293,895 | 1,245,966 |
| **Cash flows from investing activities** | | | | |
| Purchases of investments | - | - | - | (9,664,783) |
| Proceeds from maturity of investments | - | 1,096,303 | 1,096,303 | 7,189,000 |
| Net cash provided by (used in) investing activities | - | 1,096,303 | 1,096,303 | (2,475,783) |
| Net increase (decrease) in cash and cash equivalents | 488,889 | 1,901,309 | 2,390,198 | (1,229,817) |
| **Cash and cash equivalents** | | | | |
| Beginning of year | 5,061,694 | 3,014,748 | 8,076,442 | 9,306,259 |
| End of year | $ 5,550,583 | $ 4,916,057 | $ 10,466,640 | $ 8,076,442 |
| **Supplemental disclosure of cash flow information** | | | | |
| Cash paid (received) during the year for income taxes | $ 398 | $ 17,103 | $ 17,501 | $ (1,722) |

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

### 1. Summary of Significant Accounting Policies

Marriott's Kaua'i Beach Club Owners Association, Inc. (the "Association") was incorporated on February 20, 1995 in the State of Hawaii, and commenced operations on October 1, 1995. The purpose of the Association is to administer and manage the vacation ownership project created and established as Marriott's Kaua'i Beach Club Vacation Ownership Program at Marriott's Kaua'i Resort and Beach Club condominium project (the "Ownership Condominium"). As of December 31, 2017 and 2016, the Ownership Condominium consisted of 12,000 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 condominium assets are not recorded on the financial records of the Association. The Association is managed under an agreement with Marriott Resorts Hospitality Corporation ("MRHC"). Under an on-site management agreement, MRHC delegated on-site management of the Association to Essex House Condominium Corporation ("Essex"), a subsidiary of Marriott International.

**Comparative Information**
While comparative information is not required under accounting principles generally accepted in the United States of America, the Association believes that this information is useful and has included comparative financial information from the financial statements as of and for the year ended December 31, 2016. Within the Balance Sheets and Statements of Cash Flows, prior year balances, by fund, have been condensed for comparative purposes. This summarized information is not intended to be a full presentation in conformity with accounting principles generally accepted in the United States of America, which would require certain additional information. Accordingly, such information should be read in conjunction with the Association's audited financial statements as of and for the year ended December 31, 2016.

**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 is accumulating funds for future major repairs and replacements. Accumulated funds are held in separate savings accounts and generally are not available for normal operations.

Essex, 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 $1,846,019 has been included in the 2018 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.

**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, bonds and equity-linked certificates of deposit.

The Association's certificates of deposit and bonds 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.

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"). 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.

The following table summarizes the Association's investments recorded at fair value on a recurring basis at December 31, 2017 and 2016:

| | 2017 | | | |
|---|---|---|---|---|
| | Fair Value Measurements Using | | | |
| | **Level 1** | **Level 2** | **Level 3** | **Total** |
| Equity-linked certificates of deposit | $ - | $ 740,000 | $ - | $ 740,000 |

| | 2016 | | | |
|---|---|---|---|---|
| | Fair Value Measurements Using | | | |
| | **Level 1** | **Level 2** | **Level 3** | **Total** |
| Equity-linked certificates of deposit | $ - | $1,011,525 | $ - | $1,011,525 |

**Maintenance Fees Receivable**
Maintenance fees receivable represents an amount due from owners.

Effective January 1, 2010, the Association entered into a Foreclosed Inventory Purchase Agreement with Marriott Ownership Resorts, Inc. ("MORI"). Effective December 31, 2017, the original Foreclosed Inventory Purchase Agreement was terminated.

Effective January 1, 2018, the Association entered into a new Foreclosed Inventory Purchase Agreement with MORI. The agreements automatically renew for any number of additional one (1) year terms, unless either party terminates the agreement with a 45 day written notice. The agreements provide that MORI shall purchase the Association's foreclosed inventory subject to the terms of the agreements. Should either party terminate the agreement, there could be potential exposure regarding the allowance for doubtful accounts and bad debt expense.

As of April 16, 2018, the new agreement is in full effect and neither party has opted to terminate the agreement.

**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.

**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.

Timeshare associations are subject to taxation under Internal Revenue Code Section 528 ("Section 528"), which allows the association to be considered an exempt organization and exempt from tax on its "exempt function income." Exempt function income is defined as any amounts received as membership dues, fees, or assessments from association owners. However, associations that do not meet the income, expenditure, and organizational requirements set forth in Section 528 must file as corporations under the provisions of Internal Revenue Code Section 277 ("Section 277").

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. In 2017, the Association satisfied the requirements to file as an exempt organization under Section 528 and provided for taxes under the provisions of Section 528.

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, 2017.

The Association's federal income tax returns for 2014, 2015 and 2016 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**

The complex is comprised of HPTMI Hawaii Inc. (the "Hotel"), the Association, Marriott Kaua'i Ownership Resorts, Inc. ("MKORI") and Marriott Ownership Resorts, Inc. (the "Developer"). The Hotel's back office accounting system is utilized to record all expenses of these four entities. At the end of each month, allocations are made based on different methodologies to credit the Hotel books and allocate costs to the timeshare and condominium operations.

The allocation methodology was developed by a private consultant in 1994 at the request of the Developer with the assistance of Marriott International. These methodologies were then used by the Developer to register the property as a condominium with a hotel and timeshare operation and as the basis for allocating cost since opening in 1995. The management company (currently Essex) continues to use these methodologies in allocating costs between the owners of the Condominium Association.

The various allocation methodologies are documented in the management company's standard operating procedures. Examples of the major allocation bases are: 1) check-ins, 2) bays cleaned, 3) guest mix, and 4) square footage ownership.

**Accounting Pronouncements**
In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09 – *Revenue from Contracts with Customers (Topic 606*" ("ASU 2014-09"), as Amended. ASU 2014-09 supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, as well as most industry-specific guidance, and significantly enhances comparability of revenue recognition practices across entities and industries by providing a principle-based, comprehensive framework for addressing revenue recognition issues. In order for a provider of promised goods or services to recognize as revenue the consideration that it expects to receive in exchange for the promised goods or services, the provider should apply the following five steps: (1) identify the contract with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014-09, as amended, will be effective for annual reporting periods beginning after December 15, 2018. The new standard may be applied retrospectively or on a modified retrospective basis with the cumulative effect recognized on the date of adoption. Although the Association expects to adopt ASU 2014-09, as amended, commencing in fiscal year 2019, the Association continues to evaluate the impact that adoption of this accounting standards update will have on its financial statements and disclosures.

In February 2016, the 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, 2019, with early adoption permitted. Although the Association expects to adopt ASU 2016-02 commencing in fiscal year 2020, the Association continues to evaluate the impact that adoption of this accounting standards update will have on its financial statements and disclosures.

## 2. Investments

Investments are classified as follows at December 31, 2017 and 2016:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Amortized Cost/Principal | Fair Market Value | Amortized Cost/Principal | Fair Market Value |
| Equity-linked certificates of deposit | $ 500,000 | $ 740,000 | $ 750,000 | $ 1,011,525 |
| Certificates of deposit (held-to-maturity) | $ 2,160,000 | $ 2,155,853 | $ 2,895,000 | $ 2,894,761 |
| Bonds (held-to-maturity) | 1,868,062 | 1,857,726 | 1,885,783 | 1,876,722 |
| | $ 4,028,062 | $ 4,013,579 | $ 4,780,783 | $ 4,771,483 |

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

The contractual maturities of investments held-to-maturity and equity-linked certificates of deposit at December 31, 2017 and 2016 are as follows:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Amortized Cost/Principal | Fair Market Value | Amortized Cost/Principal | Fair Market Value |
| Due within one year | $ 4,278,062 | $ 4,407,804 | $ 985,000 | $ 1,068,759 |
| Due between one to five years | 250,000 | 345,775 | 4,545,783 | 4,714,249 |
| Total | $ 4,528,062 | $ 4,753,579 | $ 5,530,783 | $ 5,783,008 |

During the year ended December 31, 2017, an equity-linked certificate of deposit of $250,000 matured and was redeemed for $343,582. This resulted in a gain of $93,582. In prior years, $83,350 was netted in unrealized gains on fair value investments with $10,232 included in realized gain on fair value investment for the year ended December 31, 2017 in the Statements of Revenues, Expenditures and Changes in Fund Balance – Reserve for Replacement Fund.

The equity-linked certificate of deposits had unrealized gains of $61,825 and $67,550 for the years ended December 31, 2017 and 2016, respectively, which are included in the Statements of Revenues, Expenditures and Changes in Fund Balance - Reserve for Replacement Fund.

## 3. Income Taxes

The provision for income taxes consisted of the following for the years ended December 31, 2017 and 2016:

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Total | Operating Fund | Reserve for Replacement Fund | Total | Operating Fund | Reserve for Replacement Fund |
| Federal | $ 39,372 | $ 9,296 | $ 30,076 | $ 9,304 | $ 1,718 | $ 7,586 |
| State | 4,951 | 1,169 | 3,782 | 2,938 | 543 | 2,395 |
| | $ 44,323 | $ 10,465 | $ 33,858 | $ 12,242 | $ 2,261 | $ 9,981 |

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

At December 31, 2017 and 2016, the Association had the following deferred tax assets:

| | 2017 | 2016 |
|---|---|---|
| Deferred tax asset | $ 1,679,429 | $ 1,679,429 |
| Total deferred tax asset | 1,679,429 | 1,679,429 |
| Valuation allowance | (1,679,429) | (1,679,429) |
| Net deferred tax asset | $ - | $ - |

The deferred tax asset is a result of a net operating loss generated in the prior year 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.

## 4. Management Agreement

The Association has entered into a management agreement with MRHC, as the management company, for a term of three years with automatic one-year renewals unless sooner terminated by written notice or applicable law. Marriott Hotel Services, Inc. ("MHSI") 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, less certain charges identified in the agreement. During 2009, MHSI assigned the management agreement to Essex. The management fee was $916,290 and $866,199 for the years ended December 31, 2017 and 2016, respectively, and is recorded in the Statements of Revenues, Expenses and Changes in Fund Balance - Operating Fund. On February 7, 2017, the Association's Board of Directors approved the first amendment to the original management agreement to reflect a change in the frequency of the payment of the management fee effective January 1, 2017.

## 5. 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. The amount due from MRHC at December 31, 2017 and 2016 was $0 and $16,651, respectively. The Hotel pays certain expenses on behalf of the Association for which the Association will reimburse the Hotel. The amount due to the Hotel at December 31, 2017 and 2016 was $680,598 and $623,157, respectively. The net amount due to the Association of Apartment Owners of Marriott's Kaua'i Resort and Beach Club at December 31, 2017 and 2016 was $0 and $774, respectively.

Marriott Vacations Worldwide Corporation ("MVWC"), the indirect parent company of MRHC, pays certain expenses on behalf of the Association, subject to reimbursement by the Association. The net amount due from MVWC at December 31, 2017 and 2016 was $73,647 and $205,705, respectively.

MRHC collects annual maintenance fees on behalf of the Association. The amount of maintenance fees receivable due from MRHC at December 31, 2017 and 2016 was $615,389 and $276,248, respectively.

## 6. 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.

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, 2017 and 2016, the MVC Trust held 1,816 (15%) and 1,574 (13%) of the timeshare interests in the Association, respectively.

## 7. Subsequent Events

The Association has performed an evaluation of subsequent events through April 16, 2018, which is the date the financial statements were issued.

# Marriott's Kaua'i Beach Club Owners Association, Inc.
## Supplementary Information on Future Major Repairs and Replacements (Unaudited)
## Year Ended December 31, 2017

On behalf of the Board of Directors, a reserve study was completed during 2014 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 | 2018 Funding Requirement | Components of Fund Balance at December 31, 2017 |
|---|---|---|---|---|
| Furniture and fixtures | 7 | $ 23,588,231 | $ 1,846,019 | $ 8,859,488 |

**Association of Apartment Owners of Marriott's Kauai Resort and Beach Club**
**Board of Directors**

| **Name/Address** | **Phone/Fax/E-mail** | **Office** | **Term** |
|---|---|---|---|
| Arthur Gillespie<br>c/o Marriott's Kauai Beach Club<br>Executive Offices<br>3610 Rice Street<br>Lihue, Hawaii 96766 | Ph: 808-246-5019<br>Fax: 808-245-2993<br>art.gillespie@verizon.net | President | 2016-2019 |
| Chris Tatum<br>c/o Marriott's Kauai Beach Club<br>Executive Offices<br>3610 Rice Street<br>Lihue, Hawaii 96766 | Ph: 808-246-5019<br>Fax: 808-245-2993<br>chris.tatum@marriott.com | Vice President | 2015-2018 |
| Jan Yokota<br>c/o Marriott's Kauai Beach Club<br>Executive Offices<br>3610 Rice Street<br>Lihue, Hawaii 96766 | Ph: 808-246-5019<br>Fax: 808-245-2993<br>jyokota@rmrgroup.com | Secretary/Treasurer | 2017-2020 |

**Marriott's Kauai Beach Club Owners Association**
**Board of Directors**

| Name/Address | Phone/Fax/E-mail | Office | Term |
|---|---|---|---|
| Arthur Gillespie<br>c/o Marriott's Kauai Beach Club<br>Executive Offices<br>3610 Rice Street<br>Lihue, Hawaii 96766 | Ph: 808-246-5019<br>Fax: 808-245-2993<br>art.gillespie@verizon.net | President | 2015-2018 |
| George Hammond<br>c/o Marriott's Kauai Beach Club<br>Executive Offices<br>3610 Rice Street<br>Lihue, Hawaii 96766 | Ph: 808-246-5019<br>Fax: 808-245-2993<br>g_hammond@sbcglobal.net | Vice President | 2016-2019 |
| Henry Lum<br>c/o Marriott's Kauai Beach Club<br>Executive Offices<br>3610 Rice Street<br>Lihue, Hawaii 96766 | Ph: 808-246-5019<br>Fax: 808-245-2993<br>hblum@pacbell.net | Secretary/Treasurer | 2015-2018 |
| Albert Kanahele<br>c/o Marriott's Kauai Beach Club<br>Executive Offices<br>3610 Rice Street<br>Lihue, Hawaii 96766 | Ph: 808-246-5019<br>Fax: 808-245-2993<br>kanahele540@gmail.com | Director | 2017-2020 |
| Linda Pond<br>c/o Marriott's Kauai Beach Club<br>Executive Offices<br>3610 Rice Street<br>Lihue, Hawaii 96766 | Ph: 808-246-5019<br>Fax: 808-245-2993<br>Lindapond.realestate@yahoo.com | Director | 2016-2019 |