

Financial Statements and Report of Independent
Certified Public Accountants

Office of Hawaiian Affairs
State of Hawai'i

June 30, 2010

Office of Hawaiian Affairs
State of Hawai'i

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Office of Hawaiian Affairs
State of Hawai'i

LETTER FROM THE CHIEF EXECUTIVE OFFICER

Year ended June 30, 2010

To the Board of Trustees of the Office of Hawaiian Affairs

It is my pleasure to present to you, the Financial Statements and Report of Independent Certified Public Accountants of the Office of Hawaiian Affairs (OHA) for the fiscal year ended June 30, 2010. This report has been prepared by the Resource Management Line of Business. Responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures, rests with OHA. I believe the information, as presented, is fairly stated in all material aspects; that it is presented in a manner designed to fairly set forth the financial position and results of operations of OHA as measured by the financial activity of its various funds; and that all the information necessary to enable the reader to gain the maximum understanding of OHA's financial affairs has been included.

The report includes the independent auditors' report, management's discussion and analysis (MD&A), basic financial statements and notes to the financial statements.

Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, requires that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of a Management's Discussion & Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it.

THE REPORTING ENTITY

OHA was established by the 1979 Hawai'i State Legislature under the provisions of Chapter 10, Hawai'i Revised Statutes (Act 196). In 1980, the Hawai'i State Legislature approved Act 273, which, in addition to Act 196, initiated the appropriate process to organize and fund the entity. OHA's mission is to mālama (protect) Hawai'i's people and environmental resources and OHA's assets, toward ensuring the perpetuation of the culture, the enhancement of lifestyle and the protection of entitlements of Native Hawaiians, while enabling the building of a strong and healthy Hawaiian people and nation, recognized nationally and internationally.

GASB Statement No. 14, *The Financial Reporting Entity*, establishes standards for defining and reporting on the financial reporting entity. The financial reporting entity consists of OHA as the primary government, as well as other organizations for which the primary government is financially responsible as component units. Based on the common governance and the financial obligations that OHA has made to fund Hi'ilei Aloha LLC and its subsidiaries, it has been classified as a blended component unit. As a result, the financial results of Hi'ilei Aloha LLC and its subsidiaries through December 31, 2009 have been included in the financial statements of OHA for the year ended June 30, 2010 as further discussed in Note A to the financial statements.

DIVISIONS

A division is a combination of resources and activities designed to achieve an objective or objectives. OHA prepares biennial budgets and records expenditures separately for each of its divisions.

The title and objective of each division are listed below:

Division title	Division objectives
1. Board of Trustees	To work for the betterment of all Hawaiians by setting policy in response to the concerns and interest of the beneficiaries, in order to ensure the well being of Native Hawaiians; to protect their rights and entitlements in their homeland; to assist them to achieve self-determination and self-governance; and to nurture and honor their culture.
2. Support Services	To work for the betterment of conditions of all Hawaiians by providing leadership, guidance, direction, and executive oversight. OHA seeks to excel among Hawai'i's organizations in managing resources, as well as applying technology to streamline processes, and fully integrate all aspects of information sharing and program support, and to coordinate data gathering, planning, research, and development efforts with other Hawaiian agencies.
3. Beneficiary Advocacy	To seek the betterment of all Hawaiians through improving access to resources, benefits, and services, particularly in the areas of housing, education, health, and economic development. To advance the rights and interests of Hawaiians through advocacy, public policy development, dialogue, community outreach, and litigation.

PURPOSE OF THE REPORT AND DEFINITIONS

The purpose of the financial audit was to enable the independent auditors to form opinions on the financial statements of the Office of Hawaiian Affairs as of June 30, 2010 and for the year then ended. The auditors' report represents the conclusion of the independent auditors regarding the fairness of the presentations, in conformity with accounting principles generally accepted in the United States of America, set forth in the financial statements and is used to communicate such conclusion to interested parties.

The following is a glossary of certain accounting terms associated with the financial statements.

1. *Appropriations* – Authorizations granted by the State Legislature or OHA Board of Trustees permitting the agency within established fiscal and budgetary controls to incur obligations and to make expenditures for specific purposes. An appropriation is usually limited in amount and as to the period during which it may be expended.
2. *Lapse* – As applied to appropriations, this term denotes the automatic termination of an appropriation. At the end of the appropriation period, any unexpended or unencumbered balance lapses. This terminated amount is available for appropriation by the State Legislature in the ensuing fiscal year.
3. *Encumbrances* – Commitments related to unperformed (executory) contracts for goods or services.

4. *Expenditures* – Decreases in net financial resources. Expenditures include current operating expenses and capital outlays that require the current use of net current assets.
5. *Fund* – A fiscal and accounting entity with a self-balancing set of accounts recording cash and other current financial resources, together with all related liabilities and residual equities or balances, and changes therein, that are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.

OHA’S STRATEGIC PLAN REALIGNMENT

Last year, we introduced you to our new 2010-2016 Strategic Plan. The strategic plan shifts OHA’s focus from serving individual needs to applying its resources to programs and activities that will ultimately lead to systemic change and maximize its impact on all Hawaiians.

Since the strategic plan recognizes the fact that OHA can maximize its impact for all Hawaiians through prioritizing its efforts in a few key areas, rather than broadly dispersing its resources, it identifies three critical roles for OHA: advocacy, research, and asset management. Under its new Strategic Plan, OHA will shift its focus by promoting systemic change in six priority areas:

KAHUA WAIWAI

Economic Self-Sufficiency

To have choices and a sustainable future, Native Hawaiians will progress toward greater economic self-sufficiency.

‘ĀINA

Land & Water

To maintain the connection to the past and a viable land base, Native Hawaiians will participate in and benefit from responsible stewardship of Ka Pae ‘Āina ‘O Hawai‘i.

MO‘OMEHEU

Culture

To strengthen identity, Native Hawaiians will preserve, practice and perpetuate their culture.

MAULI OLA

Health

To improve the quality and longevity of life, Native Hawaiians will enjoy healthy lifestyles and experience reduced onset of chronic diseases.

EA

Governance

To restore pono and ea, Native Hawaiians will achieve self-governance, after which the assets of OHA will be transferred to the new governing entity.

HO‘ONA‘AUAO

Education

To maximize choices of life and work, Native Hawaiians will gain knowledge and excel in educational opportunities at all levels.

The launch of the new Strategic Plan required OHA to realign its organizational structure which took place from December 2009 to early February 2010. The purpose of the organizational realignment was to create organizational units, reporting relationships, management systems and performance expectations so that management could successfully fulfill advocacy, research and asset management roles to implement the Strategic Plan.

The realignment of OHA’s organizational structure resulted in a major shift from ten subject matter Hale to the four main Lines of Business (LOB) including Advocacy, Research, Community Relations and Resource Management. This shift created efficiencies through management cost savings and an organizational structure most appropriate for the effective implementation of the new Strategic Plan.

FACTORS AFFECTING FINANCIAL CONDITION

The information presented in the basic financial statements is perhaps best understood when considered from the broader perspective of the specific environment within which OHA operates.

Sources of Funding

The sources of funding for OHA include State of Hawai'i general fund appropriations, ceded land revenue payments, federal grants, and miscellaneous other income. In addition, a substantial portion of the funding comes from withdrawals made from the Native Hawaiian Trust Fund (NHTF). The goal of the NHTF is to provide superior investment returns to sustain the beneficiaries in perpetuity and to uphold OHA's mission. In this regard the Board of Trustees has established a spending policy that limits the amount of withdrawals that can be made from the fund in any given fiscal year. The updated policy limits the withdrawal to five (5) percent of the NHTF's 20-quarter rolling average market value, as defined, to ensure that resources held within the trust are available for future spending.

The beneficiary needs for services is closely tied to the local economy, while the primary source of funding, the Native Hawaiian Trust Fund, is closely tied to the national economy.

State of the Local Economy

Remnants of the great recession continued into 2010 as Hawai'i economic indicators struggled to improve during the fiscal year. While our local economy has shown signs of stabilization, the total number of jobs, personal income, and real gross domestic product ("GDP") in the State still remained depressed. Total State tax collections improved modestly from the prior year; however, agencies across State and County offices continued to face budgetary challenges. In light of the declining job growth, the economic recovery in Hawai'i is expected to be gradual and modest.

State of the National Economy

Fiscal year 2010 marked the beginning of the U.S. economic recovery from one of the most severe recessions in history. The financial market saw significant recovery beginning in July 2009 before a modest correction took place toward the end of the fiscal year 2010. Overall, the global equities market posted a double-digit return for the year. Despite the marked improvement in the financial market, fears of a double-dip recession, high unemployment, and restrained consumer spending continued to hamper the recovery and growth of our economy.

OHA's Investments

Corresponding with the global market recovery, OHA's investment portfolio showed a strong rebound in fiscal year 2010. The NHTF posted a 12.5% net return during the one year period, outperforming the strategic benchmark by 180 basis points, or 1.8 percent. Both equity and fixed income markets showed strong gains in the year, contributing to double-digit returns across all of OHA's traditional asset classes. OHA's real estate investments in public real estate investment trusts ("REITs") showed the strongest improvement, returning 53% net of fees for the year. The outstanding portfolio performance helped OHA to meet and exceed its investment benchmarks and surpass the performance of other peer institutions.

In addition to strong portfolio returns, OHA also continued to bolster its risk management program by reviewing and updating its Investment Policy Statement as appropriate, conducting on-site and off-site due diligence reviews, and performing a review of external investment advisors to help evaluate OHA's current investment managers. OHA also implemented a short-term liquidity account to manage its short-term investments in order to optimize the NHTF operational efficiency. Even though the economic recovery appears soft at this time, we believe that a

disciplined investment process and diligent management oversight should help advance the growth of the NHTF assets.

CLOSING COMMENTS

The transition from the old to the new Strategic Plan and organizational structure has been both a challenging and rewarding time. The new Strategic Plan required staff to make a shift from a subject matter to a structure based on the three main roles of advocacy, research and asset management. This resulted in a major change in how OHA conducts business and required staff to learn, adopt and implement many new systems and approaches to our important work. After 12 months of progress and experiences with implementation of the new Strategic Plan, OHA staff are excited and encouraged about the results our beneficiaries will experience over the next decade.

Respectfully submitted,

Clyde W. Nāmu‘o
Chief Executive Officer, Office of Hawaiian Affairs

Report of Independent Certified Public Accountants

Board of Trustees of the Office of Hawaiian Affairs
State of Hawai'i

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information as well as the budgetary comparison for the general fund of the Office of Hawaiian Affairs (OHA), State of Hawai'i, as of and for the year ended June 30, 2010, which collectively comprise OHA's basic financial statements as listed in the table of contents. These financial statements are the responsibility of OHA's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the consolidated financial statements of Hi'ilei Aloha LLC and its wholly-owned subsidiaries Hi'ipaka LLC and Hi'ipoi LLC (collectively, "Hi'ilei"), a blended component unit, which represent 0.1% of assets and 2.6% of revenues of the governmental funds. Those financial statements were audited by other auditor whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for Hi'ilei, is based solely on the report of the other auditor.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The consolidated financial statements of Hi'ilei were not audited in accordance with *Government Auditing Standards*. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of OHA's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of the other auditor provide a reasonable basis for our opinions.

As discussed in note A, the financial statements of the Office of Hawaiian Affairs, State of Hawai'i, are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawai'i that is attributable to the transactions of OHA. They do not purport to, and do not, present fairly the financial position of the State of Hawai'i as of June 30, 2010 and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.



Accountants &
Business Advisors

Board of Trustees of the Office of Hawaiian Affairs
State of Hawai'i

In our opinion, based on our audit and the report of the other auditor, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of OHA, as of June 30, 2010, and the respective changes in financial position and the respective budgetary comparison for the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 1, 2010 on our consideration of OHA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 8 through 14 is not a required part of the basic financial statements but is supplementary information required by the accounting principles generally accepted in the United State of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The Letter from the Chief Executive Officer, as listed in the accompanying contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to auditing procedures applied in the audit of OHA's basic financial statements and, accordingly, we express no opinion on it.

PKF Pacific Hawaii LLP

Honolulu, Hawaii
December 1, 2010

Office of Hawaiian Affairs
State of Hawai'i

MANAGEMENT'S DISCUSSION AND ANALYSIS

Year ended June 30, 2010

As management of OHA, we offer the following narrative overview and analysis to readers of our financial statements. While the financial statements and notes present only the financial activities for the fiscal year ended June 30, 2010, management discussion and analysis will address both this year and the year ended June 30, 2009.

Management's discussion and analysis is provided at the beginning of the financial statements and notes to explain the past and current position of OHA's financial condition in layman's terms. This summary should not be taken as a replacement for the financial statements and notes that immediately follow this narrative.

FINANCIAL HIGHLIGHTS

Government-wide Financial Statements Highlights

Statement of Net Assets – The assets of OHA exceeded its liabilities at fiscal year ended June 30, 2010 by \$381,170,716 (presented as “total net assets”). Of this amount, \$326,170,788 is reported as “unrestricted”, while \$28,221,110 is reported as “restricted-federal funds” and \$26,778,818 is reported as “invested in capital assets, net of related debt.” The assets of OHA exceeded its liabilities at fiscal year ended June 30, 2009 by \$363,218,668 (presented as “total net assets”). Of this amount, \$307,801,949 is reported as “unrestricted”, while \$28,451,215 is reported as “restricted-federal funds” and \$26,965,504 is reported as “invested in capital assets, net of related debt.” Unrestricted net assets represent the amount available to be used to meet OHA's ongoing obligations to beneficiaries and creditors. Restricted assets represent amounts that have legal requirements on their use.

Statement of Activities – OHA's total net assets, increased by \$17,952,048 (a 4.94% increase) in fiscal year 2010. This was primarily due to investment gains experienced in OHA's Native Hawaiian Trust Fund (NHTF). OHA's total net assets, decreased by \$83,534,938 (an 18.7% decrease) in fiscal year 2009. This was primarily due to investment losses experienced in OHA's Native Hawaiian Trust Fund (NHTF) netted by a transfer in of property to Hi'ilei Aloha LLC which is a legally separate reporting entity from OHA as discussed in Note A to the financial statements.

Additional information regarding OHA's capital assets can be found in Note H to the financial statements.

Governmental Funds Financial Statements Highlights

Governmental Funds – Fund Balances – At the close of fiscal year 2010, OHA's governmental funds reported an ending fund balance of \$356,222,709. Of this total amount, \$313,321,737 represents the unreserved fund balances with 93.5% being in the Public Land Trust Fund (PLTF). Of this \$313,321,737, \$84,000,000 is designated for debt service for DHHL-issued revenue bonds, \$20,279,891 is designated for the Native Hawaiian Revolving Loan Fund (NHRLF), \$32,473 is designated for the Fannie Mae Loan Program; \$29,419 is designated for other grants, \$588,274 is designated for Hawaiian projects; and \$2,978,703 is designated for subsequent year's expenditures, leaving \$205,412,977 as undesignated. This \$205,412,977 represents roughly 58% of the total fund balance at the end of fiscal year 2010.

At the close of fiscal year 2009, OHA's governmental funds reported an ending fund balance of \$338,573,964. Of this total amount, \$298,921,375 represents the unreserved fund balances with 93.1% being in the Public Land Trust Fund (PLTF). Of this \$298,921,375, \$87,000,000 is designated for debt service for DHHL-issued revenue

bonds, \$20,166,236 is designated for the Native Hawaiian Revolving Loan Fund (NHRLF), \$34,826 is designated for the Fannie Mae Loan Program; \$29,419 is designated for other grants, \$410,121 is designated for Hawaiian projects; and \$7,562,681 is designated for subsequent year's expenditures, leaving \$183,718,092 as undesignated. This \$183,718,092 represents roughly 54% of the total fund balance at the end of fiscal year 2009.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to OHA's basic financial statements. OHA's basic financial statements include four components: 1) *Government-wide Financial Statements*, 2) *Governmental Funds Financial Statements*, 3) *Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis)*, *General Fund*, and 4) *Notes to Financial Statements*. The first three components are intended to present different financial views of OHA. The fourth component is intended to further explain some of the information in the financial statements and provide more detail. These components are described below.

Government-wide Financial Statements

The *Government-wide Financial Statements* provide a broad view of OHA's operations in a manner similar to a private-sector business. These statements provide both short-term and long-term information about OHA's financial position, which assists in assessing OHA's economic condition at the end of the fiscal year. These are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means they follow accounting methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year even if cash involved has not been received or paid. The *Government-wide Financial Statements* include two statements.

1. The *Statement of Net Assets* presents all of OHA's assets and liabilities, with the difference between the two reported as "net assets." Over time, increases or decreases in OHA's net assets may serve as a useful indicator of whether the financial position of OHA is improving or deteriorating.
2. The *Statement of Activities* presents information showing how the government's net assets changed during the fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as earned but unused compensatory and vacation leave).

The governmental activities of OHA include program revenues (revenues dedicated internally including federal and other grants that break out charges for services, operating grants, and investment income and net gains/losses) and general revenues (including legislative appropriations, PLTF, investment income and net gains/losses on investments in the NHTF, newspaper advertisements, donations, non-imposed fringe benefits, and other revenues).

It also includes the results of its blended component unit, Hi'ilei Aloha LLC and its wholly-owned subsidiaries, through its separate fiscal year end, December 31, 2009. Hi'ilei Aloha LLC and its wholly-owned subsidiaries have been included as a blended component unit due to the common governing body.

The *Government-wide Financial Statements* are reflected on the right hand side of the "adjustments" column of each of the governmental funds financial statements.

Governmental Funds Financial Statements

A “*fund*” is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. OHA, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The governmental funds financial statements focus on individual parts of OHA, reporting OHA’s operations in more detail than the government-wide statements. All of the funds of OHA are considered “*governmental funds*” as opposed to proprietary (operate more like those of commercial enterprises) and fiduciary funds (used to account for resources held for the benefit of parties outside OHA).

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, the governmental funds financial statements focus on near-term inflows and outflows of expendable resources. They also focus on the balances of available resources at the end of the fiscal year. Such information may be useful in evaluating the government’s near-term financing requirements. This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of OHA’s finances that assist in determining whether there will be adequate financial resources available to meet the current needs of OHA.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government’s near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and the governmental activities. These reconciliations are presented in Note L to the financial statements.

OHA has two types of governmental funds that are presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures, and changes in fund balances. OHA’s two types of governmental funds are General Fund and Special Revenue Funds. The Special Revenue Funds are the PLTF, Federal Grants Fund, and Other Fund. In addition, the blended component unit, Hi’ilei Aloha LLC and its wholly-owned subsidiaries, has also been classified as a special revenue fund.

The basic governmental funds financial statements can be found to the left of the “adjustments” column, preceding the government-wide financial statements.

Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis), General Fund

The governmental funds financial statements are followed by a budgetary comparison statement, which compares the general fund’s original budget, final budget, and actual amounts prepared on a budgetary basis. A reconciliation between the actual general fund revenues and expenditures compared to the general fund revenues and expenditures prepared for budgetary purposes is included in Note B to the financial statements. The *Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis), General Fund* can be found on page 19.

Notes to Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and the governmental funds financial statements. The notes to the financial statements can be found immediately following the *Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis), General Fund*.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Statement of Net Assets

Summarized financial information of OHA's *Statement of Net Assets* as of June 30, 2010 and 2009 is as follows:

	2010	2009
Assets:		
Capital assets	\$ 26,936,605	\$ 27,176,213
Other assets	383,994,072	344,335,630
Total assets	<u>\$410,930,677</u>	<u>\$371,511,843</u>
Liabilities:		
Other liabilities	\$ 27,771,363	\$ 5,761,666
Long-term liabilities	1,988,598	2,531,509
Total liabilities	<u>29,759,961</u>	<u>8,293,175</u>
Net assets:		
Invested in capital assets, net of related debt	26,778,818	26,965,504
Restricted – Federal funds	28,221,110	28,451,215
Unrestricted	326,170,788	307,801,949
Total net assets	<u>381,170,716</u>	<u>363,218,668</u>
Total liabilities and net assets	<u>\$410,930,677</u>	<u>\$371,511,843</u>

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. OHA's net assets totaled \$381,170,716 at the end of fiscal year 2010, compared to \$363,218,668 at the end of fiscal year 2009, representing an increase of 4.94% or \$17,952,048.

Unrestricted funds represent the largest portion of OHA's net assets (85.57% and 84.74% at June 30, 2010 and 2009, respectively) and are comprised of resources that may be used to meet OHA's ongoing obligations to beneficiaries and creditors. This also includes internally imposed designations of resources.

Statement of Activities

Summarized financial information of OHA's *Statement of Activities* for the fiscal years ended June 30, 2010 and 2009 is as follows:

	2010	2009
Revenues:		
Program revenues:		
Operating grants	\$ 357,057	\$ 378,032
Charges for services	388,043	573,560
Subtotal carried forward	745,100	951,592

	<u>2010</u>	<u>2009</u>
Subtotal brought forward	\$ 745,100	\$ 951,592
Interest and investment earnings	354,026	765,557
General revenues:		
Appropriations, net of lapses	2,307,596	2,965,721
Public land trust	15,100,000	15,100,000
Interest and investment (losses) earnings	37,829,842	(73,634,518)
Newspaper ads	94,973	99,418
Donations and other	453,466	420,131
Hi'ilei Aloha LLC	1,514,403	1,027,039
Non-imposed fringe benefits	215,621	232,384
Total revenues	<u>58,615,027</u>	<u>(52,072,676)</u>
Expenses:		
Current divisions:		
Board of Trustees	1,672,848	1,956,430
Support Services	12,048,600	18,617,446
Beneficiary Advocacy	23,776,131	22,987,460
Depreciation	413,518	370,266
Hi'ilei Aloha LLC	3,007,695	3,030,955
Total expenses	<u>40,918,792</u>	<u>46,962,557</u>
Net transfers from other funds	<u>255,813</u>	<u>15,500,295</u>
Changes in net assets	<u>\$ 17,952,048</u>	<u>\$(83,534,938)</u>

OHA's net assets increased by \$17,952,048 during the year. Key elements of this increase are as follows:

General revenues interest and investment earnings increased by \$111,464,360 from the prior year, due primarily to improved market conditions. Although dividend and interest income decreased by \$1,751,196, net investment gains increased by \$113,220,383 from the prior year. OHA recognized a net investment loss of \$76,505,113 during fiscal year 2009.

During the reporting period, OHA's blended component unit, Hi'ilei Aloha LLC, recognized \$185 of interest income which is also included as interest and investment earnings, recorded as general revenues. This was a decrease of \$4,827 from the prior year. Hi'ilei Aloha LLC is a legally separate reporting entity from OHA as discussed in Note A to the financial statements.

Support services expenses decreased by \$6,568,846 from the prior year primarily as a result of decreases in operating costs including legal fees and efficiencies created through management cost saving efforts during the realignment of OHA to our new 2010-2016 Strategic Plan. In comparison, the prior year experienced an increase in support services expenses totaling \$4,347,017 primarily as a result of increased operating costs, including an increase in legal fees and rent and common area maintenance fees for office locations.

In addition, the OHA Board of Trustees authorized a payment to the State of Hawai'i during the prior fiscal year (on April 30, 2009) in the amount of \$1,241,615 in regards to House Bill 900 which was approved by the Governor on June 22, 2009 as Act 140 relating to OHA's fiscal biennium budget beginning July 1, 2009 and ending June 30, 2011 which appropriated \$4,939,318 of State general funds for use by OHA during the upcoming biennium period. No similar authorization was made during fiscal year 2010.

GOVERNMENTAL FUNDS FINANCIAL ANALYSIS

As noted earlier, OHA uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The focus of OHA's governmental funds is to provide information on near-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing OHA's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending, restricted by OHA's spending policy limitations, at the end of the fiscal year.

At the close of fiscal year 2010, OHA's governmental funds reported an ending fund balance of \$356,222,709. Of this amount, \$313,321,737, or 87.96%, represented unreserved funds, broken down as follows: 23.58% for debt service for DHHL-issued revenue bonds, 5.69% for NHRLF, 0.01% for Fannie Mae Loan Program, 0.01% for other grants, 0.17% for Hawaiian projects, 0.84% for subsequent years' expenditures, and 57.66% undesignated. Reserved fund balances accounted for \$42,900,972, or 12.04% of the total fund balance, broken down as follows: 4.35% for encumbrances, 3.34% for notes receivable, 0.15% for prepaid expenses and security deposits, and 4.20% for fiscal reserve.

At the close of fiscal year 2009, OHA's governmental funds reported an ending fund balance of \$338,573,964. Of this amount, \$298,921,375, or 88.3%, represented unreserved funds, broken down as follows: 25.70% for debt service for DHHL-issued revenue bonds, 5.96% for NHRLF, 0.01% for Fannie Mae Loan Program, 0.01% for other grants, 0.12% for Hawaiian projects, 2.24% for subsequent years' expenditures, and 54.26% undesignated. Reserved fund balances accounted for \$39,652,589, or 11.7% of the total fund balance, broken down as follows: 3.46% for encumbrances, 3.73% for notes receivable, 0.17% for prepaid expenses and security deposits, and 4.34% for fiscal reserve.

OHA's governmental funds experienced an increase of \$17,648,745 in fund balance during fiscal year 2010.

CAPITAL ASSETS AND LONG-TERM LIABILITIES

OHA's investment in capital assets amounted to \$26,936,605 and \$27,176,213, net of depreciation, as of June 30, 2010 and 2009, respectively. Capital assets include land, building, leasehold improvements, equipment and software development.

	2010	2009
Land	\$24,358,454	\$24,358,454
Buildings and improvements	1,888,849	1,934,184
Equipment	689,302	883,575
Totals	<u>\$26,936,605</u>	<u>\$27,176,213</u>

Additional information regarding OHA's capital assets can be found in Note H to the financial statements.

OHA's long-term liabilities include accrued vacation, accrued workers' compensation, accrued trustee retirement plan obligation, accrued lease guaranty obligation and capital lease obligation. Additional information about OHA's long-term liabilities can be found in Note J to the financial statements.

REQUEST FOR INFORMATION

Questions concerning any of the information provided in this report or requests for additional information should be addressed to:

Office of Hawaiian Affairs
Attn: Chief Financial Officer
711 Kapi'olani Boulevard, Suite 500
Honolulu, Hawai'i 96813

Office of Hawaiian Affairs
State of Hawai'i

GOVERNMENTAL FUNDS - BALANCE SHEET/GOVERNMENT-WIDE STATEMENT OF NET ASSETS

June 30, 2010

ASSETS	Governmental Funds					Total	Adjustments (Note L)	Government- wide Statement of Net Assets
	General Fund	Public Land Trust	Federal Grants	Other	Hi'ilei Aloha LLC			
Petty cash	\$ -	\$ 700	\$ -	\$ -	\$ 3,353	\$ 4,053	\$ -	\$ 4,053
Cash in State Treasury	539,984	3,086,763	-	-	-	3,626,747	-	3,626,747
Cash in banks	-	2,945,017	1,046,864	593,917	296,363	4,882,161	-	4,882,161
Cash held by investment manager	-	755,171	1,598,726	-	-	2,353,897	-	2,353,897
Accounts receivable	-	32,391,979	43,845	7,045	57,674	32,500,543	-	32,500,543
Interest and dividends receivable	-	155,867	83,396	-	-	239,263	-	239,263
Inventory, prepaid items and other assets	44,465	425,412	67,042	-	78,089	615,008	-	615,008
Notes receivable - due within one year	-	575,506	1,985,569	-	-	2,561,075	-	2,561,075
Notes receivable - due after one year	-	3,439,162	5,884,738	-	-	9,323,900	-	9,323,900
Security deposits	-	605	-	-	973	1,578	-	1,578
Investments	-	310,249,374	17,636,473	-	-	327,885,847	-	327,885,847
Capital assets - net	-	-	-	-	-	-	26,936,605	26,936,605
TOTAL	\$ 584,449	\$ 354,025,556	\$ 28,346,653	\$ 600,962	\$ 436,452	\$383,994,072	\$ 26,936,605	\$ 410,930,677

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs
State of Hawai'i

GOVERNMENTAL FUNDS - BALANCE SHEET/GOVERNMENT-WIDE STATEMENT OF NET ASSETS (continued)

June 30, 2010

LIABILITIES AND FUND BALANCES/NET ASSETS	Governmental Funds						Adjustments (Note L)	Government- wide Statement of Net Assets
	General Fund	Special Revenue Funds				Total		
		Public Land Trust	Federal Grants	Other	Hi'ilei Aloha LLC			
LIABILITIES								
Accounts payable and accrued liabilities	\$ 260,649	\$ 27,137,264	\$ 125,543	\$ 11,344	\$ 236,563	\$ 27,771,363	\$ -	\$ 27,771,363
Long-term liabilities								
Due within one year	-	-	-	-	-	-	598,475	598,475
Due after one year	-	-	-	-	-	-	1,390,123	1,390,123
Total liabilities	260,649	27,137,264	125,543	11,344	236,563	27,771,363	1,988,598	29,759,961
FUND BALANCES/NET ASSETS								
Fund balances								
Reserved for encumbrances	474,107	14,722,391	322,530	-	-	15,519,028	(15,519,028)	-
Reserved for notes receivable	-	4,014,668	7,870,307	-	-	11,884,975	(11,884,975)	-
Reserved for prepaid expenses and security deposits	44,465	426,017	67,042	-	-	537,524	(537,524)	-
Fiscal reserve	-	14,959,445	-	-	-	14,959,445	(14,959,445)	-
Unreserved								
Designated for debt service for DHHL-issued revenue bonds	-	84,000,000	-	-	-	84,000,000	(84,000,000)	-
Designated for Native Hawaiian revolving loans	-	-	20,279,891	-	-	20,279,891	(20,279,891)	-
Designated for Fannie Mae Loan Program	-	32,473	-	-	-	32,473	(32,473)	-
Designated for other grants	-	-	29,419	-	-	29,419	(29,419)	-
Designated for Hawaiian projects	-	-	-	588,274	-	588,274	(588,274)	-
Designated for subsequent year's expenditures	-	2,978,703	-	-	-	2,978,703	(2,978,703)	-
Undesignated	(194,772)	205,754,595	(348,079)	1,344	199,889	205,412,977	(205,412,977)	-
Total fund balances	323,800	326,888,292	28,221,110	589,618	199,889	356,222,709	(356,222,709)	-
Total liabilities and fund balances	<u>\$ 584,449</u>	<u>\$354,025,556</u>	<u>\$ 28,346,653</u>	<u>\$ 600,962</u>	<u>\$ 436,452</u>	<u>\$383,994,072</u>		
Net assets								
Invested in capital assets, net of related debt							26,778,818	26,778,818
Restricted - federal funds							28,221,110	28,221,110
Unrestricted							326,170,788	326,170,788
Total net assets							<u>\$ 381,170,716</u>	<u>\$ 381,170,716</u>

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs
State of Hawai'i

GOVERNMENTAL FUNDS - STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES/
GOVERNMENT-WIDE STATEMENT OF ACTIVITIES

Year ended June 30, 2010

	Governmental Funds					Total	Adjustments (Note L)	Government- wide Statement of Activities
	General Fund	Public Land Trust	Federal Grants	Other	Hi'iilei Aloha LLC			
Expenditures/expenses								
Current divisions:								
Board of Trustees	\$ 33,919	\$ 1,706,211	\$ -	\$ -	\$ -	\$ 1,740,130	\$ (67,282)	\$ 1,672,848
Support services	707,168	11,787,694	-	7,539	-	12,502,401	(453,801)	12,048,600
Beneficiary advocacy	1,769,233	20,798,356	1,316,850	80,137	-	23,964,576	(188,445)	23,776,131
Depreciation	-	-	-	-	-	-	413,518	413,518
Hi'iilei Aloha LLC	-	-	-	-	3,014,988	3,014,988	(7,293)	3,007,695
Total expenditures/expenses	2,510,320	34,292,261	1,316,850	87,676	3,014,988	41,222,095	(303,303)	40,918,792
Program revenues								
Charges for services	-	-	388,043	-	-	388,043	-	388,043
Operating grants	-	-	349,057	8,000	-	357,057	-	357,057
Interest and investment earnings	-	-	349,645	4,381	-	354,026	-	354,026
Total program revenues	-	-	1,086,745	12,381	-	1,099,126	-	1,099,126
Net program expenditures/expenses	(2,510,320)	(34,292,261)	(230,105)	(75,295)	(3,014,988)	(40,122,969)	303,303	(39,819,666)
General revenues								
Appropriations, net of lapses	2,307,596	-	-	-	-	2,307,596	-	2,307,596
Public land trust	-	15,100,000	-	-	-	15,100,000	-	15,100,000
Interest and investment earnings	-	37,829,657	-	-	185	37,829,842	-	37,829,842
Newspaper advertisements	-	-	-	94,973	-	94,973	-	94,973
Donations and other	-	371,531	-	81,935	-	453,466	-	453,466
Hi'iilei Aloha LLC	-	-	-	-	1,514,403	1,514,403	-	1,514,403
Non-imposed fringe benefits	215,621	-	-	-	-	215,621	-	215,621
Total general revenues	2,523,217	53,301,188	-	176,908	1,514,588	57,515,901	-	57,515,901
EXCESS OF REVENUES (DEFICIENCY) OVER EXPENDITURES/EXPENSES (carried forward)	\$ 12,897	\$ 19,008,927	\$ (230,105)	\$ 101,613	\$ (1,500,400)	\$ 17,392,932	\$ 303,303	\$ 17,696,235

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs
State of Hawai'i

GOVERNMENTAL FUNDS - STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES/
GOVERNMENT-WIDE STATEMENT OF ACTIVITIES (continued)

Year ended June 30, 2010

	Governmental Funds					Total	Adjustments (Note L)	Government- wide Statement of Activities
	General Fund	Public Land Trust	Special Revenue Funds					
		Federal Grants	Other	Hi'iilei Aloha LLC				
EXCESS OF REVENUES (DEFICIENCY) OVER EXPENDITURES/EXPENSES (brought forward)	\$ 12,897	\$ 19,008,927	\$ (230,105)	\$ 101,613	\$ (1,500,400)	\$ 17,392,932	\$ 303,303	\$ 17,696,235
Other financing sources (uses)								
Net transfers (to) from other funds	-	(1,266,279)	-	69,355	1,452,737	255,813	-	255,813
Net change in fund balance/net assets	<u>12,897</u>	<u>17,742,648</u>	<u>(230,105)</u>	<u>170,968</u>	<u>(47,663)</u>	<u>17,648,745</u>	<u>303,303</u>	<u>17,952,048</u>
Fund balance/net assets								
Beginning of year	<u>310,903</u>	<u>309,145,644</u>	<u>28,451,215</u>	<u>418,650</u>	<u>247,552</u>	<u>338,573,964</u>	<u>24,644,704</u>	<u>363,218,668</u>
End of year	<u>\$ 323,800</u>	<u>\$ 326,888,292</u>	<u>\$ 28,221,110</u>	<u>\$ 589,618</u>	<u>\$ 199,889</u>	<u>\$ 356,222,709</u>	<u>\$ 24,948,007</u>	<u>\$ 381,170,716</u>

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs
State of Hawai'i

STATEMENT OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL
(BUDGETARY BASIS), GENERAL FUND

Year ended June 30, 2010

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual (budgetary basis)</u>	<u>Variance</u>
Revenues:				
State appropriations, net of lapses	<u>\$2,469,659</u>	<u>\$2,469,659</u>	<u>\$2,307,596</u>	<u>\$(162,063)</u>
Total revenues	2,469,659	2,469,659	2,307,596	(162,063)
Expenditures:				
Board of Trustees	29,935	29,935	24,456	5,479
Support services	808,657	808,657	602,418	206,239
Beneficiary advocacy	<u>1,631,067</u>	<u>1,631,067</u>	<u>1,682,422</u>	<u>(51,355)</u>
Total expenditures	<u>2,469,659</u>	<u>2,469,659</u>	<u>2,309,296</u>	<u>160,363</u>
(DEFICIENCY) EXCESS OF REVENUES OVER EXPENDITURES	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (1,700)</u>	<u>\$ (1,700)</u>

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Financial Statement Presentation and Basis of Accounting

The financial statements of the Office of Hawaiian Affairs (OHA) are prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB).

Reporting Entity

The accompanying basic financial statements present the financial activity of OHA (Primary Government) and its blended component unit, which is a legally separate organization for which the Primary Government is financially accountable.

Hi'ilei Aloha LLC, a Hawai'i limited liability company formed by OHA in September 2007, is presented as a blended component unit due to the common governing body with the primary government. The results of Hi'ilei Aloha LLC as of December 31, 2009, its fiscal year end, have been included in the financial statements. Hi'ilei Aloha LLC and its wholly-owned subsidiaries, Hi'ipaka LLC and Hi'ipoi LLC are exempt from federal income tax under Sections 501(a) and 501(c)3 of the Internal Revenue Code.

Government-wide Financial Statements – The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. Program revenues include (a) fees and charges paid by the recipients of goods or services offered by the programs and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program.

Resources that are dedicated internally are reported as general revenues rather than as program revenues. Net assets are restricted when constraints placed on them are either externally imposed or are imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net assets.

Governmental Funds Financial Statements – The governmental funds financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, OHA considers revenues to be available if they are collected within 60 days of the end of the current fiscal year end. Principal revenue sources susceptible to accrual include Federal grants, public land trust revenue, and interest and dividends on investments.

Expenditures are generally recorded when a liability is incurred as under accrual accounting. Modifications to the accrual basis of accounting include the employees' vested annual leave which is recorded as an expenditure when utilized or paid. The amount of accumulated annual leave unpaid at June 30, 2010 has been reported only in the government-wide financial statements.

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

1. Financial Statement Presentation and Basis of Accounting (continued)

The operations of each fund are accounted for by providing a separate set of self-balancing accounts that comprise the assets, liabilities, fund balance, revenues and expenditures of the fund. The funds are intended to conform to the State of Hawai'i general accounting system and are structured to comply with the requirements of appropriations and allotments authorized by State law.

A description of the funds administered by OHA and included in the governmental funds financial statements follows.

General Fund – The general fund of OHA is part of the State of Hawai'i General Fund. However, OHA's general fund financial statements reflect only OHA's appropriations and obligations. The general fund is used to account for all financial resources except those required to be accounted for in another fund, and includes the operating budget of general funds appropriated by the Hawai'i State Legislature.

Special Revenue Funds – These funds include OHA's proceeds and income from the Public Land Trust as defined in Chapter 10, Hawai'i Revised Statutes, as well as the proceeds and income of the Native Hawaiian Rights Fund, the NHRLF and other grants. Expenditures reflect those from the specific grant or designated fund and from other OHA Board of Trustee appropriations of the Public Land Trust Funds. Hi'ilei Aloha LLC, OHA's blended component unit, has also been accounted for in a special revenue fund.

2. Investments

Investments are stated at fair value in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. OHA uses the first-in, first-out (FIFO) cost method in computing the gain or loss on sale of marketable equity securities.

3. Inventory and Prepaid Items

All inventories are stated at the lower of cost (first-in, first-out method) or market. Inventories of governmental funds are recorded as expenditures when consumed rather than when purchased. Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

4. Capital Assets

Capital assets include tangible and intangible assets acquired with estimated useful lives greater than one year. Capital assets acquired for general organization purposes are recorded as expenditures in the governmental funds financial statements. Donated fixed assets are recorded at estimated fair value at the time received on the government-wide financial statements. Depreciation and amortization expense is recorded in the government-wide financial statements. Buildings, equipment, furniture and fixtures and improvements are depreciated on the straight-line method over their estimated useful lives. There is no depreciation recorded for land.

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

5. Accrued Vacation

OHA accrues all vacation and compensatory pay at current salary rates; including additional amounts for certain salary-related expenses associated with the payment of compensated absences, in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. The June 30, 2010 balance includes fringe benefits computed at the rate of 7.65% of accrued vacation and compensatory pay. Accrued vacation is reported as an expense when earned in the government-wide financial statements, but not reported as an expenditure in the governmental funds financial statements, as current financial resources are not used.

6. Risk Management

OHA is exposed to various risks of loss from torts, theft of or damage to assets, errors and omissions, and employee injuries and illnesses. OHA participates in a State-sponsored general liability, automotive, and workers' compensation self-insurance program.

7. Governmental Funds – Fund Balance Reserves and Designations

The governmental funds financial statements present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditure or (2) legally segregated for a specific future use. The reserves for related assets such as fixed assets and prepayments are examples of the former. Reserves for encumbrances, contracts, and other specific purposes are examples of the latter. The governmental funds' designation of fund balance reflects tentative plans for future use of financial resources.

8. Encumbrances

Encumbrances against budgeted appropriations are recorded upon the execution of contracts or purchase orders. Such encumbrances are accounted for as a segregation of fund balance in the governmental funds financial statements. The related expenditure is reported in the period in which the liability is incurred.

9. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) 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, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from estimates.

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

10. Concentrations of Credit Risk

The financial instruments that potentially expose OHA to concentrations of credit risk consist principally of notes receivable. OHA extends credit to native Hawaiian and Hawaiian persons and agencies that use OHA's funds for the betterment of Native Hawaiians and Hawaiians. The mix of notes receivable at June 30, 2010 are as follows:

Native Hawaiian and Hawaiian persons	91.7%
Agencies	7.7
Other	0.6
	<hr/>
	100.0%
	<hr/>

11. Notes Receivable

Notes receivable consist of notes made to Native Hawaiian-owned businesses and individuals. Management provides an allowance for doubtful accounts equal to the estimated amounts deemed uncollectible by management which it considers outstanding for more than 90 days. Management also provides a general reserve for its notes receivable.

NOTE B – BIENNIAL BUDGET

Because it is not a part of the executive branch, OHA's budget is considered by the Hawai'i State Legislature to be separate from the State Administration's submittal, and its development follows a different procedure. The budgetary data reflected in the basic financial statements is established as follows:

- *The Budget* – In the fall of each odd-numbered fiscal year, OHA's Administration drafts the program and budget recommendations that will be the basis for OHA's biennium budget request. Once approved by the OHA Board of Trustees, the budget is submitted directly to the State Legislature prior to its convening. The budget is generally constructed around OHA's operations (offices) and programs (divisions) and states programmatic objectives, expected outcomes, and financial requirements. The budget also shows the proportion of funding requested from general funds to be appropriated by the Legislature and from trust funds appropriated by OHA's Board of Trustees.
- *Legislative Review* – Once the budget is submitted to the State Legislature, the review process follows that which is applied to the executive branch, with the budget being reviewed by House Finance Committee, Senate Ways and Means Committee, and the respective subject matter committee in the House and Senate. The State Legislature may request provisos and may require financial analysis and evaluation of those programs funded with general funds, but has no discretion over trust fund allocations.

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE B – BIENNIAL BUDGET (continued)

- *Program Execution* – Except as limited by policy decisions of OHA's Board of Trustees, provisos of the State Legislature, and other provisions of law, OHA's Administration is responsible for the proper management of the programs. Appropriation changes and transfers can be authorized by the Board; those impacting general funds are reported to the State Legislature.

The budget is adopted for the general fund and is prepared on a basis other than GAAP. The actual results of operations are presented on the budgetary basis in the statement of revenues and expenditures – budget and actual to provide a meaningful comparison of actual results to the legislative budget.

The major differences between the budgetary basis and GAAP basis are that: (1) encumbrances are recorded as the equivalent of expenditures under the budgetary basis; and (2) revenue is recognized when received under the budgetary basis.

Adjustments necessary to reconcile the results of operations for the year ended June 30, 2010 from the budgetary basis to GAAP basis are as follows:

Excess of expenditures over revenues – actual (budgetary basis)	\$ (1,700)
Reserve for encumbrances at June 30	474,107
Prior year reserve for encumbrances	(267,717)
Accrued payables and payroll	199,801
Prepaid expenditures not recognized for budgetary purposes – net of prior-year accruals	(17,738)
Expenditures for liquidation of prior-year encumbrances	<u>(373,856)</u>
Excess of revenues over expenditures – actual (GAAP basis)	<u>\$ 12,897</u>

NOTE C – APPROPRIATIONS

OHA is authorized to transfer appropriation amounts and staffing positions between programs for operating purposes, provided that a report of all transfers are made to the State Legislature prior to convening of the next legislative session. Act 140, SLH 2009 authorizes a total of \$2,469,659 general funds, and \$5,810,847 trust funds for OHA's programs for fiscal year 2010.

NOTE D – CASH

The State maintains a cash pool that is used by all agencies. OHA's portion of this pool is indicated on the *Governmental Funds Balance Sheet* as "Cash in State Treasury." The Hawai'i Revised Statutes authorizes the Director of Finance to invest in obligations of, or guaranteed by, the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally-insured financial institutions. OHA has elected not to receive any earnings from this cash pool.

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE D – CASH (continued)

OHA's cash included in State pooled funds is fully collateralized with securities held by third-party agents in the State's name, as required by the Hawai'i Revised Statutes, Section 38-8. At June 30, 2010, OHA's cash held in the State Treasury totaled \$3,626,747.

OHA holds all other cash in banking institutions held outside of the State Treasury to maximize investment returns in accordance with Hawai'i Revised Statutes, Section 10-5. At June 30, 2010, these deposits totaled \$4,585,798, and had a corresponding bank balance of \$5,201,426. Of this bank balance, all was insured by either the Federal Deposit Insurance Corporation or National Credit Union Administration, or collateralized or invested in U.S. Government securities.

At December 31, 2009, Hi'ilei Aloha LLC, OHA's blended component unit, had deposits totaling \$296,363 with a corresponding bank balance of \$362,257. Hi'ilei Aloha LLC and its wholly-owned subsidiaries, Hi'ipaka LLC and Hi'ipoi LLC maintain separate legal entity cash accounts with a financial institution in the State of Hawai'i. Balances are insured up to \$250,000 per account holder by the Federal Deposit Insurance Corporation (FDIC). Balances may at times exceed the FDIC's insurance limits.

NOTE E – INVENTORY, PREPAID ITEMS AND OTHER ASSETS

At June 30, 2010, OHA did not maintain inventory. At December 31, 2009, Hi'ilei Aloha LLC, OHA's blended component unit, had inventory totaling \$34,747 which consisted of items held for sale.

At June 30, 2010, OHA had prepaid items totaling \$480,090. At December 31, 2009, Hi'ilei Aloha LLC, OHA's blended component unit, had prepaid items totaling \$43,342.

NOTE F – NOTES RECEIVABLE

Notes receivable at June 30, 2010 consist of the following:

Loans receivable serviced by First Hawaiian Bank (of which, \$2,231,053 is guaranteed by Department of Hawaiian Home Lands (DHHL))	\$ 3,564,655
Native Hawaiian Revolving Loan Fund	9,069,386
Other	<u>1,651,671</u>
Total	14,285,712
Less allowance for doubtful accounts	<u>(2,400,737)</u>
Net	11,884,975
Amounts due within one year	<u>(2,561,075)</u>
Amounts due after one year	<u>\$ 9,323,900</u>

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE G – INVESTMENTS

Under the Hawai'i Revised Statutes, Chapter 10, the Board of Trustees may collect, receive, deposit, withdraw, and invest money and property on behalf of the office to further the mission of OHA. On May 29, 2003, the OHA Board of Trustees adopted the Native Hawaiian Trust Fund Investment Policy Statement (NHTF investment policy), as updated April 15, 2010. The Board of Trustees maintain responsibility for setting the investment policy guidelines, asset allocation constraints, and monitoring the advisors to ensure they act prudently and follow the investment policy.

OHA's investment policy allows for the following investments:

- * U.S. large cap
- * U.S. small cap equities
- * International equities
- * Core fixed income
- * High yield
- * Real estate
- * Absolute return
- * Private equity

Investments as of June 30, 2010 and their maturities were as follows:

Investment type	Fund	Fair value	Investment maturities (in years)	
			Less than one	One thru five
U.S. treasuries	NHRLF	\$ 10,982,099	\$ –	\$10,982,099
U.S. agencies	NHRLF	6,654,374	1,949,268	4,705,106
Mutual & commingled funds	NHTF	253,590,209	253,590,209	–
Hedge funds	NHTF	21,319,939	21,319,939	–
Private equity funds	NHTF	28,164,704	28,164,704	–
Common & preferred stock	NHTF	7,174,510	7,174,510	–
Other	NHTF	12	12	–
Total investments		327,885,847	312,198,642	15,687,205
Money market funds (not considered investments)	Various	2,353,897	2,353,897	–
Total investments		<u>\$330,239,744</u>	<u>\$314,552,539</u>	<u>\$15,687,205</u>

For all investments held in accordance with OHA's NHTF investment policy, funds are managed by investment advisors who are responsible for the prudent management of all assets subject to their oversight and are involved in all key decisions, such as manager selection, within the context set by the investment policy. The advisors are also responsible for the adherence to the NHTF investment policy which provides objectives, guidelines and procedures as to the type of investments, assets allocations, long term targets, asset

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE G – INVESTMENTS (continued)

diversification, benchmark, performance objectives, and of restricted investments. The NHTF investment policy provides for the superior investment returns to sustain the beneficiaries of the Trust in perpetuity and to uphold the mission of the NHTF.

In addition, OHA has a separate investment policy for the NHRLF, which is restricted to investments in government backed securities (fixed securities) which strive for higher rates of return with the potential for greater principal stability than longer term fixed income investments. Interest rate, credit and concentration risks for the NHRLF investments are as follows:

Foreign Currency Risk

To diversify the NHTF portfolio against market fluctuations, OHA's investment policy allows for investments in foreign countries. As of June 30, 2010, OHA's foreign currency risks are as follows:

Investment Type	Currency	Value (US Dollar)
Mutual & commingled funds	Various	\$71,162,903
Private equity funds	Euro	\$ 5,083,396

Interest Rate Risk

As a means to limit the amount of exposure to fair market value losses attributed to rising interest rates, OHA's NHRLF investment policy for the liquidity portfolio limits investments to the following maximum maturities:

Type of Investment	Maximum Maturity
U.S. Treasuries	5 years
U.S. Agencies	5 years

The duration of the investment portfolio, under normal market conditions, range between plus or minus 50% of the investment policy benchmark.

Credit Risk

Pursuant to 45 C.F.R. 1336.72(a), "any portion of the revolving loan fund that is not required for expenditure must be invested in obligations of the United States or in obligations guaranteed or insured by the United States." At June 30, 2010, credit rates for all securities of government agencies were rated at Aaa (Moody's) or AAA (Standard & Poor's).

Concentration of Credit Risk

The NHRLF investment policy states that except for U.S. Treasury Securities and U.S. Government Sponsored Agency Obligations, fixed income securities will be limited to not more than 5% of the total portfolio, at the time of purchase, in any one issue.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE H – CAPITAL ASSETS

Capital assets activities for the year ended June 30, 2010 are as follows:

	July 1, 2009	Additions/ transfer in	Retirements/ transfer out	June 30, 2010
Capital assets not depreciated:				
Land	\$24,358,454	\$ –	\$ –	\$24,358,454
Total capital assets not depreciated	24,358,454	–	–	24,358,454
Capital assets being depreciated:				
Buildings	2,017,849	26,720	(34,877)	2,009,692
Leasehold improvements	867,535	1,624	–	869,159
Furniture, fixtures and equipment	4,507,568	181,936	(180,928)	4,508,576
Total capital assets being depreciated	7,392,952	210,280	(215,805)	7,387,427
Less accumulated depreciation	(4,575,193)	(413,518)	179,435	(4,809,276)
Capital assets being depreciated – net	2,817,759	(203,238)	(36,370)	2,578,151
Capital assets – net	\$27,176,213	\$(203,238)	\$ (36,370)	\$26,936,605

Net capital assets are further detailed below:

Detail of capital assets - net	June 30, 2010
OHA capital assets – net	\$12,525,253
Hi'ilei Aloha LLC capital assets – net	14,411,352
Total capital assets – net	\$26,936,605

NOTE I – CAPITAL LEASES

OHA leases photocopiers and mail postage meter machines for all offices. Capital leases are recorded as assets and liabilities and amortized over the term of the lease agreement by use of the straight line method. The amortization of assets recorded under capital leases is included with depreciation expenses. As of June 30, 2010, assets recorded under capital lease included in machinery, equipment, furniture and fixtures is \$279,015 and related amortization is \$139,133.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE I – CAPITAL LEASES (continued)

At June 30, 2010, the present value of minimum lease payments is \$157,787 and the long-term obligation is \$102,552. Below are minimum lease payments through 2013 and the computation of the current and long-term capital lease obligation:

Fiscal year ending June 30,	
2011	\$ 65,846
2012	61,214
2013	<u>49,388</u>
Total minimum lease payments	176,448
Less stated interest	<u>(18,661)</u>
Present value of minimum lease payments (obligation under capital lease)	157,787
Less current portion	<u>(55,235)</u>
Long-term capital lease obligation	<u><u>\$102,552</u></u>

NOTE J – LONG-TERM LIABILITIES

Long-term liabilities for the year ended June 30, 2010 are as follows:

	July 1, 2009	Additions	Reductions	June 30, 2010	Amounts due within one year	Amounts due after one year
Accrued vacation	\$1,301,267	\$694,549	\$ (709,097)	\$1,286,719	\$469,814	\$ 816,905
Accrued workers' compensation	849,775	–	(460,017)	389,758	–	389,758
Accrued trustee retirement plan	169,758	–	(77,550)	92,208	11,300	80,908
Accrued lease guaranty obligation	–	62,126	–	62,126	62,126	–
Capital lease obligation	<u>210,709</u>	<u>–</u>	<u>(52,922)</u>	<u>157,787</u>	<u>55,235</u>	<u>102,552</u>
Long-term liabilities	<u><u>\$2,531,509</u></u>	<u><u>\$756,675</u></u>	<u><u>\$(1,299,586)</u></u>	<u><u>\$1,988,598</u></u>	<u><u>\$598,475</u></u>	<u><u>\$1,390,123</u></u>

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE K – OPERATING LEASES

OHA leases office space and equipment under various noncancelable operating leases through December 2012. Future minimum payments under all leases as of June 30, 2010 are approximated as follows:

Fiscal year ending June 30,	
2011	\$361,600
2012	42,359
2013	<u>9,583</u>
Total	<u>\$413,542</u>

Rent expense (including taxes and common area maintenance) under operating leases totaled \$1,130,947 for the year ended June 30, 2010.

In August 1998, OHA entered into a 35 year lease with the Department of Land and Natural Resources (DLNR) for the use of the premises known as the Old Waialua Court House in Waialua, Oahu. Lease rent is gratis, however, OHA pays for all operating and repair costs associated with maintaining the property. OHA sublets a portion of the property to a not-for-profit organization which reimburses OHA for their portion of the costs associated with maintaining the property as set forth in the lease agreement between OHA and DLNR.

Hi'ilei Aloha LLC, OHA's blended component unit, leases office space for its office located in Honolulu, Hawai'i, from OHA, under a lease that expires in February 2011. It also leases two commercial buildings, a poi factory and an adjoining office in Kaua'i, under a lease that expires in February 2013. Future minimum payments under all leases as of December 31, 2009 are approximated as follows:

Year ending December 31,	
2010	\$16,120
2011	11,720
2012	11,320
2013	<u>1,890</u>
Total	<u>\$41,050</u>

Rent expense under operating leases totaled approximately \$16,100 for the year ended December 31, 2009.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE L – RECONCILIATIONS OF GOVERNMENT-WIDE AND GOVERNMENTAL FUNDS
FINANCIAL STATEMENTS

The following schedule reconciles the governmental fund balance to net assets:

Total fund balance – governmental funds	\$356,222,709
Amounts reported for governmental activities in the statement of net assets are different because:	
Net capital assets used in governmental activities are not current financial resources and therefore are not reported in the funds	26,936,605
Long-term liabilities not due and payable in the current period and therefore not reported in the funds:	
Accrued vacation	(1,286,719)
Accrued workers' compensation	(389,758)
Accrued trustee retirement plan	(92,208)
Accrued lease guaranty obligation	(62,126)
Capital lease obligation	(157,787)
Subtotal	(1,988,598)
Total net assets – government-wide	\$381,170,716

The following schedule reconciles the changes in fund balance to changes in net assets:

Net changes in fund balances – total governmental funds	\$17,648,745
Amounts reported for governmental activities in the statement of activities is different because:	
Governmental funds report capital outlays and capital lease payments as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation and amortization expense. This is the amount by which depreciation and related debt exceeded capital outlays during the year	(239,608)
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds:	
Accrued vacation	14,548
Accrued workers' compensation	460,017
Accrued trustee retirement plan	77,550
Accrued lease guaranty obligation	(62,126)
Capital lease obligation	52,922
Subtotal	542,911
Changes in net assets – government-wide	\$17,952,048

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE M – EMPLOYEE BENEFITS

Defined Benefit Pension Plans

All full-time employees of OHA are eligible to participate in the Employees' Retirement System of the State of Hawai'i (ERS), a cost-sharing, multiple-employer public employee retirement system covering eligible employees of the State and counties.

The ERS is composed of a contributory retirement plan, a noncontributory retirement plan, and a hybrid plan. Eligible employees who were in service and a member of the existing contributory plan on June 30, 1984, were given an option to remain in the existing plan or join the noncontributory plan, effective January 1, 1985. All new eligible employees hired after June 30, 1984 and July 1, 2006 automatically become members of the noncontributory plan and hybrid plan, respectively. All plans provide death and disability benefits and cost of living increases. Benefits are established by State statute.

In the contributory plan, employees may elect normal retirement at age 55 with five years of credited service or elect early retirement at any age with 25 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life, of 2% of their average final compensation (AFC), as defined, for each year of credited service. Benefits fully vest on reaching five years of service; retirement benefits are actuarially reduced for early retirement. Covered contributory plan employees are required by State statute to contribute 7.8% of their salary to the plan; OHA is required by State statute to contribute the amounts determined by actuarial valuations.

In the noncontributory plan, employees may elect normal retirement at age 62 with ten years of credited service or at age 55 with 30 years of credit service, or elect early retirement at age 55 with 20 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life, of 1.25% of their average final compensation (AFC), as defined, for each year of credited service. Benefits fully vest on reaching ten years of service; retirement benefits are actuarially reduced for early retirement. OHA is required by State statute to contribute the amounts determined by actuarial valuations.

In the hybrid plan, employees may elect normal retirement at age 62 with five years of credited service or at age 55 with 30 years of credited service, or elect early retirement at age 55, with 20 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life, of 2% of their average final compensation (AFC), as defined for each year of credited service. Benefits fully vest on reaching five years of service, retirement benefits are actuarially reduced for early retirement. Covered hybrid plan employees are required by State statute to contribute 6.0% of their salary to the plan; OHA is required by State statute to contribute the amounts determined by actuarial valuations.

Contributions by OHA for the fiscal years ending June 30, 2010, 2009, and 2008 were approximately \$1,156,000, \$1,257,000, and \$1,054,000, respectively. The contribution rate for the fiscal years ending June 30, 2010 and 2009 was 15.0% while the contribution rate for the fiscal year ending June 30, 2008, was 13.75%.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE M – EMPLOYEE BENEFITS (continued)

Defined Benefit Pension Plans (continued)

The ERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to the Employees' Retirement System, 201 Merchant Street, Suite 1400, Honolulu, Hawai'i 96813-2980 or by calling (808) 586-1735.

Post-Retirement Health Care and Life Insurance Benefits

In addition, the State of Hawai'i Employer-Union Benefits Trust Fund (EUTF) provides certain health care (medical, prescription drug, vision and dental) and life insurance benefits for retired employees under a multiple employer defined benefit postemployment program. OHA's contributions for retiree health and group life insurance benefits are subject to the State law governing the EUTF. The EUTF pays for some or all of these benefits for eligible employees, in accordance with the guidelines issued under State law. The EUTF also reimburses Medicare expenses of retirees and qualified spouses who are at least 62 years of age and have at least ten years of service.

Effective July 1, 2007, the State adopted the provisions of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postretirement Benefits Other Than Pensions*. OHA's annual other postemployment benefit (OPEB) cost is allocated by the State based on a percentage of OHA's payroll. The State has elected not to allocate an additional share of its annual required contribution to OHA. As such, OHA has not recorded a liability for OPEB as of June 30, 2010. OHA contributed approximately \$514,000 in OPEB expenses for the fiscal year ended June 30, 2010.

The EUTF issues a publicly available financial report that included financial statements and required supplementary information. That report may be obtained by writing to the Employer Union Health Benefits Trust Fund, 201 Merchant Street, Suite 1520, Honolulu, Hawaii 96813 or by calling (808) 586-7390.

Trustee Retirement Plan

The OHA Board of Trustees terminated the dormant supplemental retirement plan, the Office of Hawaiian Affairs Supplemental Plan for Trustees ("the Plan") which was established in 1999 for the benefit of the Trustees. The Plan was designed to qualify as an unfunded deferred compensation under ERISA sections 201(1), 301(a)(3), and 401(a)(1), and as a pension for past services under Hawai'i Revised Statutes, Section 235-7(a)(3). The lifetime estimated liability for claims is recorded in the accompanying financial statements and disclosed in Note J.

Hi'ilei Aloha LLC Retirement Plan

Hi'ilei Aloha LLC, OHA's blended component unit, offers a 401(k) profit sharing plan. Employees become eligible upon six (6) months of employment and may contribute to the plan to the extent allowed by law. Hi'ilei Aloha LLC matches employees' contributions up to 4% of salary. Contribution expense amounted to \$27,028 for the year ended December 31, 2009.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE M – EMPLOYEE BENEFITS (continued)

Sick Leave

Accumulated sick leave amounted to \$2,222,158 as of June 30, 2010. Sick leave accumulates at the rate of 14 hours for each month of service, as defined, without limit. Sick pay can be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for sick leave is recorded in the accompanying financial statements.

NOTE N – NON-IMPOSED EMPLOYEE FRINGE BENEFITS

Payroll fringe benefit costs for employees of OHA funded by state appropriations (general fund) are assumed by the State and are not charged to OHA's operating funds. These costs, totaling \$215,621 for the fiscal year ended June 30, 2010, have been reported as revenues and expenditures of OHA's general fund.

NOTE O – RISK MANAGEMENT AND CONTINGENT LIABILITIES

Workers' Compensation and Other Self-Insurance Liabilities

As a state agency, OHA participates in the state's risk management program. The State maintains certain insurance coverage to satisfy bond indenture agreements as well as for other purposes, but is substantially self-insured for all other perils. The State records a liability for risk financing and insurance related losses, including incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies.

In addition to the state coverage, OHA purchases Public Officials and Employment Practices Liability insurance, Bankers' Professional Liability insurance, and general and excess liability for property owned or required by lease agreements entered into.

The State is self-insured for workers' compensation. Accordingly, OHA is liable for workers' compensation claims filed by its employees. Liabilities for workers' compensation claims are established if information indicates that it is probable that liabilities have been incurred and the amount of those claims can be reasonably estimated. The workers' compensation reserve approximated \$390,000 at June 30, 2010. The estimated losses will be paid from the NHTE.

Ceded Lands – Public Land Trust

In *Office of Hawaiian Affairs v. Hawai'i Housing Authority* ("OHA v. HHA"), Civil No. 95-2682-07, all proceedings of the lawsuit were stayed on January 11, 2000 pending the Hawai'i Supreme Court's decision in *Office of Hawaiian Affairs v. State of Hawai'i* ("OHA v. State I"), Docket No. 07-1372. OHA disagreed that the decision rendered by the Hawai'i Supreme Court on September 12, 2001 in OHA v. State I required the dismissal of the claims in OHA v. HHA (which relates to the valuation of five parcels transferred to HHA for affordable public housing units). OHA had sued for new appraisals and further payment but the State of Hawai'i counterclaimed alleging that the amounts paid were in error. At June 30, 2010, the case remains stayed.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE O – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

Ceded Lands – Public Land Trust (continued)

This case could have a potential financial impact relative to the valuation of the appraisals. However, at the present time, OHA receives a fixed sum for its pro rata share of the revenues from the Hawai'i State Legislature and so there probably is no financial impact.

Civil Complaints

In *Day, et al. v. Apoliona, et al.*, Civil No. 05-0649 ACK-BMK, United States District Court of the State of Hawai'i, five native Hawaiians filed a complaint in 2005 (Plaintiffs) against two former OHA trustees and the current OHA trustees alleging that OHA was wrongfully expending its trust fund monies on all Hawaiian beneficiaries and not just exclusively on those beneficiaries with 50% or more blood quantum. Plaintiffs were seeking injunctive relief to enjoin and restrain OHA from certain expenditures of its trust funds as well as a declaratory judgment with regard to certain legal issues. Subsequently, in August, 2006, the case was dismissed by a federal judge on jurisdictional grounds.

Plaintiffs filed a Notice of Appeal with the United States Court of Appeals for the Ninth Circuit. The case was heard by a three judge panel on June 5, 2007 and, without expressing any opinion of the merits of the plaintiff's allegations, issued a ruling on August 7, 2007 reversing the District Court's dismissal of the case on jurisdictional grounds and remanding the case to the United States District Court for further proceedings. The State Attorney General was given intervener status and sought a rehearing en banc of the panel decision. This request was rejected by the Ninth Circuit Court of Appeals. Since the Ninth Circuit's remand of the case to the District Court, the OHA defendants ("OHA") filed a Second Motion for Summary Judgment in May, 2008. The Plaintiffs opposed the Motion and OHA filed its reply on May 29, 2008. The hearing on the motion was scheduled for Monday, June 9, 2008, before U.S. District Judge Susan Mollway. On June 20, 2008, the Court granted OHA's Second Motion for Summary Judgment.

The State of Hawai'i, on May 22, 2008, filed a Statement of Position, positing an alternative reason for granting judgment in favor of defendants. The State of Hawai'i's motion for summary judgment on this alternative ground was filed on June 4, 2008 and was set for hearing on July 7, 2008. OHA filed a Statement of No Position on June 17, 2008. Plaintiffs' filed a Memorandum in Opposition on June 19, 2008. The Court dismissed the case on June 20, 2008.

On July 15, 2008, Putative Intervenor, Wendell Marumoto filed a Notice of Appeal to the United States Court of Appeals for the Ninth Circuit. Opening, Answering, and an optional Reply Briefs were filed.

On July 21, 2008, the Day Plaintiffs filed a Notice of Appeal to the United States Court of Appeals for the Ninth Circuit. Opening and Answering Briefs were filed. The optional Reply Brief, originally due on January 2, 2009, was not filed until February 18, 2009 due to the Day Plaintiffs filing of a Motion to Extend Time to file Reply Brief. The Reply Brief was filed on February 19, 2009. Oral argument was set for and held on October 13, 2009 before a three-judge panel.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE O – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

Civil Complaints (continued)

On July 26, 2010, the Ninth Circuit Court of Appeals ruled in favor of OHA affirming the United States District Court's grant of summary judgment on June 20, 2008. Plaintiff's attorney is in the process of filing a Petition for Writ of Certiorari to the U.S. Supreme Court.

In *Kuroiwa, Jr., et al. v Linda Lingle, et al.*, Civil No. 08-0153 JMS-KSC, United States District Court, Plaintiffs Kuroiwa filed their Complaint and motions for temporary restraining order and preliminary injunction on April 3, 2008. At a status conference on April 8, 2008, U.S. District Court Judge Michael Seabright denied Plaintiffs' motion for temporary restraining order, and set a date of June 30, 2008 (later moved to July 1, 2008) for a hearing on the motion for preliminary injunction and on defendants' anticipated motions to dismiss.

On April 25, 2008, Plaintiffs moved for reconsideration of the order denying the temporary restraining order. Defendants filed opposition memoranda and, on April 25, 2008, the Court denied the motion, reiterating its conclusions that the Ninth Circuit's *Arakaki v. Lingle*, 477 F.3d 1048 (9th Cir. 2007) case controls, and that Plaintiffs had no likelihood of success on the merits.

On May 9, 2008, having filed and served answers to the Complaint (as counsel for Plaintiffs did not agree that the Court implicitly extended the time for answers by setting a deadline for motions to dismiss), OHA and the State filed their motions for judgment on the pleadings and their memoranda in opposition to Plaintiffs' motion for preliminary injunction, pursuant to the Court's order. On June 9, 2008, Plaintiffs' filed their opposition to OHA and the State's motion for judgment on the pleadings. On July 1, 2008, the Court granted OHA and the State's motions and dismissed the case. OHA filed a Rule 11 Motion for Sanctions against Kuroiwa's counsel H. William Burgess, Esq. for having filed a frivolous lawsuit. That Motion was granted by Judge Seabright and sanctions in favor of OHA were awarded.

On October 14, 2008, Kuroiwa, Jr., et al. filed a Notice of Appeal to the United States Court of Appeals for the Ninth Circuit. The Opening Brief was due and filed on November 19, 2008. The Answering Brief was originally due on December 19, 2008, but was extended until January 2, 2009. The answering brief was filed on January 31, 2009. The optional Reply Brief was filed on March 2, 2009.

Oral arguments for *Kuroiwa* case was set and held on October 13, 2009 before a three-judge panel. By Memorandum Opinion filed on November 5, 2009 in the United States Court of Appeals, the three-judge panel denied Plaintiffs' attorney, H. William Burgess' appeals from United States District Courts. The Ninth Circuit Court of Appeals affirmed the United States District Court's decision to dismiss the *Kuroiwa* lawsuit and also affirmed that Plaintiff's counsel was properly sanctioned for filing a frivolous complaint and that the Rule 11 sanctions motions against both the state's counsel and OHA's counsel was also completely frivolous. In November, Plaintiff's counsel filed a Petition for Panel or En Banc Rehearing which was denied on December 17, 2009.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE O – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

Litigation

OHA is a party to legal proceedings and claims that arise in the ordinary course of business. Although occasional adverse decisions (or settlements) may occur, other than the matters described above, OHA believes that the final disposition of such matters will not have a material adverse effect on the financial position or changes in the financial position of OHA.

Guaranty

On December 27, 2006, OHA entered into an agreement with an unrelated company to act as guarantor of the company's lease agreement. The company's lease agreement was amended on December 21, 2009 and now expires on April 20, 2014. At any time through that date, should the company be over 30 days past due and upon landlord notice to OHA of the company's default, OHA will be obligated to perform pursuant to the guaranty by making payments on all past due obligations of rent, sums, costs and charges of the company up to a maximum amount of \$150,000. As of June 30, 2010, the landlord has not asked OHA to perform pursuant to the guaranty, however, OHA has made a provision for potential liability equal to the amount of past due obligations of rent, sums, costs and charges of the company as of June 30, 2010. The potential liability as of June 30, 2010 has been disclosed in Note J.

Hi'ilei Aloha LLC

Hi'ipaka LLC, which is a wholly owned subsidiary of OHA's blended component unit, Hi'ilei Aloha LLC, is a party to a litigation arising from the normal course of business. It is Hi'ipaka LLC management's opinion, based on consultation with legal counsel, that the final outcome of this matter will not result in a material adverse effect on Hi'ipaka LLC's financial position.

NOTE P – RELATED PARTY TRANSACTIONS

OHA receives a portion of ceded land revenues from various state agencies. In June 2006, Act 178 was passed which laid the foundation for a quarterly guaranteed ceded land revenue stream of \$3,775,000, totaling \$15,100,000 per year. Total received during the year ended June 30, 2010 was \$15,100,000 as reported in the financial statements under general revenue, public land trust. As of June 30, 2010, the related receivable was \$688,237 reported in the financial statements under accounts receivable, PLTF.

Besides property leased from DLNR, as discussed in Note K, Executive Order 3724 granted OHA a set aside of land located in Kekaha, Kaua'i (Kekaha Armory), to be used for Hawaiian cultural and educational purposes in which OHA would control and manage the property. OHA is responsible for all maintenance costs associated with the property. Upon cancellation of the Executive Order and/or in the event of non-use for a continuous period of one year, for purposes described above, the property will revert back to DLNR, free of all liens and encumbrances. Unless sooner terminated, OHA leases the Kekaha Armory to a not-for-profit organization for a maximum period of 66 years commencing on November 2000, for \$1 per year to utilize such property for purposes in accordance with the Executive Order.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2010

NOTE P – RELATED PARTY TRANSACTIONS (continued)

Pursuant to Executive Order 07-05 Act 224, which became effective on July 1, 2006, the State appropriated \$180,000 out of Public Land Trust proceeds to be used for the repair and maintenance of the Royal Mausoleum at Mauna 'Ala. While the Royal Mausoleum was donated to OHA, the site is managed by the State Parks division of the DLNR. As of June 30, 2010, \$78,795 was paid for services rendered under this agreement.

Payments made to OHA's blended component unit, Hi'ilei Aloha LLC, during fiscal year 2010 totaled \$1,201,724 resulting in a net operating transfer out in the fund financial statements. Hi'ilei Aloha LLC is a legally separate reporting entity from OHA as discussed in Note A.

In December 2008, OHA and DHHL mutually agreed to a collaborative financing arrangement to provide funds for DHHL's use in the planning, design and construction of infrastructure for homesteads for native Hawaiians on properties owned and controlled by DHHL. OHA's obligation under the agreement was to pay DHHL an annual fee not to exceed \$3,000,000 for 30 years. For the year ended June 30, 2010, OHA remitted \$3,000,000 to DHHL. As of June 30, 2010, OHA has designated \$84,000,000 of its unreserved funds for future payments to DHHL.

In October 2009, the OHA Board of Trustees approved the OHA Strategic Reorganization and Retirement Program ("Retirement Incentive Program"). Under the Retirement Incentive Program, certain employees were entitled to receive basic severance, enhanced severance and voluntary retirement incentive amounts. The Retirement Incentive Program was created for the specific and limited purpose of assisting OHA and its employees during OHA's organizational restructuring and is not an ongoing program. During the year ended June 30, 2010, the cost of termination benefits was \$450,245.