

May 2018

Dear Waikoloa Beach Marriott's Resort Owner,

The 2017 Audit Report for the WBHR South Tower Units Association is enclosed for your review.

If you have questions, please contact Karl Schwartzlow, Regional Director of Finance, via email at [karl.schwartzlow@vacationclub.com](mailto:karl.schwartzlow@vacationclub.com) or by phone at 808-667-8268.

Sincerely,

*Jason Marino*  
Secretary/Treasurer  
WBHR South Tower Units Association

Enclosure

# **WBHR South Tower Units Association**

**Financial Statements**

**May 11, 2017 (Inception) through December 31, 2017**

# WBHR South Tower Units Association

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Period from May 11, 2017 (Inception) through December 31, 2017

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## Report of Independent Auditors

The Board of Directors of  
WBHR South Tower Units Association

We have audited the accompanying financial statements of WBHR South Tower Units Association (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, of revenues, expenditures and changes in fund balance - reserve for replacement fund, and of cash flows for the period from May 11, 2017 (Inception) through 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 WBHR South Tower Units Association at December 31, 2017, and the results of its operations and its cash flows for the period from May 11, 2017 (Inception) through December 31, 2017 in accordance with accounting principles generally accepted in the United States of America.



**Other Matter**

Accounting principles generally accepted in the United States of America require that the Supplementary Information on Future Major Repairs and Replacements (Unaudited) on page 13 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.

A handwritten signature in black ink that reads "PricewaterhouseCoopers 22P". The signature is written in a cursive, flowing style.

Certified Public Accountants  
April 19, 2018

**WBHR South Tower Units Association**  
**Balance Sheet**  
**December 31, 2017**

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	Operating Fund	Reserve for Replacement Fund	Total
<b>Assets</b>			
Cash and cash equivalents	\$ 9,509,506	\$ 1,460,933	\$ 10,970,439
Investments	740,000	-	740,000
Accrued interest receivable	566	-	566
Prepaid expenses and other assets	459,833	-	459,833
Due from Marriott Vacations Worldwide Corporation	2,581	-	2,581
Total assets	<u>\$ 10,712,486</u>	<u>\$ 1,460,933</u>	<u>\$ 12,173,419</u>
<b>Liabilities and Fund Balances</b>			
Liabilities			
Accrued expenses	\$ 35,846	\$ -	\$ 35,846
Unearned maintenance fees	9,098,498	1,417,318	10,515,816
General excise tax accrual	36,400	-	36,400
Income tax payable	11,271	212	11,483
Due to Marriott Hotel Services, Inc.	534,154	-	534,154
Total liabilities	<u>9,716,169</u>	<u>1,417,530</u>	<u>11,133,699</u>
Fund balances	<u>996,317</u>	<u>43,403</u>	<u>1,039,720</u>
Total liabilities and fund balances	<u>\$ 10,712,486</u>	<u>\$ 1,460,933</u>	<u>\$ 12,173,419</u>

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

**WBHR South Tower Units Association**  
**Statement of Revenues, Expenses and Changes in Fund Balance – Operating**  
**Fund**  
**Period from May 11, 2017 (Inception) through December 31, 2017**

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<b>Revenues</b>	
Maintenance fees	\$ 6,459,558
Bank interest	16,884
Antenna income	22,082
Total revenues	<u>6,498,524</u>
<b>Expenses</b>	
Accounting	165,112
Activities	55,899
Administration	679,935
Association of Unit Owners of Waikoloa Beach Hotel and Resort assessment	730,785
Audit fee	13,850
Cable television	28,998
Electricity	241,329
Front desk	546,825
Gas	53,766
General excise tax	282,722
High-speed internet	3,676
Housekeeping	763,138
Human resources	5,250
Income tax expense	11,271
Insurance	81,196
Loss prevention / security	128,670
Maintenance	355,094
Management fee	823,560
Property taxes	155,068
Room service	15,625
Telephone	170,480
Waikoloa Beach Resort conference assessment	4,820
Waikoloa Resort association assessment	61,079
Water and sewer	124,059
Total expenses	<u>5,502,207</u>
Excess of revenues over expenses	996,317
<b>Fund balance</b>	
Beginning of period	<u>-</u>
End of period	<u>\$ 996,317</u>

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

**WBHR South Tower Units Association**  
**Statement of Revenues, Expenditures and Changes in Fund Balance – Reserve**  
**for Replacement Fund**  
**Period from May 11, 2017 (Inception) through December 31, 2017**

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<b>Revenues</b>	
Reserve for replacement assessment	\$ 139,104
Bank interest	607
Total revenues	139,711
<b>Expenditures</b>	
Furniture and fixtures	86,596
External building maintenance	9,500
Income tax expense	212
Total expenditures	96,308
Excess of revenues over expenditures	43,403
<b>Fund balance</b>	
Beginning of period	-
End of period	\$ 43,403

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



**WBHR South Tower Units Association**  
**Statement of Cash Flows**  
**Period from May 11, 2017 (Inception) through December 31, 2017**

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	Operating Fund	Reserve for Replacement Fund	Total
<b>Cash flows from operating activities</b>			
Excess of revenues over expenses/expenditures	\$ 996,317	\$ 43,403	\$ 1,039,720
Adjustments to reconcile excess of revenues over expenses/expenditures to net cash provided by operating activities			
Changes in operating assets and liabilities			
Increase in accrued interest receivable	(566)	-	(566)
Increase in prepaid expenses and other assets	(459,833)	-	(459,833)
Increase in due from Marriott Vacations Worldwide Corporation	(2,581)	-	(2,581)
Increase in accrued expenses	35,846	-	35,846
Increase unearned maintenance fees	9,098,498	1,417,318	10,515,816
Increase in general excise tax accrual	36,400	-	36,400
Increase in income tax payable	11,271	212	11,483
Increase in due to Marriott Hotel Services, Inc.	534,154	-	534,154
Net cash provided by operating activities	<u>10,249,506</u>	<u>1,460,933</u>	<u>11,710,439</u>
<b>Cash flows from investing activities</b>			
Purchases of investments	<u>(740,000)</u>	-	<u>(740,000)</u>
Net cash used in investing activities	<u>(740,000)</u>	-	<u>(740,000)</u>
Net increase in cash and cash equivalents	9,509,506	1,460,933	10,970,439
<b>Cash and cash equivalents</b>			
Beginning of period	-	-	-
End of period	<u>\$ 9,509,506</u>	<u>\$ 1,460,933</u>	<u>\$ 10,970,439</u>
<b>Supplemental disclosure of cash flow information</b>			
Cash paid during the period for income taxes	\$ -	\$ -	\$ -

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

# **WBHR South Tower Units Association**

## **Notes to Financial Statements**

### **Period from May 11, 2017 (Inception) through December 31, 2017**

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#### **1. Summary of Significant Accounting Policies**

WBHR South Tower Units Association (the "Association") was incorporated on May 11, 2017 in the State of Hawaii. The purpose of the Association is to administer and manage the condominium units situated within the South Tower of the Waikoloa Beach Hotel and Resort condominium project located in Waikoloa Beach, Hawaii ("Units"), and the Limited Common Elements appurtenant to such Units. The Association consists of 112 units. The Association's declaration provides that each unit owner has an undivided interest in the facilities and, accordingly, the Association assets are not recorded in the financial statements of the Association. Operations of the Association commenced on May 11, 2017. 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 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.

The amount of annual contribution is based on estimates of future needs for repairs and replacements of common property components. MRHC, on behalf of the Board of Directors, utilizes 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 unaudited Supplementary Information on Future Major Repairs and Replacements is based on these 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 \$1,417,318 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.

# **WBHR South Tower Units Association**

## **Notes to Financial Statements**

### **Period from May 11, 2017 (Inception) through December 31, 2017**

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#### **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. 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.

#### **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 Association had no investments recorded at fair value on a recurring basis at December 31, 2017.

#### **Unearned Maintenance Fees**

Unearned maintenance fees represent prepayment of the next year's 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.

# WBHR South Tower Units Association

## Notes to Financial Statements

### Period from May 11, 2017 (Inception) through December 31, 2017

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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 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 period from May 11, 2017 (Inception) through December 31, 2017.

#### **Cost Allocation Methodology**

Marriott Hotel Services, Inc. (the "Hotel Manager") allocates to the Association its portion of Shared Costs on a monthly basis, in accordance with the allocation methodology outlined in Exhibit A of the Condominium Unit Integration Agreement (the "Integration Agreement"), between SMG I Hotel Waikoloa, LLC (the "Developer/Hotel Owner"), The Association of Unit Owners of Waikoloa Beach Hotel and Resort (the "Condominium Association"), and MHSI (the "Hotel Manager"). The amount due to Marriott Hotel Services, Inc. at December 31, 2017 was \$534,154.

#### **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

**WBHR South Tower Units Association**  
**Notes to Financial Statements**  
**Period from May 11, 2017 (Inception) through December 31, 2017**

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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:

	<b>Amortized Cost</b>	<b>Fair Market Value</b>
Certificates of deposit (held-to-maturity)	\$ 740,000	\$ 739,631
	<u>\$ 740,000</u>	<u>\$ 739,631</u>

The contractual maturities of investments at December 31, 2017 are as follows:

	<b>Amortized Cost</b>	<b>Fair Market Value</b>
Due within one year	\$ 740,000	\$ 739,631
	<u>\$ 740,000</u>	<u>\$ 739,631</u>

**3. Association of Unit Owners of Waikoloa Beach Hotel and Resort Assessment**

The Association is a member of the Association of Unit Owners of Waikoloa Beach Hotel and Resort. The Association recorded an assessment of \$730,785 in the Statement of Revenues, Expenses and Changes in Fund Balance – Operating Fund for the period from May 11, 2017 (Inception) through December 31, 2017.

**4. Income Taxes**

The provision for income taxes consisted of the following for period from May 11, 2017 (Inception) through December 31, 2017:

	<b>Total</b>	<b>Operating Fund</b>	<b>Reserve for Replacement Fund</b>
Federal	\$ 10,030	\$ 9,844	\$ 186
State	1,453	1,427	26
	<u>\$ 11,483</u>	<u>\$ 11,271</u>	<u>\$ 212</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 relates to state income taxes and the exclusion of exempt function income.

**WBHR South Tower Units Association**  
**Notes to Financial Statements**  
**Period from May 11, 2017 (Inception) through December 31, 2017**

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**5. Management Agreement**

On May 11, 2017, the Association entered into a management agreement with MRHC, for a term of five years with automatic renewal for successive five year periods unless sooner terminated by either party per the terms of the agreement. MRHC is responsible for the management, maintenance and operations of the facilities, in exchange for an annual fee of 15% of the annual budget of the Association, exclusive of the management fee itself and any management or operating fee to be paid to Marriott Hotel Services, Inc. ("MHSI"), its affiliates or subsidiaries, to whom MRHC has delegated or subcontracted certain on-site management services. The Association recorded an MHSI operating fee of \$284,096 within Administration expense in the Statement of Revenues, Expenses and Changes in Fund Balance – Operating Fund for the period from May 11, 2017 (Inception) through December 31, 2017. The Association recorded a management fee of \$823,560 in the Statement of Revenues, Expenses and Changes in Fund Balance – Operating Fund for the period from May 11, 2017 (Inception) through December 31, 2017.

**6. Related Party Transactions**

Certain services, including off-site accounting and administration are provided by MRHC and allocated to the Association based on the number of units, as a percentage of total units 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 amount due from MVWC at December 31, 2017 was \$2,581.

**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 a high credit quality financial institution. In addition, the Board maintains its investments in a portfolio that the Board 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 have 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 objectives are safety of principal, adequate liquidity, and maximization of current income, with an emphasis on minimizing exposure of principal loss.

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, the MVC Trust held 112 (100 %) of the units in the Association.

**WBHR South Tower Units Association**  
**Notes to Financial Statements**  
**Period from May 11, 2017 (Inception) through December 31, 2017**

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**8. Subsequent Events**

The Association has performed an evaluation of subsequent events through April 19, 2018 which is the date the financial statements were issued.

**WBHR South Tower Units Association**  
**Supplementary Information on Future Major Repairs and Replacements**  
**(Unaudited)**  
**Period from May 11, 2017 (Inception) through December 31, 2017**

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On behalf of the Board of Directors, a reserve study was completed in 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.

	<b>Estimated Remaining Useful Lives (Years)</b>	<b>Estimated Current Replacement Costs</b>	<b>2018 Funding Requirement</b>	<b>Components of Fund Balance at December 31, 2017</b>
Roof replacement	13	\$ 349,650	\$ 31,671	\$ -
Furniture and fixtures	15	13,899,407	1,091,125	52,903
Building painting	9	134,400	17,584	-
External building maintenance	8	451,000	66,383	(9,500)
Common area rehabilitation	9	1,609,310	210,555	-
		<u>\$ 16,443,767</u>	<u>\$ 1,417,318</u>	<u>\$ 43,403</u>



**WBHR South Tower Units Association  
Board of Directors**

<b>Name/Address</b>	<b>Phone/Fax</b>	<b>Office Held</b>	<b>Term</b>
Richard Hayward c/o Waikoloa Beach Marriott Resort 69-275 Waikoloa Beach Drive Waikoloa Beach, HI 96738	Resort Main Phone: 808-886-6789 Resort Main Fax: 808-886-3601	President	2017-2020
Tom McCormack c/o Waikoloa Beach Marriott Resort 69-275 Waikoloa Beach Drive Waikoloa Beach, HI 96738	Resort Main Phone: 808-886-6789 Resort Main Fax: 808-886-3601	Vice President	2017-2019
Jason Marino c/o Waikoloa Beach Marriott Resort 69-275 Waikoloa Beach Drive Waikoloa Beach, HI 96738	Resort Main Phone: 808-886-6789 Resort Main Fax: 808-886-3601	Secretary/Treasurer	2017-2019