

**Office of Hawaiian Affairs,
State of Hawai‘i**

Financial Statements
June 30, 2014

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Office of Hawaiian Affairs, State of Hawai'i

Letter from the Chief Executive Officer
Year Ended June 30, 2014

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, 2014. 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 an 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 Ho'okele Pono LLC and Hi'ilei Aloha LLC and its subsidiaries, they have been classified as blended component units. As a result, the financial results of Ho'okele Pono LLC and Hi'ilei Aloha LLC and its subsidiaries through December 31, 2013 have been included in the financial statements of OHA for the year ended June 30, 2014.

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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 statement of the Office of Hawaiian Affairs as of June 30, 2014, 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.

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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.

EMPOWERING HAWAIIANS

Guided by our 2010-2018 Strategic Plan, OHA has honed our roles as Advocate, Researcher, and Asset Manager striving to affect positive systemic change to improve the conditions of all Hawaiians in the following six priority areas:

HO'OKAHUA 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.

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In addition, we continued to fulfill our promise to the State Department of Hawaiian Home Lands, providing up to \$3 million annually over 30 years to pay the debt service on its infrastructure improvement – an example of how Hawaiian-focused agencies can, and must, work hand-in-hand to leverage assets toward a common goal. This is just part of the approximately \$12.7 million in grants OHA awarded in fiscal year 2014 to improve, among other things, the health, education, housing, and economic conditions of Native Hawaiians.

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 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 NHTF, is closely tied to the national economy.

State of the Local Economy

Hawai'i's Gross Domestic Product (GDP) increased by 1.9% in 2013 and is forecasted to grow by 2.5% in 2014. GDP for 2013 is at the highest point in Hawaii's history (\$75 billion) and well above the old peak of \$66 billion in 2008. On a year on year basis, however, Hawaii's economy had massive decreases in both visitor numbers and visitor expenditures. Visitor arrivals increased by only 1.7% in comparison to 2012 (9.7%) and visitor spending increased by only 2.4% with much of the growth coming from Asia. The weakness of the yen and the Japanese economy are causing fewer Japanese tourists to visit. Hawai'i's unemployment rate fell to 4.8% at the end of December 2013, down from the 5.7% figure reported a year earlier and was below the national unemployment rate of 7.8%. Much of this drop can be attributed to increases in construction hiring. Local price inflation (+1.8% in 2013) remains an obstacle as higher prices in healthcare, energy, and housing drove down real personal income growth in 2013. Hawaii's economy remains vulnerable to changes in both the national and global economy.

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State of the National Economy

Six years after the onset of the financial crisis, the US economic recovery is regaining momentum. Jobs continue to be added above expectations and real GDP is about 6% above its pre-crisis level. Despite the US Federal Reserve ending its bond buying campaign, the US stock market has surpassed its pre-crisis highs and the US housing market has stabilized. However, even with the improvement of key economic indicators, there are signs that the American populace is not benefiting evenly. Domestically, although unemployment has fallen, real incomes have been stagnant while healthcare and education costs increase. Most of the employment gains are due to jobs created in specific sectors such as energy and IT. Although the US equity market has climbed a wall of worry since the 2009 lows, there is no denying that there are multiple storm clouds on the horizon. Overseas, the ECB continues to struggle with slow growth and double digit levels of unemployment while growth is continuing to slow in Asia.

OHA's Investments

OHA's investment portfolio reported a 15.9% return in fiscal year 2014, outperforming its strategic benchmark by 0.8%, on a net-of-fees basis. OHA's alternative assets portfolio reported stellar performance and outperformed its benchmark by 157 basis points with a net return of 12.7%. OHA's global credit portfolio also outperformed its benchmark while global real assets and equities underperformed. The overall outperformance of the Trust Fund during the year was primarily driven by OHA's alternative assets portfolio.

CLOSING COMMENTS

On behalf of the Office of Hawaiian Affairs, I would like to express our gratitude to the Board of Trustees, Administration of the State of Hawai'i and members of the Hawai'i State Legislature for their continuing support. We look forward to helping even more Hawaiians as we continue to carry out our Strategic Plan and hope that everyone will join us in looking toward a bright future for our Native Hawaiian people.

Respectfully submitted,

Kamana'opono M. Crabbe, Ph.D
Its Ka Pouhana, Chief Executive Officer, Office of Hawaiian Affairs



A Hawaii Limited Liability Partnership

Independent Auditor's Report

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

Report on the Financial Statements

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, 2014, and the related notes to the financial statements, which collectively comprise OHA's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement. 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") and Ho'okele Pono LLC, blended component units, which represents 0.46% of assets and 5.52% of revenues of the governmental funds. Those financial statements were audited by another auditor whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for Hi'ilei and Ho'okele Pono LLC, is based solely on the reports of the other auditor. The consolidated financial statements of Hi'ilei and Ho'okele Pono LLC were not audited in accordance with *Government Auditing Standards*.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation

and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinion

In our opinion, 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 the OHA, as of June 30, 2014, and the respective changes in financial position and the respective budgetary comparison of the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 9 through 17 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise OHA's basic financial statements. The Letter from the Chief Executive Officer is presented for purposes of additional analysis and is not a required part of the basic financial statements. The Letter from the Chief Executive Officer has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 5, 2015, on our consideration of OHA's internal control over financial reporting and 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* in considering the OHA's internal control over financial reporting and compliance.

KMH LLP

KMH LLP

Honolulu, Hawai'i
March 5, 2015

Office of Hawaiian Affairs, State of Hawai'i

Management's Discussion and Analysis - Unaudited
June 30, 2014

As management of the Office of Hawaiian Affairs (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, 2014, management discussion and analysis will address both this year and the year ended June 30, 2013.

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 Position – The assets of OHA exceeded its liabilities at fiscal year ended June 30, 2014 by \$642,260,381 (presented as “total net position”). Of this amount, \$385,146,109 is reported as “unrestricted”, while \$27,540,859 is reported as “restricted-federal funds” and \$229,573,413 is reported as “invested in capital assets, net of related debt.” The assets of OHA exceeded its liabilities at fiscal year ended June 30, 2013 by \$613,093,035 (presented as “total net position”). Of this amount, \$356,274,639 is reported as “unrestricted”, while \$27,784,204 is reported as “restricted-federal funds” and \$229,034,192 is reported as “invested in capital assets, net of related debt.” Unrestricted net position represents 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 position, increased by \$29,167,346 (a 4.76% increase) in fiscal year 2014. This was primarily due to revenue from interest and investment earnings in the amount of approximately \$54 million.

Additional information regarding OHA's investments can be found in Note 8 to the financial statements.

Governmental Funds Financial Statements Highlights

Governmental Funds – Fund Balances – In fiscal year 2014, OHA's governmental funds reported an ending fund balance of \$414,218,878. Of this total amount, \$666,469, or 0.16% is classified as nonspendable for inventory, prepaid expenses and security deposits. Restricted fund balance totaled \$28,052,832 or 6.77%, broken down as follows: 98.13% for Native Hawaiian Revolving Loan Fund program of which \$10,769,307 relates to the long-term portion of outstanding loans, and 1.87% restricted

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for other federal programs administered by OHA. \$40,045,384 or 9.66% is classified as committed, based on the Board of Trustees' resolution to commit these funds towards the debt service of DHHL-issued revenue bonds. Assigned fund balance comprises 83.51% or \$345,935,411 of fund balance, broken down as follows: \$12,171,178 or 3.52% has been encumbered, \$1,303,848 or 0.38% represents the non-current portion of outstanding loans and \$332,460,385 or 96.10% is available for future expenditures. Negative unassigned fund balance amounts included in the General and Federal Funds will be covered by fiscal year 2015 appropriations and grant draws, respectively.

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 Position* presents all of OHA's assets and liabilities, with the difference between the two reported as "net position." Over time, increases or decreases in OHA's net position 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 position changed during the fiscal year. All changes in net position 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).

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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, Public Land Trust Fund (PLTF), investment income and net gains/losses on investments in the Native Hawaiian Trust Fund (NHTF), newspaper advertisements, donations, non-imposed fringe benefits, and other revenues).

It also includes the results of its blended component units, Ho'okele Pono LLC and Hi'ilei Aloha LLC and its wholly-owned subsidiaries, through its separate fiscal year end, December 31, 2013. Ho'okele Pono LLC and Hi'ilei Aloha LLC have been included as blended component units 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.

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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 13 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 units, Ho'okele Pono LLC and Hi'ilei Aloha LLC and its wholly-owned subsidiaries, have also been classified as a special revenue funds.

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 3 to the financial statements. The *Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis), General Fund* can be found on page 21.

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*.

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GOVERNMENT-WIDE FINANCIAL ANALYSIS

Statement of Net Position

Summarized financial information of OHA's *Statement of Net Position* as of June 30, 2014 and 2013 is as follows:

	<u>2014</u>	<u>2013</u>
Assets:		
Capital assets	\$ 257,128,051	\$ 252,198,625
Other assets	<u>432,633,066</u>	<u>395,093,374</u>
Total assets	<u>\$ 689,761,117</u>	<u>\$ 647,291,999</u>
Liabilities:		
Other liabilities	\$ 18,188,424	\$ 9,482,819
Long-term liabilities	<u>29,312,312</u>	<u>24,716,145</u>
Total liabilities	<u>47,500,736</u>	<u>34,198,964</u>
Net position:		
Invested in capital assets, net of related debt	229,573,413	229,034,192
Restricted – Federal funds	27,540,859	27,784,204
Unrestricted	<u>385,146,109</u>	<u>356,274,639</u>
Total net position	<u>642,260,381</u>	<u>613,093,035</u>
Total liabilities and net position	<u>\$ 689,761,117</u>	<u>\$ 647,291,999</u>

As noted earlier, net position may serve over time as a useful indicator of a government's financial position. OHA's net position totaled \$642,260,381 at the end of fiscal year 2014, compared to \$613,093,035 at the end of fiscal year 2013, representing an increase of 4.76% or \$29,167,346.

Unrestricted funds represent the largest portion of OHA's net position (59.97% and 58.11% at June 30, 2014 and 2013, 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 assignments of resources.

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Statement of Activities

Summarized financial information of OHA's *Statement of Activities* for the fiscal years ended June 30, 2014 and 2013 is as follows:

	<u>2014</u>	<u>2013</u>
Revenues:		
Program revenues:		
Operating grants	\$ 479,036	\$ 403,052
Charges for services	714,810	767,097
Interest and investment earnings	5,295	19,560
General revenues:		
Appropriations, net of lapses	3,134,074	2,353,001
Public Land Trust	19,180,485	19,029,735
Interest and investment earnings (losses)	53,858,748	35,089,035
Newspaper ads	78,749	80,356
Donations and other	293,486	1,137,786
Hi'ilei Aloha LLC	4,344,603	3,233,561
Non-imposed fringe benefits	196,529	191,152
Total revenues	<u>82,285,815</u>	<u>62,304,335</u>
Expenses:		
Current divisions:		
Board of Trustees	2,262,864	2,085,809
Support Services	18,271,663	18,102,738
Beneficiary Advocacy	25,258,042	22,503,694
Depreciation	2,579,713	1,351,099
Ho'okele Pono LLC	379,514	376,339
Hi'ilei Aloha LLC	4,404,761	3,909,405
Total expenses	<u>53,156,557</u>	<u>48,329,084</u>
Net transfers (to)/from other funds	<u>38,088</u>	<u>4,089</u>
Changes in net position	<u>\$ 29,167,346</u>	<u>\$ 13,979,340</u>

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OHA's changes in net position increased by \$15,188,006 during the year. Key elements of this increase compared to the prior are as follows:

Total revenues interest and investment earnings increased by \$18,755,448 from the prior year primarily due to improved market conditions during all four quarters of fiscal year 2014. Although interest and investment earnings related to program revenues decreased by \$14,265, general revenue interest and investment earnings increased by \$18,769,713.

General revenues, donations and others, decreased by \$844,300 from prior year primarily due to the prior year's acceptance of a 20.75 acre property donation in the ahupua'a of Palauea, between Kihei and Makena in southeast Maui, valued at approximately \$896,000.

Increases in net position were offset by an increase in expenses in fiscal year 2014 of \$4,827,473. This change was comprised of an increase of \$1,228,614 in depreciation expense and an increase of \$3,598,859 related to OHA operations, including its blended component units. Beneficiary advocacy expenses increased by \$2,754,348 primarily due to reallocation of certain programmatic expenses between functions during the year. Increases in various overhead costs and employee positions also contributed to higher beneficiary advocacy expenses in fiscal year 2014. The \$1,228,614 increase in depreciation expense was primarily due to the properties that were acquired during prior year and leasehold improvements made during fiscal year 2014.

\$495,536 of the \$4,827,473 increase is attributed to the operations of OHA's blended component unit Hi'ilei Aloha LLC and subsidiaries. The increase costs incurred are directly related to increased operations which have yielded an increase of revenues of \$1,111,042. With assistance from OHA, Hi'ilei Aloha LLC and subsidiaries continues progress towards self-sustainability.

Additional information regarding OHA's capital assets can be found in Note 9 to the financial statements.

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.

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June 30, 2014

At the close of fiscal year 2014, OHA's governmental funds reported an ending fund balance of \$414,218,878. Fund balance was segregated in to the following categories: Nonspendable, Restricted, Committed, Assigned and Unassigned.

Nonspendable fund balance totaled \$666,469 or 0.16% due to amounts related to inventory, prepaid expenses and security deposits.

Restricted fund balance totaled \$28,052,832 or 6.77%, and is comprised of the following: \$27,529,463 or 98.13% for the Native Hawaiian Revolving Loan Fund program of which \$10,769,307 relates to the long-term portion of outstanding loans, and \$523,369 or 1.87% restricted for State Proviso programs and the remainder for other federal programs administered by OHA.

Committed fund balance totaled \$40,045,384 or 9.66% based on the Board of Trustees' resolution to commit these funds towards the debt service of DHHL-issued revenue bonds.

Assigned fund balance totaled \$345,935,411 or 83.51% of fund balance and is comprised of the following: \$12,171,178 or 3.52% has been encumbered, \$1,303,848 or 0.38% represents the non-current portion of outstanding loans and \$332,460,385 or 96.10% is available for future expenditures.

Unassigned fund balance totaled (\$481,218) or (0.11%) of fund balance and will be covered by fiscal year 2015 appropriations.

At the close of fiscal year 2013, OHA's governmental funds reported an ending fund balance of \$385,610,555.

Nonspendable fund balance totaled \$630,840 or 0.16% due to amounts related to inventory, prepaid expenses and security deposits.

Restricted fund balance totaled \$27,780,242 or 7.20%, and is comprised of the following: \$27,762,668 or 99.94% for the Native Hawaiian Revolving Loan Fund program of which \$13,410,186 relates to the long-term portion of outstanding loans, and \$17,574 or 0.06% restricted for other federal programs administered by OHA.

Committed fund balance totaled \$40,711,267 or 10.56% based on the Board of Trustees' resolution to commit these funds towards the debt service of DHHL-issued revenue bonds.

Assigned fund balance totaled \$316,509,436 or 82.08% of fund balance and is comprised of the following: \$12,897,172 or 4.08% has been encumbered, \$1,626,689 or 0.51% represents the non-current portion of outstanding loans and \$301,985,575 or 95.41% is available for future expenditures.

**Office of Hawaiian Affairs,
State of Hawai'i**

Management's Discussion and Analysis - Unaudited
June 30, 2014

Unassigned fund balance totaled (\$21,230) and was covered by fiscal year 2014 appropriations.

OHA's governmental funds experienced an increase of \$28,728,323 in fund balance during fiscal year 2014.

CAPITAL ASSETS AND LONG-TERM LIABILITIES

OHA's investment in capital assets amounted to \$257,128,051 and \$252,198,625, net of depreciation, as of June 30, 2014 and 2013, respectively. Capital assets include land, building, leasehold improvements, equipment and software development.

	<u>2014</u>	<u>2013</u>
Land	\$ 226,965,802	\$ 226,965,802
Construction in progress	-	316,860
Buildings and improvements	32,277,729	26,206,217
Equipment	6,278,838	4,998,553
Accumulated Depreciation	<u>(8,394,318)</u>	<u>(6,288,807)</u>
Totals	<u>\$ 257,128,051</u>	<u>\$ 252,198,625</u>

The increase in capital assets is primarily due to renovation of a commercial property in the amount of approximately \$5.9 million. Additional information regarding OHA's capital assets can be found in Note 9 to the financial statements.

OHA's long-term liabilities include notes payable, accrued vacation, accrued workers' compensation, and capital lease obligation. The increase in long-term liabilities is primarily due to the debt incurred, approximately \$4.3 million, to finance the renovation of commercial property during the year. Additional information about OHA's long-term liabilities can be found in Note 12 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
560 N. Nimitz Hwy, Suite 200
Honolulu, Hawai'i 96817

Office of Hawaiian Affairs, State of Hawai'i

Governmental Funds - Statement of Net Position/Government-Wide Statement of Net Position
June 30, 2014

Assets	Governmental Funds							Adjustments (Note 13)	Government- wide Statement of Net Assets
	Special Revenue Funds								
	General Fund	Public Land Trust	Federal Grants	Other	Ho'okele Pono LLC	Hi'ilei Aloha LLC	Total		
Petty cash	\$ -	\$ 700	\$ -	\$ -	\$ -	\$ 5,500	\$ 6,200	\$ -	\$ 6,200
Cash in State Treasury	444,476	5,158,719	-	-	-	-	5,603,195	-	5,603,195
Cash in banks	-	8,521,647	5,249,948	871,584	103,737	1,595,349	16,342,265	-	16,342,265
Cash held by investment manager	-	1,143,595	2,641,962	-	-	-	3,785,557	-	3,785,557
Restricted cash	-	-	243,903	-	-	-	243,903	-	243,903
Accounts receivable	-	18,498,933	68,286	12,709	45,515	118,870	18,744,313	-	18,744,313
Interest and dividends receivable	-	267,777	69,496	-	-	-	337,273	-	337,273
Inventory, prepaid items and other assets	39,598	489,450	3,027	-	2,113	132,281	666,469	225,764	892,233
Notes receivable - due within one year	-	519,495	3,798,609	-	-	-	4,318,104	-	4,318,104
Notes receivable - due after one year	-	1,303,848	10,769,307	-	-	-	12,073,155	-	12,073,155
Investments	-	365,196,261	5,090,607	-	-	-	370,286,868	-	370,286,868
Capital assets - net	-	-	-	-	-	-	-	257,128,051	257,128,051
Total assets	\$ 484,074	\$ 401,100,425	\$ 27,935,145	\$ 884,293	\$ 151,365	\$ 1,852,000	\$ 432,407,302	\$ 257,353,815	\$ 689,761,117

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i

Governmental Funds - Statement of Net Position/Government-Wide Statement of Net Position (continued)
June 30, 2014

Liabilities and Fund Balances/Net Assets	Governmental Funds							Adjustments (Note 13)	Government- wide Statement of Net Assets
	Special Revenue Funds						Total		
	General Fund	Public Land Trust	Federal Grants	Other	Ho'okele Pono LLC	Hī'ilei Aloha LLC			
Accounts payable and accrued liabilities	\$ 314,394	\$ 16,006,695	\$ 94,286	\$ 150	\$ 17,114	\$ 498,409	\$ 16,931,048	\$ -	\$ 16,931,048
Due to State of Hawaii	-	957,376	300,000	-	-	-	1,257,376	-	1,257,376
Long-term liabilities:									
Due within one year	-	-	-	-	-	-	-	772,340	772,340
Due after one year	-	-	-	-	-	-	-	28,539,972	28,539,972
Total liabilities	314,394	16,964,071	394,286	150	17,114	498,409	18,188,424	29,312,312	47,500,736
Commitments and Contingencies									
Fund balances/net assets									
Fund balances									
Nonspendable -									
Inventory, prepaid items & security deposits	39,598	489,450	3,027	-	2,113	132,281	666,469	(666,469)	-
Restricted for:									
Beneficiary advocacy	154,972	-	368,397	-	-	-	523,369	(523,369)	-
Native Hawaiian loan programs	-	-	16,760,156	-	-	-	16,760,156	(16,760,156)	-
Long-term portion of notes receivable	-	-	10,769,307	-	-	-	10,769,307	(10,769,307)	-
Committed to -									
DHHL-issued revenue bonds	-	40,045,384	-	-	-	-	40,045,384	(40,045,384)	-
Assigned to:									
Support services	54,170	5,513,350	-	-	-	-	5,567,520	(5,567,520)	-
Beneficiary advocacy	42,130	6,338,161	-	884,143	-	-	7,264,434	(7,264,434)	-
Ho'okele Pono LLC	-	-	-	-	132,138	-	132,138	(132,138)	-
Hī'ilei Aloha LLC	-	-	-	-	-	1,221,310	1,221,310	(1,221,310)	-
Long-term portion of notes receivable	-	1,303,848	-	-	-	-	1,303,848	(1,303,848)	-
Public Land Trust	-	330,446,161	-	-	-	-	330,446,161	(330,446,161)	-
Unassigned	(121,190)	-	(360,028)	-	-	-	(481,218)	481,218	-
Total fund balances	169,680	384,136,354	27,540,859	884,143	134,251	1,353,591	414,218,878	(414,218,878)	-
Total liabilities and fund balances	\$ 484,074	\$ 401,100,425	\$ 27,935,145	\$ 884,293	\$ 151,365	\$ 1,852,000	\$ 432,407,302		
Net Position:									
Invested in capital assets, net of related debt							229,573,413		229,573,413
Restricted - federal funds							27,540,859		27,540,859
Unrestricted							385,146,109		385,146,109
Total net position							\$ 642,260,381		\$ 642,260,381

See accompanying notes to the basic financial statements.

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, 2014

	Governmental Funds							Adjustments (Note 13)	Government-wide Statement of Activities
	Special Revenue Funds								
	General Fund	Public Land Trust	Federal Grants	Other	Ho'okele Pono LLC	Hi'ilei Aloha LLC	Total		
Expenditures/Expenses:									
Current divisions:									
Board of trustees	\$ 38,728	\$ 2,224,136	\$ -	\$ -	\$ -	\$ -	\$ 2,262,864	\$ -	\$ 2,262,864
Support services	1,789,572	23,425,115	752	1,777	-	-	25,217,216	(6,945,553)	18,271,663
Beneficiary advocacy	1,687,189	22,312,406	1,258,447	-	-	-	25,258,042	-	25,258,042
Depreciation	-	-	-	-	-	-	-	2,579,713	2,579,713
Ho'okele Pono LLC	-	-	-	-	379,514	-	379,514	-	379,514
Hi'ilei Aloha LLC	-	-	-	-	-	5,113,757	5,113,757	(708,996)	4,404,761
Total expenditures/expenses	3,515,489	47,961,657	1,259,199	1,777	379,514	5,113,757	58,231,393	(5,074,836)	53,156,557
Program Revenues:									
Charges for services	-	-	714,810	-	-	-	714,810	-	714,810
Operating grants	-	-	274,154	-	204,882	-	479,036	-	479,036
Interest and investment earnings	-	-	3,174	2,121	-	-	5,295	-	5,295
Total program revenues	-	-	992,138	2,121	204,882	-	1,199,141	-	1,199,141
Net program expenditures/expenses	(3,515,489)	(47,961,657)	(267,061)	344	(174,632)	(5,113,757)	(57,032,252)	5,074,836	(51,957,416)
General Revenues:									
Appropriations, net of lapses of \$7,500	3,134,074	-	-	-	-	-	3,134,074	-	3,134,074
Public Land Trust	-	19,180,485	-	-	-	-	19,180,485	-	19,180,485
Interest and investment earnings	-	53,858,748	-	-	-	-	53,858,748	-	53,858,748
Newspaper advertisements	-	-	-	78,749	-	-	78,749	-	78,749
Donations and other	-	210,405	23,716	59,365	-	-	293,486	-	293,486
Hi'ilei Aloha LLC	-	-	-	-	-	4,344,603	4,344,603	-	4,344,603
Non-imposed fringe benefits	196,529	-	-	-	-	-	196,529	-	196,529
Total general revenues	3,330,603	73,249,638	23,716	138,114	-	4,344,603	81,086,674	-	81,086,674
(Deficiency) excess of revenues over expenditures/expenses	(184,886)	25,287,981	(243,345)	138,458	(174,632)	(769,154)	24,054,422	5,074,836	29,129,258
Other Financing (Uses) Sources:									
Proceeds from debt	-	4,320,000	-	-	-	-	4,320,000	(4,320,000)	-
Proceeds from capital lease obligations	-	195,813	-	-	-	-	195,813	(195,813)	-
Net transfers (to) from other funds	-	(1,583,929)	-	-	180,457	1,441,560	38,088	-	38,088
Net change in fund balance/net position	(184,886)	28,219,865	(243,345)	138,458	5,825	672,406	28,608,323	559,023	29,167,346
Fund Balances/Net Position:									
Beginning of year	354,566	355,916,489	27,784,204	745,685	128,426	681,185	385,610,555	227,482,480	613,093,035
End of year	\$ 169,680	\$ 384,136,354	\$ 27,540,859	\$ 884,143	\$ 134,251	\$ 1,353,591	\$ 414,218,878	\$ 228,041,503	\$ 642,260,381

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i

Statement of Revenues and Expenditures - Budget and Actual (Budgetary Basis), General Fund
Year Ended June 30, 2014

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual (budgetary basis)</u>	<u>Variance</u>
Revenues -				
State appropriations, net of lapses	<u>\$ 3,141,574</u>	<u>\$ 3,141,574</u>	<u>\$ 3,134,074</u>	<u>\$ (7,500)</u>
Total revenues	<u>3,141,574</u>	<u>3,141,574</u>	<u>3,134,074</u>	<u>(7,500)</u>
Expenditures:				
Board of Trustees	28,435	28,435	27,752	683
Support services	700,159	700,159	1,479,277	(779,118)
Beneficiary advocacy	<u>2,412,980</u>	<u>2,412,980</u>	<u>1,669,020</u>	<u>743,960</u>
Total expenditures	<u>3,141,574</u>	<u>3,141,574</u>	<u>3,176,049</u>	<u>(34,475)</u>
DEFICIENCY OF REVENUES UNDER EXPENDITURES	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (41,975)</u>	<u>\$ (41,975)</u>

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2014

1. Financial Reporting Entity

The accompanying basic financial statements present the financial activity of the Office of Hawaiian Affairs (Primary Government) and its blended component units, which are legally separate organizations for which the Primary Government is financially accountable.

Hi'ilei Aloha LLC and Ho'okele Pono LLC, Hawai'i limited liability companies formed by the Office of Hawaiian Affairs (OHA) in September 2007 and May 2010, respectively, are presented as blended component units due to the common governing bodies with the primary government. The results of Hi'ilei Aloha LLC and its wholly-owned subsidiaries and Ho'okele Pono as of December 31, 2013, their fiscal year ends, have been included in the financial statements. For the period January 1, 2014 through June 30, 2014, Hi'ilei Aloha LLC and Ho'okele Pono LLC have not entered into any significant or unusual transactions.

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. Ho'okele Pono LLC is also exempt from federal income taxes under Section 501 (a) and 501 (c)3 of the Internal Revenue Code.

2. Significant Accounting Policies

a. Basis of Presentation

OHA's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

b. 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. Principal revenue sources susceptible to accrual include Federal grants, public land trust revenue, and interest and dividends on investments.

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2014

2. Significant Accounting Policies (continued)

b. Governmental Funds Financial Statements (continued)

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, workers' compensation, and capital lease obligations which are recorded as expenditures when utilized or paid. The amount of accumulated annual leave unpaid, accrued workers' compensation, and capital lease obligations at June 30, 2014 have been reported only in the government-wide financial statements.

When both restricted and unrestricted resources are available for use, it is OHA's policy to use restricted funds first, then unrestricted resources as they are needed.

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 Native Hawaiian Revolving Loan Fund (NHRLF) and other grants included in the Federal Grants Fund. 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 and Ho'okele Pono LLC have also been accounted for as special revenue funds.

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2014

2. Significant Accounting Policies (continued)

c. 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 position is 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 position.

d. Investments

Investments are stated at fair value in accordance with GASB Codification Section 150, Investments. OHA uses the first-in, first-out (FIFO) cost method in computing the gain or loss on sale of marketable equity securities.

e. 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.

**Office of Hawaiian Affairs,
State of Hawai'i**

Notes to the Basic Financial Statements
June 30, 2014

2. Significant Accounting Policies (continued)

f. 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. The estimated useful lives of capital assets are as follows:

Buildings	30 years
Leasehold improvements	Various
Furniture, fixtures, and equipment	5 years

g. Accrued Vacation and Compensatory Pay

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 Codification Section C60, Compensated Absences. The balance at June 30, 2014 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.

h. 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.

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2014

2. Significant Accounting Policies (continued)

i. Governmental Funds – Fund Balance

GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB 54) provides guidance on the reporting of stabilization arrangements and changes the classifications and definitions to the following:

Nonspendable Fund Balance

Includes amounts that are (a) not in a spendable form or (b) legally or contractually required to remain intact. Examples include prepaid expenses and security deposits. These balances have been identified for proper presentation on OHA's Governmental Funds - Balance Sheet.

Restricted Fund Balance

Includes amounts restricted to a specific purpose as constraints placed on the use of these resources are either (a) externally imposed (e.g. grantors, creditors, laws, regulations) or (b) imposed by law through constitutional provisions or enabling legislation. Federal grants administered by OHA and specific proviso's identified in OHA's general fund appropriation have been presented under "restricted fund balance."

Committed Fund Balance

Includes amounts that can only be used for specific purposes based on constraints imposed by formal action of the entity's highest level of decision-making authority. For OHA purposes, "committed" funds have been identified as constraints imposed by Board of Trustee Resolution.

Assigned Fund Balance

Includes amounts that are constrained as to use by the entity's intent to be used for specific purposes, but are neither "restricted" or "committed". Intent should be expressed by (a) the governing body itself or (b) a body or official to which the governing body has delegated such authority to assign amounts to be used for specific reasons. These constraints are more easily modified and/or removed. Generally all funding of any fund, other than the General Fund are "assigned." Public Land Trust as presented on OHA's Governmental Funds - Balance Sheet includes trust fund corpus for which no specific purpose has been defined. Draws from this line item are made annually pursuant to biennium budget approved by the Board of Trustees.

**Office of Hawaiian Affairs,
State of Hawai'i**

Notes to the Basic Financial Statements
June 30, 2014

2. Significant Accounting Policies (continued)

i. Governmental Funds – Fund Balance (continued)

Unassigned Fund Balance

Is the residual classification for the general fund that has not been "restricted", "committed" or "assigned" in any way, however, may be subject to future reclassification. This classification also includes any negative residual balance when actual expenditures exceed available resources of a fund.

Stabilization Arrangements

Includes funds formally set aside for use in emergency situations or to cover revenue shortages or budgetary imbalances. These arrangements require specific circumstances on the availability of funds and restrictions as to use. OHA's Fiscal Reserve policy, as approved by the Board of Trustees, does not meet the criteria to warrant classification of "committed" funding under GASB 54.

OHA's Fiscal Reserve is comprised of lapsed fiscal year funding for its Public Land Trust budget. The Public Land Trust fiscal year budget is subject to Trustee approval prior to the start of each fiscal year. Use of Fiscal Reserve funding is subject to Board of Trustee approval and may be used to cover any current year funding shortfalls. As of June 30, 2014, OHA had approximately, \$5.9 million in its Fiscal Reserve.

**Office of Hawaiian Affairs,
State of Hawai'i**

Notes to the Basic Financial Statements
June 30, 2014

2. Significant Accounting Policies (continued)

j. Encumbrances

Encumbrances against budgeted appropriations are recorded upon the execution of contracts or purchase orders. Such encumbrances have been classified by expenditure division (i.e. Board of Trustees, Support services, Beneficiary advocacy) by fund balance classification (i.e. Restricted, Committed, Assigned) in the governmental funds financial statements. The related expenditure is reported in the period in which the liability is incurred. Encumbrances as of June 30, 2014 consist of the following:

	<u>Encumbrances</u>
General Fund	\$ 251,272
Public Land Trust	11,851,511
Federal Grants	652,672
Other	<u>223,366</u>
	<u>\$ 12,978,821</u>

k. Use of Estimates

The preparation of financial statements in conformity with 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 the Basic Financial Statements
June 30, 2014

2. Significant Accounting Policies (continued)

l. Concentrations of Credit Risk

The financial instruments that potentially expose OHA to concentrations of credit risk consist principally of its investments and receivables. See Note 8 for a discussion of credit risk of OHA's investments. 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, 2014 are as follows:

Native Hawaiian and Hawaiian persons	94.4%
Agencies	5.1%
Other	<u>0.5%</u>
	<u>100.0%</u>

m. Notes Receivables

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 allowance for its notes receivable.

n. Recent Accounting Pronouncements

In March 2012, the GASB issued GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* (GASB 65). This Statement reclassifies, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as revenues and expenses, certain items that were previously reported as assets and liabilities. The provisions of GASB 65 are effective for periods beginning after December 15, 2012. The adoption of this Statement did not have a significant effect on OHA's financial statements.

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2014

2. Significant Accounting Policies (continued)

n. Recent Accounting Pronouncements (continued)

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*, replacing the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 50, *Pension Disclosures*, as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria. Moreover, this Statement requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits. The provisions for this Statement are effective for periods beginning after June 15, 2014. OHA has not yet determined the effect this Statement will have on its financial statements.

In November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date* – an amendment of GASB Statement No. 68. The objective of this statement is to address an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The provisions of this Statement are required to be applied simultaneously with the provisions of Statement 68 and are effective for periods beginning after June 15, 2014. OHA has not yet determined the effect this Statement will have on its financial statements.

3. 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 OHA's Board of Trustees, the general funds 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.

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2014

3. Biennial Budget (continued)

- **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.
- **Program Execution** - Except as limited by policy decisions of OHA's Board of Trustees, provisions 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 OHA's Board of Trustees; 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, 2014 from the budgetary basis to GAAP basis are as follows:

Deficiency of revenues under expenditures – actual (budgetary) basis	\$ (41,975)
Reserve for encumbrances at June 30	251,272
Prior year reserve for encumbrances	104,588
Accrued payables and payroll	(241,095)
Prepaid expenditures not recognized for budgetary purposes – net of prior-year accruals	3,668
Expenditures for liquidation of prior-year encumbrances	<u>(261,344)</u>
Deficiency of revenues under expenditures – actual (GAAP) basis	<u>\$ (184,886)</u>

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2014

4. 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 170, Sessions Laws of Hawai'i (SLH) 2013 authorizes a total of \$3,141,574 in general funds.

5. 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.

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, 2014, OHA's cash held in the State Treasury totaled \$5,603,195.

OHA holds 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, 2014, OHA had approximately \$528,000 which was not collateralized and was in excess of Federal Deposit Insurance Corporation (FDIC) insurance limits.

At December 31, 2013, Hi'ilei Aloha LLC had deposits totaling \$1,595,349 with a corresponding bank balance of \$1,612,043. 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 FDIC. Balances may at times, however, exceed the FDIC's insurance limits.

At December 31, 2013, Ho'okele Pono LLC did not have bank balances that exceed FDIC insurance limits. Balances may at times, however, exceed the FDIC's insurance limits.

**Office of Hawaiian Affairs,
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Notes to the Basic Financial Statements
June 30, 2014

6. Inventory, Prepaid Items and Other Assets

At June 30, 2014, OHA did not maintain inventory. At December 31, 2013, Ho'okele Pono LLC, did not maintain inventory. At December 31, 2013, Hi'ilei Aloha LLC, had inventory totaling \$78,141 which consisted of items held for sale.

At June 30, 2014, OHA had prepaid items totaling \$506,377. At December 31, 2013, Hi'ilei Aloha LLC, and Ho'okele Pono LLC had prepaid items totaling \$54,140 and \$2,113, respectively.

7. Notes Receivable

Notes receivable at June 30, 2014 consist of the following:

Loan receivable serviced by First Hawaiian Bank (of which \$1,211,723 is guaranteed by Department of Hawaiian Home Lands (DHHL))	\$ 1,456,016
Native Hawaiian Revolving Loan Fund	15,563,807
Other	<u>1,489,522</u>
Total	18,509,345
Less allowance for doubtful accounts	<u>(2,118,086)</u>
Net	16,391,259
Amounts due within one year	<u>(4,318,104)</u>
Amounts due after one year	<u><u>\$ 12,073,155</u></u>

**Office of Hawaiian Affairs,
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Notes to the Basic Financial Statements
June 30, 2014

8. Investments

Under the Hawai'i Revised Statutes, Chapter 10, OHA's Board of Trustees may collect, receive, deposit, withdraw, and invest money and property to further the mission of OHA. On May 29, 2003, OHA's Board of Trustees adopted the Native Hawaiian Trust Fund Investment Policy Statement (NHTF investment policy), as updated September 27, 2012. OHA's 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 investments in U.S. large cap, U.S. small cap equities, international equities, core fixed income, high yield, real estate, absolute return, and private equity securities.

Investments as of June 30, 2014 and their maturities were as follows:

Investment type	Fund	Fair value	Investment maturities (in years)	
			Less than one	One thru five
Mutual funds	NHTF	\$ 146,425,217	\$ 146,425,217	\$ -
Commingled funds	NHTF	85,399,998	85,399,998	-
Private equity	NHTF	47,069,803	-	47,069,803
Hedge funds	NHTF	45,554,429	45,554,429	-
Common trust fund	NHTF	33,775,091	33,775,091	-
Private debt	NHTF	6,971,723	-	6,971,723
U.S. treasuries	NHRLF	3,948,007	-	3,948,007
U.S. agencies	NHRLF	1,142,600	-	1,142,600
Total investments		370,286,868	311,154,735	59,132,133
Money market funds (not considered investments)	Various	3,785,557	3,785,557	-
Total		\$ 374,072,425	\$ 314,940,292	\$ 59,132,133

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2014

8. Investments (continued)

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 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. Foreign currency, interest rate, credit and concentration of credit risks for the NHRLF investments are as follows:

a. 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, 2014, OHA's foreign currency risks are as follows:

Investment Type	Currency	Value (US Dollar)
Mutual funds	Various	\$ 146,425,217
Commingled funds	Various	85,399,998
Private equity	Various	47,189,803
Common trust funds	Various	33,775,091
Hedge funds	Various	37,466,241
Hedge funds	Euro	8,088,188
Private debt	Various	<u>6,971,723</u>
Total		<u>\$ 365,316,261</u>

**Office of Hawaiian Affairs,
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Notes to the Basic Financial Statements
June 30, 2014

8. Investments (continued)

b. 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.

c. Credit Risk

Pursuant to 45 C.P.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, 2014, credit rates for all securities of government agencies were rated at Aaa (Moody's) or AAA (Standard & Poor's).

d. 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. OHA is in compliance with this policy.

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Notes to the Basic Financial Statements
June 30, 2014

9. Capital Assets

OHA's capital assets activities during the year ended June 30, 2014 was as follows:

	Balance July 1, 2013	Additions	Deductions	Transfers	Balance June 30, 2014
Capital assets not depreciated:					
Land	\$213,961,981	\$ -	\$ -	\$ -	\$213,961,981
Construction in progress	316,860	-	-	(316,860)	-
Total capital assets not depreciated	214,278,841	-	-	(316,860)	213,961,981
Capital assets being depreciated:					
Buildings	23,700,356	-	-	-	23,700,356
Leasehold improvements	635,221	5,188,700	-	316,860	6,140,781
Furniture, fixtures and equipment	4,373,876	1,639,935	(502,694)	-	5,511,117
Total capital assets being depreciated	28,709,453	6,828,635	(502,694)	316,860	35,352,254
Less accumulated depreciation	(5,585,520)	(2,279,053)	474,202	-	(7,390,371)
Capital assets being depreciated - net	23,123,933	4,549,582	(28,492)	316,860	27,961,883
Capital assets, net	<u>\$237,402,774</u>	<u>\$ 4,549,582</u>	<u>\$ (28,492)</u>	<u>\$ -</u>	<u>\$241,923,864</u>

**Office of Hawaiian Affairs,
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Notes to the Basic Financial Statements
June 30, 2014

9. Capital Assets (continued)

Hi'ilei Aloha LLC's capital assets activities as of December 31, 2013 are as follows:

	Balance January 1, 2013	Additions	Deductions	Balance December 31, 2013
Capital assets not depreciated:				
Land	\$ 13,003,821	\$ -	\$ -	\$ 13,003,821
Total capital assets not depreciated	<u>13,003,821</u>	<u>-</u>	<u>-</u>	<u>13,003,821</u>
Capital assets being depreciated:				
Buildings	968,388	-	-	968,388
Leasehold improvements	902,252	565,952	-	1,468,204
Furniture, fixtures and equipment	<u>624,677</u>	<u>143,044</u>	<u>-</u>	<u>767,721</u>
Total capital assets being depreciated	2,495,317	708,996	-	3,204,313
Less accumulated depreciation	<u>(703,287)</u>	<u>(300,660)</u>	<u>-</u>	<u>(1,003,947)</u>
Capital assets being depreciated - net	<u>1,792,030</u>	<u>408,336</u>	<u>-</u>	<u>2,200,366</u>
Capital assets, net	<u>\$ 14,795,851</u>	<u>\$ 408,336</u>	<u>-</u>	<u>\$ 15,204,187</u>

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Notes to the Basic Financial Statements
June 30, 2014

10. 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, 2014, assets recorded under capital lease included in machinery, equipment, furniture and fixtures is \$463,053 and related amortization is \$232,130.

At June 30, 2014, the current portion of minimum lease payments is \$114,654 and the long-term obligation is \$145,484. Below are minimum lease payments through 2018 and the computation of the current and long-term capital lease obligation:

Fiscal year ending June 30,	
2015	\$ 120,881
2016	120,083
2017	26,415
2018	<u>691</u>
Total minimum lease payments	268,070
Less interest	<u>(7,932)</u>
Present value of minimum lease payments	260,138
Less current portion	<u>(114,654)</u>
Long-term capital lease obligation	<u><u>\$ 145,484</u></u>

**Office of Hawaiian Affairs,
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Notes to the Basic Financial Statements
June 30, 2014

11. Operating Leases

OHA leases office space and equipment under various noncancelable operating leases through December 2017. Future minimum payments under all leases as of June 30, 2014 are as follows:

Fiscal year ending June 30,	
2015	\$ 822,000
2016	837,000
2017	833,000
2018	<u>423,000</u>
Total	<u>\$ 2,915,000</u>

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.

Rent expense (including taxes and common area maintenance) under all operating leases totaled approximately \$377,000 for the year ended June 30, 2014.

Hi'ilei Aloha LLC leases office space for its office located in Honolulu, Hawai'i, from OHA, under a lease that expires February 2015. The lease includes base rent, plus a proportionate share of building operating expenses and general excise tax.

**Office of Hawaiian Affairs,
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Notes to the Basic Financial Statements
June 30, 2014

11. Operating Leases (continued)

Future minimum payment obligations under all leases as of December 31, 2013 are approximately as follows:

Year ending December 31,	
2014	\$ 48,000
2015	8,200
	<hr/>
Total	<u>\$ 56,200</u>

Rent expense under operating leases totaled approximately \$72,600 for the year ended December 31, 2013.

Portions of Kaka'ako Makai, land included in capital assets, and Na Lama Kukui, building included in capital assets, are currently leased under operating lease arrangements that expire through 2042 and 2022, respectively. For the year ended June 30, 2014, rental revenue from Kaka'ako Makai and Na Lama Kukui amounted to approximately \$1,895,000 and \$2,320,000, respectively, and are recorded in the financial statements under General Revenues in the PLTF.

As of June 30, 2014, approximate minimum future lease rentals under non-cancellable operating leases are as follows:

Fiscal year ending June 30,	
2015	\$ 2,277,000
2016	1,575,000
2017	1,169,000
2018	852,000
2019	765,000
2020-2024	2,805,000
2025-2029	2,153,000
2030-2034	2,153,000
2035-2039	1,695,000
2040-2042	802,000
	<hr/>
Total	<u>\$ 16,246,000</u>

**Office of Hawaiian Affairs,
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Notes to the Basic Financial Statements
June 30, 2014

12. Long-Term Liabilities

On August 14, 2012, OHA entered into a \$21,370,000 long term note payable to finance the purchase of Na Lama Kukui, formerly known as the Gentry Pacific Design Center. The interest rate is fixed at 3.35%. The note is due in full on September 1, 2022 and is collateralized by a mortgage lien on the Center, assignment of OHA's right, title and interest as landlord in and to any rents under tenant leases and rental agreements on the Center and security interest in all furniture, fixtures, and equipment. On July 26, 2013 the agreement was modified to increase the interest rate to 3.6% and include certain financial covenants. At June 30, 2014, OHA was in compliance with those covenants. Future principal and interest payments are as follows:

Year ending June 30,	Principal	Interest	Total
2015	\$ -	\$ 725,838	\$ 725,838
2016	455,914	720,097	1,176,011
2017	561,514	701,748	1,263,262
2018	580,886	682,376	1,263,262
2019	600,926	662,336	1,263,262
2020-2023	19,170,760	1,959,043	21,129,803
Total	<u>\$ 21,370,000</u>	<u>\$ 5,451,438</u>	<u>\$ 26,821,438</u>

On June 28, 2013 OHA entered into a \$6,758,000 line of credit to finance the renovation of Na Lama Kukui. OHA had drawn \$5,924,500 as of June 30, 2014. The interest rate is contingent upon certain elections by OHA. The line of credit is due in full on June 28, 2023. The line of credit is collateralized by all investment property and financial assets held in certain investment accounts. There were no principal payments made as of June 30, 2014. The line of credit is also subject to certain financial covenants. At June 30, 2014, OHA was in compliance with those covenants. Future principal and interest payments are as follows:

Year ending June 30,	Principal	Interest	Total
2015	\$ -	\$ 102,645	\$ 102,645
2016	-	124,951	124,951
2017	246,854	149,051	395,905
2018	987,417	150,428	1,137,845
2019	987,417	152,895	1,140,312
2020-2023	3,702,812	295,820	3,998,632
Total	<u>\$ 5,924,500</u>	<u>\$ 975,790</u>	<u>\$ 6,900,290</u>

**Office of Hawaiian Affairs,
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Notes to the Basic Financial Statements
June 30, 2014

12. Long-Term Liabilities (continued)

In the past, long-term liabilities have generally been paid by the Public Land Trust Fund.

Long-term liabilities for the year ended June 30, 2014 are as follows:

	Balance July 1, 2013	Additions	Reductions	Balance June 30, 2014	Amount due within one year	Amount Due after one year
Accrued vacation	\$ 1,492,167	\$ 733,616	\$ (515,927)	\$ 1,709,856	\$ 657,686	\$ 1,052,170
Workers' compensation	59,545	-	(11,727)	47,818	-	47,818
Capital lease obligation	189,933	195,813	(125,608)	260,138	114,654	145,484
Notes payable	21,370,000	-	-	21,370,000	-	21,370,000
Line of credit	1,604,500	4,320,000	-	5,924,500	-	5,924,500
Long- term liabilities	<u>\$ 24,716,145</u>	<u>\$ 5,249,429</u>	<u>\$ (653,262)</u>	<u>\$ 29,312,312</u>	<u>\$ 772,340</u>	<u>\$ 28,539,972</u>

**Office of Hawaiian Affairs,
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Notes to the Basic Financial Statements
June 30, 2014

13. Reconciliations of Government-wide and Governmental Funds Financial Statements

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

Total fund balance – governmental funds	\$ 414,218,878
Amounts reported for governmental activities in the statement of net position is different because:	
Net capital assets used in governmental activities are not current financial resources and therefore are not reported in the funds	257,128,051
Net other assets used in governmental activities are not current financial resources and therefore are not reported in the funds	225,764
Long-term liabilities not due and payable in the current period and therefore not reported in the funds:	
Accrued vacation	(1,709,856)
Accrued workers' compensation	(47,818)
Capital lease obligation	(260,138)
Note payable	(21,370,000)
Line of credit payable	(5,924,500)
Subtotal	<u>(29,312,312)</u>
Total net position – government-wide	<u><u>\$ 642,260,381</u></u>

**Office of Hawaiian Affairs,
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Notes to the Basic Financial Statements
June 30, 2014

**13. Reconciliations of Government-wide and Governmental Funds Financial Statements
(continued)**

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

Net change in fund balances – total governmental funds	\$ 28,608,323
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.	
Expenditures for capital assets	7,537,631
Add current year depreciation and other changes	<u>(2,579,713)</u>
	4,957,918
The net effect of other miscellaneous transactions involving capital assets.	
Loss on disposal of capital assets	(28,492)
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:	
Other assets	225,764
Accrued vacation	(217,689)
Accrued workers' compensation	11,727
Capital lease obligation	(70,205)
Line of credit payable	<u>(4,320,000)</u>
Subtotal	<u>(4,370,403)</u>
Changes in net position – government-wide	<u><u>\$ 29,167,346</u></u>

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2014

14. Employee Benefits

a. 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 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.

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2014

14. Employee Benefits (continued)

a. Defined Benefit Pension Plans (continued)

Such employees are entitled to retirement benefits, payable monthly for life, of 2% of their 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, 2014, 2013, and 2012 were approximately \$1,483,000; \$1,354,000; and \$1,324,000, respectively. The contribution rate for the fiscal years ending June 30, 2014, 2013, and 2012 was 16%, 15%, and 15%, respectively.

The ERS issues a publically 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.

b. 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.

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, 2014. OHA contributed approximately \$953,000 in OPEB expenses for the fiscal year ended June 30, 2014.

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2014

14. Employee Benefits (continued)

b. Post-Retirement Health Care and Life Insurance Benefits (continued)

The EUTF issues a publically 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, Hawai'i 96813 or by calling (808) 586-7390.

c. Trustee Retirement Plan

OHA's Board of Trustees froze 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 plan 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).

d. Hi'ilei Aloha LLC and Ho'okele Pono LLC Retirement Plan

Hi'ilei Aloha LLC and Ho'okele Pono LLC offer 401(k) profit sharing plans. 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 and Ho'okele Pono match employees' contributions up to a specified percentage of salary. For the year ended December 31, 2013, contribution expense amounted to \$63,897 and \$2,980 for Hi'ilei Aloha LLC and Ho'okele Pono LLC, respectively.

e. Sick Leave

Accumulated sick leave amounted to \$3,093,836 as of June 30, 2014. 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.

15. 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 \$196,529 for the fiscal year ended June 30, 2014, have been reported as revenues and expenditures of OHA's general fund.

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Notes to the Basic Financial Statements
June 30, 2014

16. Risk Management and Contingent Liabilities

a. 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. In fiscal year 2013 OHA purchased a third party workers' compensation policy, but was still liable for outstanding claims related to periods in which OHA was self-insured. The workers' compensation reserve approximated \$48,000 at June 30, 2014. The estimated losses will be paid from the NHTF.

b. Civil Complaints

In *C. Kaui Jochanan Amsterdam v. Haunani Apoliona, et al.*, Civil No. 10-00525 DAE-BMK, United States District Court of the State of Hawai'i, Mr. Amsterdam filed a complaint against OHA trustees on September 13, 2010, which was dismissed on March 3, 2011. The plaintiff filed an Amended Complaint on April 5, 2011 which was subsequently dismissed on August 16, 2011. The plaintiff filed a Second Amended Complaint on September 14, 2011 which was subsequently dismissed on February 27, 2012. The plaintiff filed an appeal to the United States Court of Appeals on March 23, 2012. The plaintiff's opening brief was filed on October 15, 2012, OHA's answering brief was filed on November 13, 2012, and the optional reply brief was filed on November 30, 2013. A Mandate was issued by the Court on April 10, 2014 in favor of OHA. The case is now over.

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Notes to the Basic Financial Statements
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16. Risk Management and Contingent Liabilities (continued)

b. Civil Complaints (continued)

In *Samuel L Kealoha Jr., et al. v. Colette Y. Pi'ipi'i Machado, et al.*, Civil No. 11-1-0575-03 KKS, Circuit Court of the First Circuit, the allegations track a previous United States District Court case, *Day, et al. v. Apoliona, et al.*, Civil No. 05-0649 ACK-BMK, except now, the plaintiffs claim that they have state claims that were not previously litigated. In the matter of *Day, et al. v. Apoliona, et al.*, the United States District Court ruled in favor of OHA. Similarly on December 6, 2011, the matter of *Samuel L Kealoha Jr., et al. v. Colette Y. Pi'ipi'i Machado, et al.*, the First Circuit Court dismissed the case, via Final Judgment. On December 29, 2011, plaintiffs filed a notice of appeal. On August 22, 2012, plaintiffs filed in the Supreme Court, an application for transfer from the Intermediate Court of Appeal, and the transfer was granted on September 24, 2012. The Oral Argument was held on April 4, 2013. The Opinion of the Court was received on December 3, 2013, in favor of OHA. The Judgment on Appeal was entered on January 16, 2014. The case is now over.

In *Michelle Takai v. State of Hawai'i, Office of Hawaiian Affairs*, Civil No. 12-1-2074-07 ECN, Circuit Court of the First Circuit, on July 31, 2012, the plaintiff filed a whistleblower and gender discrimination lawsuit against OHA citing HRS Sec. 378-62 and HRS Sec. 378-2.3. OHA filed an answer to complaint on December 12, 2012. Both parties have agreed to participate in private mediation at a future date.

In *Keola K. Akana v. Office of Hawaiian Affairs, et al.*, Civil No. 13-00275 LEK-BMK, Circuit Court of the First Circuit, on May 30, 2013, the plaintiff sought general, special, and punitive damages against OHA. The case was dismissed on September 3, 2013 and re-filed in the Circuit Court of the First Circuit on September 5, 2013 in *Keola K. Akana v. Office of Hawaiian Affairs, et al.*, Civil No. 13-1-2401-09 GWBC. A settlement was reached on September 15, 2014.

In *Akana v. Trustees*, Civil No. 13-1-2485-09, First Circuit Court, on September 13, 2013, the plaintiff has sued the OHA trustees claiming that they improperly convened in executive sessions to discuss matters that were not properly discussed in such sessions. OHA believes that the claims have no merit and filed a motion for summary judgment based upon their counterclaim. A hearing on that motion was held on January 29, 2015. A decision is pending.

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Notes to the Basic Financial Statements
June 30, 2014

16. Risk Management and Contingent Liabilities (continued)

b. Civil Complaints (continued)

In *De Mont R. D. Conner and Rachel L. Kailianu-Conner v. Office of Hawaiian Affairs, et al*, Civil No. 14-00350 DKW-RLP, United States District Court, on August 5, 2014, the plaintiffs sought an injunction stopping the use of funds to support the Native Hawaiian Roll Commission and further nation building efforts. An answer was filed on August 29, 2014 on behalf of OHA. The court conducted a hearing on OHA's counter motion to dismiss for lack of jurisdiction or, in the alternative, for judgment on the pleadings on December 18, 2014. The court issued its order granting defendants' motions to dismiss for lack of subject matter jurisdiction on December 31, 2014 and the case was closed.

c. Quiet Title Litigation

Under HRS 669-3(e), OHA is required to be joined as a defendant in any action to quiet title to an interest in kuleana if an owner of an inheritable interest in the kuleana died intestate *or* partially intestate and without any heirs or other takers. OHA typically responds in these actions by answering the complaint, seeking discovery and information, reviewing the evidence to determine whether OHA has an escheat interest in the kuleana, and participating in the litigation as necessary.

As of June 30, 2014, OHA is currently evaluating its potential interest in 17 quiet title actions. OHA continues to monitor this action for any potential escheated interest.

d. 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.

e. Hi'ilei Aloha LLC

Hi'ipaka LLC, which is a wholly owned subsidiary of Hi'ilei Aloha LLC, is a party to 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.

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17. 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. The total received during the year ended June 30, 2014 was \$15,100,000 as reported in the financial statements under general revenue, public land trust. As of June 30, 2014, there was no related receivables reported in the financial statements under the PLTF.

Besides property leased from DLNR, as discussed in Note 11, 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 65 years commencing on November 2000, to utilize such property for purposes in accordance with the Executive Order.

During fiscal year 2014, OHA made payments of \$1,583,929 to Hi'ilei Aloha LLC and Ho'okele Pono LLC. These payments were reported as transfers in the fund financial statements. The resulting net transfer in of \$38,088 on the fund financial statements is due to the difference in reporting period for the blended component units noted in Note 1.

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, in fulfillment of OHA's mission to better the conditions of native Hawaiians. 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, 2014, OHA remitted \$3,000,000 to DHHL and amounts have been presented as beneficiary advocacy expenditures in the PLTF; governmental funds – statement of revenues, expenditures, and changes in fund balances. As of June 30, 2014, OHA has committed \$40,045,384 of its fund balances for future payments to DHHL.

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18. Subsequent Events

OHA has evaluated subsequent events through March 5, 2015, the date on which the financial statements were available to be issued.

On January 28, 2015, OHA entered into a \$5,000,000 line of credit to finance OHA's governance planning initiative and other projects. The interest rate and maturity date are contingent upon certain elections by OHA. The line of credit is collateralized by all financial assets held in certain investment accounts. OHA has not drawn on the line of credit as of the date on which the financial statements were available to be issued.