

Financial statements and independent auditors' report

**Office of Hawaiian Affairs**  
**State of Hawaii**

June 30, 2004

Office of Hawaiian Affairs  
State of Hawaii

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Office of Hawaiian Affairs  
State of Hawaii

INTRODUCTION

Year ended June 30, 2004

**GENERAL**

*Organization* – Office of Hawaiian Affairs (OHA) was established by the 1979 Hawaii State Legislature under the provisions of Chapter 10, Hawaii Revised Statutes (“Act 196”). In 1980, the Hawaii State Legislature approved Act 273, which, in addition to Act 196, initiated the appropriate process to organize and fund the entity.

The purposes of OHA include the following:

- Betterment of conditions of Native Hawaiians;
- Betterment of conditions of Hawaiians;
- Serve as the principal public agency in the State responsible for the performance, development, and coordination of programs and activities relating to Native Hawaiians and Hawaiians, except that the Hawaiian Homes Commission Act shall be administered by its own commission;
- Assess the policies and practices of other agencies impacting on Native Hawaiians and Hawaiians, and conduct advocacy efforts for Native Hawaiians and Hawaiians;
- Apply for, receive, and disburse grants and donations from all sources for Native Hawaiian and Hawaiian programs and services;
- Serve as a receptacle for reparations.

**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:

<b>Division title</b>	<b>Division objectives</b>
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 Hawaii'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 an opinion as to the financial position of Office of Hawaiian Affairs at June 30, 2004, and the results of its operations for the year then ended. The auditors' report represents the conclusion of the independent auditors regarding the fairness of the presentations, in conformity with accounting principles generally accepted in the United States of America, set forth in the financial statements and is used to communicate such conclusion to interested parties.

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

1. *Appropriations* – Authorizations granted by the State Legislature or OHA Board of Trustees permitting the agency within established fiscal and budgetary controls to incur obligations and to make expenditures for specific purposes. An appropriation is usually limited in amount and as to the period during which it may be expended.
2. *Lapse* – As applied to appropriations, this term denotes the automatic termination of an appropriation. At the end of the appropriation period, any unexpended or unencumbered balance lapses. This terminated amount is available for appropriation by the State Legislature in the ensuing fiscal year.
3. *Encumbrances* – Commitments related to unperformed (executory) contracts for goods or services.
4. *Expenditures* – Decreases in net financial resources. Expenditures include current operating expenses and capital outlays that require the current use of net current assets.
5. *Fund* – A fiscal and accounting entity with a self-balancing set of accounts recording cash and other current financial resources, together with all related liabilities and residual equities or balances, and changes therein, that are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.

## Independent Auditors' Report

Board of Trustees of Office of Hawaiian Affairs  
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Office of Hawaiian Affairs (OHA), State of Hawaii, as of and for the year ended June 30, 2004, which collectively comprise OHA's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the OHA's management. Our responsibility is to express opinions 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 as established by the Auditing Standards Board of the American Institute of Certified Public Accountants and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of OHA's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our 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 OHA, as of June 30, 2004, and the respective changes in financial position thereof and the respective budgetary comparison for the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in note M to the basic financial statements, OHA is self-insured for workers' compensation, automobile, and general liabilities. Several claims were filed against OHA during the year ended June 30, 2004. Although OHA has recorded an estimated loss for such claims, as well as from any unasserted claims, the ultimate results may differ from OHA's estimates, due to the subjectivity of the data used by OHA to compute these amounts.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 9, 2005 on our consideration of OHA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on

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compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 5 through 11 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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

A handwritten signature in black ink, appearing to read "Grant Shuman" followed by a flourish.

Honolulu, Hawaii  
March 9, 2005

Office of Hawaiian Affairs  
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS

Year ended June 30, 2004

As management of the Office of Hawaiian Affairs ("OHA"), we offer readers of OHA's financial statements this narrative overview and analysis of the financial activities of OHA for the fiscal years ended June 30, 2004 and 2003. While the audit report presents only the financial activities for the fiscal year ended June 30, 2004, the management discussion and analysis will address both this year and the year ended June 30, 2003. For the purposes of comparability, data for the fiscal year ended June 30, 2003 has been reclassified to conform to the current year's financial presentation for the fiscal year ended June 30, 2004.

The management's discussion and analysis is provided at the beginning of the audit report to provide in layman's terms the past and current position of OHA's financial condition. This summary should not be taken as a replacement for the audit report that immediately follows this narrative.

## FINANCIAL HIGHLIGHTS

### Government-wide Financial Statements Highlights

*Statements of Net Assets* – The assets of OHA exceeded its liabilities at fiscal year ended June 30, 2004 by \$381,265,558 (presented as "total net assets"). Of this amount, \$354,249,201 is reported as "unrestricted", while \$24,691,826 is reported as "restricted-federal funds" and \$2,324,531 is reported as "invested in capital assets." The assets of OHA exceeded its liabilities at fiscal year ended June 30, 2003 by \$345,033,209. Of this amount, \$318,216,749 was reported as "unrestricted," while \$24,258,851 was reported as "restricted-federal funds" and \$2,557,609 was reported as "invested in capital assets." Unrestricted net assets represent the amount available to be used to meet OHA's ongoing obligations to beneficiaries and creditors. Restricted assets represent amounts that have legal requirements on their use.

*Changes in Net Assets* – OHA's total net assets, increased by \$36,232,349 (a 10.5% increase) in fiscal year 2004. This was primarily due to gains experienced on the fair value of OHA's Native Hawaiian Trust Fund. OHA's total net assets, increased by \$25,915,788 (an 8.1% increase) in fiscal year 2003. This was primarily due to gains experienced on the fair value of OHA's Native Hawaiian Trust Fund as well as the reestablishment of Ceded Land Revenue disbursements to OHA by the State.

### Governmental Funds Financial Statements Highlights

*Governmental Funds – Fund Balances* – As of the close of fiscal year 2004, OHA's governmental funds reported an ending fund balance of \$380,422,676. Of this total amount, \$361,872,741 represents the unreserved fund balances with 93.7% being in the Public Land Trust Fund. Of this \$361,872,741, \$22,859,936 is designated for the Native Hawaiian Revolving Loan Fund, \$4,000,000 is designated for the Fannie Mae Loan Program; \$29,419 is designated for other grants, \$646,155 is designated for Hawaiian projects; and \$4,759,032 is designated for subsequent year's expenditures, leaving \$329,578,199 as undesignated. This \$329,578,199 is roughly 86.6% of the total fund balance at the end of fiscal year 2004.

As of the close of fiscal year 2003, OHA's governmental funds reported an ending fund balance of \$343,480,698. Of this total amount, \$326,430,041 represented unreserved fund balances with 93.1% being in the Public Land Trust Fund. Of this \$326,430,041, \$22,459,489 was designated for the Native Hawaiian Revolving Loan Fund, \$4,000,000

was designated for the Fannie Mae Loan Program; \$29,419 was designated for other grants, \$216,880 was designated for Hawaiian projects; and \$32,236,052 was designated for subsequent year's expenditures, leaving \$267,488,201 as undesignated. The \$267,488,201 was roughly 77.9% of the total fund balance at the end of fiscal year 2003.

## 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) Statements of Revenues and Expenditures – Budget and Actual (Budgetary Basis), General Fund, and 4) notes to the 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 methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year even if cash involved has not been received or paid. The government-wide financial statements include two statements.

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

Both of the above financial statements distinguish functions of OHA that are principally supported by inter-governmental revenues (*governmental activities*) from other functions that are intended to recover all of a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of OHA include program revenues (Federal and other grants that break out charges for services, operating grants, capital grants, and the Native Hawaiian Rights Fund) and general revenues (dividends and interest income, legislative appropriations, non-imposed fringe benefits, newspaper advertisements, donations, Public Land Trust funds, and other revenues).

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 spendable resources. They also focus on the balances of spendable resources available 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 assists in determining whether there will be adequate financial resources available to meet the current needs of OHA.

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

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 Public Land Trust Fund, Federal Grants Fund, and Other Fund.

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

### **Statements of Revenues and Expenditures – Budget and Actual (Budgetary Basis)**

The basic financial statements are followed by a budgetary comparison schedule, which includes a reconciliation between the actual general fund revenues and expenditures on a budgetary basis compared to budgeted general fund revenues and expenditures approved by State Legislature.

### **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 Statements of Revenues and Expenditures – Budget and Actual (Budgetary Basis), General Fund.

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

### Statement of Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. OHA's net assets totaled \$381,265,558 at the end of fiscal year 2004, compared to \$345,033,209 at the end of fiscal year 2003.

The largest portion of OHA's net assets (92.9% and 92.2% at June 30, 2004 and 2003, respectively) represents resources that may be used to meet OHA's ongoing obligations to beneficiaries and creditors. Internally imposed designations of resources are not presented as restricted net assets.

Summarized financial information of OHA's statement of net assets as of June 30, 2004 and 2003 is as follows:

	2004	2003
Capital assets	\$ 2,324,531	\$ 2,557,609
Other assets	383,181,412	345,493,891
Total assets	<u>\$385,505,943</u>	<u>\$348,051,500</u>
Other liabilities	\$ 3,392,346	\$ 2,172,359
Long-term liabilities	848,039	845,932
Total liabilities	4,240,385	3,018,291
Invested in capital assets	2,324,531	2,557,609
Restricted – federal funds	24,691,826	24,258,851
Unrestricted	354,249,201	318,216,749
Total net assets	<u>381,265,558</u>	<u>345,033,209</u>
Total liabilities and net assets	<u>\$385,505,943</u>	<u>\$348,051,500</u>

A portion of OHA's net assets (0.6% and 0.7% at June 30, 2004 and 2003, respectively) reflects its investment in capital assets such as equipment and software development, less any related debt used to acquire those assets that are still outstanding. OHA uses these capital assets to provide services to beneficiaries; consequently, these assets are not available for future spending. Although OHA's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt, if any, must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

At the end of fiscal years 2004 and 2003, OHA is able to report a positive balance in its category of government-wide net assets.

### Changes in Net Assets

OHA's net assets increased by \$36,232,349 or 10.5% from fiscal year 2003. Approximately 17.8% of OHA's total revenue came from the Public Land Trust, while 7.3% came from dividend and interest income, 70.0% came from net investment gains, and 4.5% resulted from Legislative appropriations. This is in direct contrast to revenue amounts from fiscal year 2003, which were 44.0%, 20.7%, 26.9% and 6.4% for the same categories, respectively. This significant change was due in part to a one-time restoration of Ceded Land Revenue payments made to OHA in

fiscal year 2003 for prior fiscal years. A larger part of this change was related to positive market gains by OHA's Native Hawaiian Trust Fund in fiscal year 2004, the first full year under OHA's revised Investment Policy and new portfolio managers. The nature of OHA's NHTF under the new managers, being invested in primarily mutual funds, also contributed to this change as dividend and interest income dropped in favor of increased market share value.

Summarized financial information of OHA's statement of changes in net assets for the fiscal years ended June 30, 2004 and 2003 is as follows:

	<u>2004</u>	<u>2003</u>
Revenues:		
Program revenues:		
Operating grants	\$ 321,056	\$ 333,688
Charges for services	92,381	118,848
Dividend and interest income	586,402	769,562
Net investment gains (losses)	(516,690)	176,173
General revenues:		
Appropriations	2,532,647	2,532,663
Public land trust	9,915,962	17,543,804
Dividend and interest income	3,508,407	7,492,725
Net investment gains (losses)	39,021,376	10,522,261
Newspaper ads	51,459	44,696
Donations and other	96,206	158,557
Non-imposed fringe benefits	186,193	150,815
Total revenues	<u>55,795,399</u>	<u>39,843,792</u>
Expenses:		
Current divisions:		
Board of Trustees	1,731,115	909,946
Support Services	7,939,757	6,788,640
Beneficiary Advocacy	9,223,394	5,626,573
Depreciation	625,966	536,556
Total expenses	<u>19,520,232</u>	<u>13,861,715</u>
Excess of revenues over expenses	36,275,167	25,982,077
Other financing sources (uses):		
Lapse of cash to State General Fund	<u>(42,818)</u>	<u>(66,289)</u>
Total other financing sources (uses)	<u>(42,818)</u>	<u>(66,289)</u>
CHANGES IN NET ASSETS	<u><u>\$36,232,349</u></u>	<u><u>\$25,915,788</u></u>

## 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 spendable 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.

As of the close of fiscal year 2004, OHA's governmental funds reported an ending fund balance of \$380,422,676. Of this amount, approximately \$361,872,741, or 95.1%, are unreserved funds, broken down as follows: 6.0% for Native Hawaiian Revolving Loans, 1.0% for Fannie Mae Loan Program, .008% for Other Grants, 0.2% for Hawaiian projects, 1.3% for subsequent years expenditures, and 86.6% undesignated. Reserved fund balances accounted for \$18,549,935, or 4.9% of the total fund balance, broken down as follows: 1.7% for encumbrances, 3.1% for notes receivable, and 0.1% for prepaid expenses and security deposits.

As of the close of fiscal year 2003, OHA's governmental funds reported an ending fund balance of \$343,480,698. Of this amount, approximately \$326,430,041, or 95.0%, were unreserved funds, broken down as follows: 6.5% for Native Hawaiian Revolving Loans, 1.1% for Fannie Mae Loan Program, 0.009% for Other Grants, 0.1% for Hawaiian projects, 9.4% for subsequent years expenditures, and 77.9% undesignated. Reserved fund balances accounted for \$17,050,657, or 5.0% of the total fund balance, broken down as follows: 1.0% for encumbrances, 3.8% for notes receivable, and 0.2% for prepaid expenses and security deposits.

## **ECONOMIC FACTORS**

The current state of Hawaii's economy can be described as good with improvements over prior years continuing to be achieved. While much of Hawaii's new economic growth continues to come from investments in construction and real estate, the old standby tourism industry ended 2004 with strong performance similar to that shown in 2003.

Hawaii's tourism industry saw almost 7 million visitors in 2004, an 8.3% increase over 2003 and a strong showing against the 6.3% increase originally forecasted. Total visitor expenditures set an all-time record at \$10.3 billion, an increasingly important figure as visitor length of stay and average daily expenditure continue to increase.

Calendar year 2004 saw the continuance of an employment growth pattern that had also been experienced during 2003. Hawaii's unemployment rate, continuing to hover below 4%, was frequently the lowest in the nation, including a succession of 5 months in a row. Nearly 29,000 new jobs were created over the past two years.

In Hawaii's construction industry, private building permits in 2004 were estimated to exceed \$2.7 billion, a 15% increase over the prior year. Construction spending is forecasted to remain high, with both residential investment and military construction and housing privatization efforts continuing at record levels through 2005 and beyond.

State tax revenues through the first half of fiscal year 2005 (December 2004) were almost 14.3% higher than the same period a year before.

Not all economic factors were positive, Hawaii's consumer price index was estimated to nearly double over 2003 figures, predicted to end the year around 3.5%. Real personal income growth fell behind 2003 levels, slipping from 2.4% to around 2.1%. Nominal personal income growth, spurred by local inflation, continued to grow. Consumer prices in Hawaii rose 3.3% between the 2<sup>nd</sup> half of 2003 to the 2<sup>nd</sup> half of 2004, with housing and transportation responsible for more than three-fourths of the total increase.

Market indicators for OHA's Native Hawaiian Trust Fund (NHTF) remained strong at the close of fiscal year 2004 and on into the first half of fiscal year 2005. U.S. equity markets, a significant portion of OHA's NHTF, closed calendar year 2004 with returns in the vicinity of 12% while fixed income indexes returned yields in the 5% range. OHA's NHTF began calendar year at approximately \$325 million, and ended the year at \$355 million, reflecting the benefits of asset diversification as laid out in OHA's Investment Policy Statement.

Recognizing a need to expend a greater level of resources for current beneficiaries, in the latter half of 2004, OHA's Board of Trustees passed a revision to OHA's Spending Policy. This revision recognized that restriction of trust funds for future beneficiaries may come at the detriment of current beneficiaries, therefore, the Board of Trustees authorized the inclusion of annual Ceded Land revenues in addition to the NHTF annual budgetary spending limitation.

## **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; Treasury and Other Services; 711 Kapiolani Boulevard, Suite 500; Honolulu, HI 96813.

Office of Hawaiian Affairs  
State of Hawaii

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

June 30, 2004

ASSETS	Governmental Funds					Adjustments (note J)	Government- wide statement of net assets
	General Fund	Special Revenue Funds			Total		
		Public Land Trust	Federal Grants	Other			
Petty cash	\$ 10,000	\$ -	\$ -	\$ -	\$ 10,000	\$ -	\$ 10,000
Cash in State Treasury	597,615	9,942,026	815,934	669,023	12,024,598	-	12,024,598
Cash in banks	-	6,205,845	-	-	6,205,845	-	6,205,845
Cash held by investment manager	-	65,542	156,241	-	221,783	-	221,783
Accounts receivable	585	52,256	7,163	11,476	71,480	175,384	246,864
Interest and dividends receivable	-	176,574	159,687	-	336,261	-	336,261
Prepaid and other assets	39,647	173,127	16,126	-	228,900	-	228,900
Notes receivable - due within one year	-	766,139	291,310	-	1,057,449	-	1,057,449
Notes receivable - due after one year	-	10,187,745	491,688	-	10,679,433	-	10,679,433
Security deposits	-	44,215	1,803	-	46,018	-	46,018
Investments	-	329,264,325	22,859,936	-	352,124,261	-	352,124,261
Capital assets - net	-	-	-	-	-	2,324,531	2,324,531
<b>TOTAL</b>	<b>\$647,847</b>	<b>\$356,877,794</b>	<b>\$24,799,888</b>	<b>\$680,499</b>	<b>\$383,006,028</b>	<b>\$2,499,915</b>	<b>\$385,505,943</b>

The accompanying notes are an integral part of this statement.

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

June 30, 2004

LIABILITIES AND FUND BALANCES/NET ASSETS	Governmental Funds					Adjustments (note J)	Government- wide statement of net assets
	General Fund	Special Revenue Funds			Total		
		Public Land Trust	Federal Grants	Other			
<b>LIABILITIES:</b>							
Accounts payable and accrued liabilities	\$ 259,198	\$ 2,183,224	\$ 108,062	\$ 22,868	\$ 2,573,352	\$ 537,105	\$ 3,110,457
Due to State of Hawaii	10,000	-	-	-	10,000	-	10,000
Long-term liabilities:							
Due within one year	-	-	-	-	-	271,889	271,889
Due after one year	-	-	-	-	-	848,039	848,039
Total liabilities	269,198	2,183,224	108,062	22,868	2,583,352	1,657,033	4,240,385
<b>FUND BALANCES/NET ASSETS:</b>							
Fund balances:							
Reserved for encumbrances	597,615	5,697,510	220,142	22,868	6,538,135	(6,538,135)	-
Reserved for notes receivable	-	10,953,884	782,998	-	11,736,882	(11,736,882)	-
Reserved for prepaid expenses and security deposits	39,647	217,342	17,929	-	274,918	(274,918)	-
Unreserved:							
Designated for Native Hawaiian revolving loans	-	-	22,859,936	-	22,859,936	(22,859,936)	-
Designated for Fannie Mae Loan Program	-	4,000,000	-	-	4,000,000	(4,000,000)	-
Designated for other grants	-	-	29,419	-	29,419	(29,419)	-
Designated for Hawaiian projects	-	-	-	646,155	646,155	(646,155)	-
Designated for subsequent year's expenditures	-	4,759,032	-	-	4,759,032	(4,759,032)	-
Undesignated	(258,613)	329,066,802	781,402	(11,392)	329,578,199	(329,578,199)	-
Total fund balances	378,649	354,694,570	24,691,826	657,631	380,422,676	(380,422,676)	-
Total liabilities and fund balances	<u>\$ 647,847</u>	<u>\$ 356,877,794</u>	<u>\$ 24,799,888</u>	<u>\$ 680,499</u>	<u>\$ 383,006,028</u>		
Net assets:							
Invested in capital assets						2,324,531	2,324,531
Restricted - federal funds						24,691,826	24,691,826
Unrestricted						354,249,201	354,249,201
Total net assets						<u>\$ 381,265,558</u>	<u>\$ 381,265,558</u>

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs  
State of Hawaii

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

Year ended June 30, 2004

	Governmental Funds				Total	Adjustments (note J)	Government- wide Statement of Activities
	General Fund	Special Revenue Funds					
	Public Land Trust	Federal Grants	Other				
Expenditures/expenses:							
Current divisions:							
Board of Trustees	\$ 45,010	\$ 1,669,567	\$ -	\$ -	\$ 1,714,577	\$ 16,538	\$ 1,731,115
Support services	1,243,175	6,983,941	45,075	22,868	8,295,059	(355,302)	7,939,757
Beneficiary advocacy	1,485,622	7,109,096	28,153	42,370	8,665,241	558,153	9,223,394
Depreciation	-	-	-	-	-	625,966	625,966
Total expenditures/expenses	2,773,807	15,762,604	73,228	65,238	18,674,877	845,355	19,520,232
Program revenues:							
Charges for services	-	-	75,777	16,604	92,381	-	92,381
Operating grants and contributions							
Operating grants	-	-	321,056	-	321,056	-	321,056
Dividend and interest income	-	-	626,060	-	626,060	(39,658)	586,402
Investment losses	-	-	(516,690)	-	(516,690)	-	(516,690)
Total program revenues	-	-	506,203	16,604	522,807	(39,658)	483,149
Net program revenue (expenses)	(2,773,807)	(15,762,604)	432,975	(48,634)	(18,152,070)	(885,013)	(19,037,083)
General revenues:							
Appropriations	2,532,647	-	-	-	2,532,647	-	2,532,647
Public land trust	-	9,740,578	-	-	9,740,578	175,384	9,915,962
Dividend and interest income	-	3,508,407	-	-	3,508,407	-	3,508,407
Investment gains	-	39,021,376	-	-	39,021,376	-	39,021,376
Newspaper advertisements	-	-	-	51,459	51,459	-	51,459
Donations and other	-	96,081	-	125	96,206	-	96,206
Non-imposed fringe benefits	186,193	-	-	-	186,193	-	186,193
Total general revenues	2,718,840	52,366,442	-	51,584	55,136,866	175,384	55,312,250
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES (carried forward)	\$ (54,967)	\$ 36,603,838	\$ 432,975	\$ 2,950	\$ 36,984,796	\$ (709,629)	\$ 36,275,167

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs  
State of Hawaii

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

Year ended June 30, 2004

	Governmental Funds					Adjustments (note J)	Government- wide Statement of Activities
	General Fund	Special Revenue Funds			Total		
	Public Land Trust	Federal Grants	Other				
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES (brought forward)	\$ (54,967)	\$ 36,603,838	\$ 432,975	\$ 2,950	\$ 36,984,796	\$ (709,629)	\$ 36,275,167
Other financing sources (uses):							
Operating transfers (net)	29,298	(29,298)	-	-	-		-
Lapse of cash to State General Fund	(42,818)	-	-	-	(42,818)		(42,818)
Total other financing sources (uses)	(13,520)	(29,298)	-	-	(42,818)		(42,818)
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES	(68,487)	36,574,540	432,975	2,950	36,941,978	(36,941,978)	-
CHANGE IN NET ASSETS						36,232,349	36,232,349
Fund balance/net assets:							
Beginning of year	447,136	318,120,030	24,258,851	654,681	343,480,698	1,552,511	345,033,209
End of year	<u>\$ 378,649</u>	<u>\$ 354,694,570</u>	<u>\$ 24,691,826</u>	<u>\$ 657,631</u>	<u>\$ 380,422,676</u>	<u>\$ 842,882</u>	<u>\$ 381,265,558</u>

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs  
State of Hawaii

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

Year ended June 30, 2004

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual (budgetary basis)</u>	<u>Variance</u>
Revenues:				
State appropriations	<u>\$2,532,647</u>	<u>\$2,532,647</u>	<u>\$2,532,647</u>	<u>\$ -</u>
Total revenues	2,532,647	2,532,647	2,532,647	-
Expenditures:				
Board of Trustees	34,972	35,119	34,870	249
Support services	1,685,726	1,882,856	1,863,715	19,141
Beneficiary advocacy	<u>811,949</u>	<u>614,672</u>	<u>610,046</u>	<u>4,626</u>
Total expenditures	<u>2,532,647</u>	<u>2,532,647</u>	<u>2,508,631</u>	<u>24,016</u>
EXCESS OF REVENUES OVER EXPENDITURES	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 24,016</u>	<u>\$(24,016)</u>

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Financial Statement Presentation and Basis of Accounting

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

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

*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.

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

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include:

- Employees’ vested annual leaves are recorded as expenditures when utilized. The amount of accumulated annual leave unpaid at June 30, 2004 has been reported only in the government-wide financial statements.
- Executory purchase orders and contracts are recorded as a reservation of fund balance.

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 Hawaii 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 Hawaii General Fund. However, OHA’s General Fund financial statements reflect only OHA’s appropriations and obligations. The General Fund is

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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 State Legislature.

*Special Revenue Funds* – These funds include OHA’s proceeds and income from the Public Land Trust as defined in Chapter 10, Hawaii Revised Statutes, as well as the proceeds and income of the Native Hawaiian Rights Fund, the Native Hawaiian Revolving Loan Fund and other grants. Expenditures reflect those from the specific grant or designated fund and from other Board appropriations of Public Land Trust funds.

2. Investments

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

3. Capital Assets

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. Depreciation expense is recorded in the government-wide financial statements. Buildings, equipment, and improvements are depreciated on the straight-line method over their estimated useful lives. There is no depreciation recorded for land and work-in-progress.

4. Accrued Vacation

OHA accrues all vacation and compensatory pay at current salary rates, including additional amounts for certain salary-related expenses associated with the payment of compensated absences, in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. The June 30, 2004 balance includes fringe benefits computed at the rate of 7.65% of accrued vacation and compensatory pay. Accrued vacation is reported as an expense when earned in the government-wide financial statements, but not reported as an expenditure in the governmental funds financial statements, as current financial resources are not used.

5. Risk Management

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

6. Governmental Funds – Fund Balance Reserves and Designations

The governmental funds financial statements present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditure or (2) legally segregated for a specific future use. The reserves for related assets such as inventories and prepayments are examples of the former. Reserves for

Office of Hawaiian Affairs  
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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

6. Governmental Funds – Fund Balance Reserves and Designations (continued)

encumbrances, contracts, and other specific purposes are examples of the latter. The governmental funds' designation of fund balance reflects tentative plans for future use of financial resources.

7. Encumbrances

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

8. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

9. Concentrations of Credit Risk

The financial instruments that potentially expose OHA to concentrations of credit risk consist principally of notes receivable. OHA extends credit to Native Hawaiian and Hawaiian persons and agencies who use OHA's funds for the betterment of Native Hawaiians and Hawaiians. The mix of notes receivable at June 30, 2004 are as follows:

Native Hawaiian and Hawaiian persons	89%
Agencies	9
Other	2
	<hr/>
	100%
	<hr/> <hr/>

NOTE B – BIENNIAL BUDGET

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

- *The Budget* – In the fall of each odd-numbered fiscal year, OHA's Administration drafts the program and budget recommendations that will be the basis for OHA's biennium budget request. Once approved by the Board, the budget is submitted directly to the State Legislature prior to its convening. The budget is generally

Office of Hawaiian Affairs  
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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE B – BIENNIAL BUDGET (continued)

constructed around OHA's operations (offices) and programs (divisions) and states programmatic objectives, expected outcomes, and financial requirements. The budget also shows the proportion of funding requested from general funds to be appropriated by the Legislature and from trust funds appropriated by OHA's Board of Trustees.

- *Legislative Review* – Once the budget is submitted to the State Legislature, the review process follows that which is applied to the executive branch, with the budget being reviewed by House Finance Committee, Senate Ways and Means Committee, and the respective subject matter committee in the House and Senate. The State Legislature may request provisos and may require financial analysis and evaluation of those programs funded with general funds, but has no discretion over trust fund allocations.
- *Program Execution* – Except as limited by policy decisions of OHA's Board of Trustees, provisos of the State Legislature, and other provisions of law, OHA's Administration is responsible for the proper management of the programs. Appropriation changes and transfers can be authorized by the Board; those impacting general funds are reported to the State Legislature.

The budget is adopted for the General Fund and is prepared on a basis other than GAAP. The actual results of operations are presented on the budgetary basis in the statements 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 convert the results of operations and fund balances for the year ended June 30, 2004 from the budgetary basis to GAAP basis are as follows:

Excess of revenues over expenditures – actual (budgetary basis)	\$ 24,016
Reserve for encumbrances	419,832
Accrued payables and payroll	(232,101)
Prepaid expenditures not recognized for budgetary purposes – net of prior-year accruals	34,589
Expenditures for liquidation of prior-year encumbrances	(301,303)
Lapse of cash to State General Fund	(42,818)
Transfer of cash	<u>29,298</u>
Excess (deficiency) of revenues over expenditures – actual (GAAP basis)	<u>\$ (68,487)</u>

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE C – APPROPRIATIONS

OHA is authorized to transfer appropriation amounts between programs for operating purposes, provided that a report of all transfers is made to the State Legislature prior to convening of the next legislative session. Act 147 SLH 1999 required OHA to match portions of general fund appropriations on a dollar-for-dollar basis. This required match was satisfied by the expenditure of Special Revenue Fund monies. State of Hawaii General Fund legislative appropriations for the year ended June 30, 2004 totaled \$2,532,647.

NOTE D – CASH

The State maintains a cash pool that is used by all agencies. OHA's portion of this pool is indicated on the Governmental Funds Balance Sheet as "Cash in State Treasury." The Hawaii Revised Statutes authorize 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'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 Hawaii Revised Statutes Section 38-8. At June 30, 2004, OHA's deposits with financial institutions totaled \$6,437,628 and had corresponding bank balances of \$6,403,040. The portion of the bank balances covered by FDIC insurance totaled \$112,619 in 2004; the remainder was uninsured and uncollateralized.

NOTE E – NOTES RECEIVABLE

Notes receivable at June 30, 2004 consists of the following:

First Hawaiian Bank and State of Hawaii – Department of Hawaiian Home Lands loan receivable	\$11,071,203
Native Hawaiian Revolving Loan Fund	3,105,378
Other	<u>1,921,973</u>
Total	16,098,554
Less allowance for doubtful accounts	<u>(4,361,672)</u>
Net	11,736,882
Amounts due within one year	<u>1,057,449</u>
Amounts due after one year	<u><u>\$10,679,433</u></u>

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE F – INVESTMENTS

OHA's investments are categorized per GASB Statement No. 3, *Deposits with Financial Institutions, Investments and Reverse Repurchase Agreements*, to give an indication of credit and market risks assumed at June 30, 2004. Category 1 includes investments that are insured, registered, or held by OHA or its agent in OHA's name. Category 2 includes investments that are uninsured and unregistered, and held by the counterparty's trust department or agent in OHA's name. Category 3 includes investments that are uninsured and unregistered, and held by the counterparty, or by its trust department or agent but not in OHA's name.

The investments, including cash held by investment manager, at June 30, 2004, all of which are classified in Category 1, are as follows:

Mutual funds	\$304,727,550
Marketable equity securities – common stocks	8,649,658
U.S. Government obligations – Native Hawaiian Revolving Loan Fund	22,859,936
Cash management fund	221,783
Hedge funds	<u>15,887,117</u>
Total	<u>\$352,346,044</u>

The calculation of realized gains and losses is independent of the calculation of the net increase or decrease in fair value of investments. Realized gains and losses on investments that had been held more than one fiscal year and sold in the current year have been recognized as an increase or decrease in fair value of investment reported in the prior year. Summarized changes in fair value of investments information for the year ended June 30, 2004 are as follows:

Realized gain on sale of investments	\$ 13,778,084
Unrealized gain on investments held at June 30	<u>24,726,602</u>
Net increase in fair value of investments	<u>\$ 38,504,686</u>

Office of Hawaiian Affairs  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE G – CAPITAL ASSETS

Capital assets activities for the year ended June 30, 2004 are as follow:

	July 1, 2003	Additions	Retirements/ transfer	June 30, 2004
Capital assets not being depreciated:				
Land	\$ 84,100	\$ –	\$ –	\$ 84,100
Work-in-progress – software	167,185	–	(167,185)	–
Total capital assets not being depreciated	251,285	–	(167,185)	84,100
Capital assets being depreciated:				
Buildings	1,045,141	–	–	1,045,141
Leasehold improvements	389,337	61,982	–	451,319
Machinery, equipment, furniture and fixtures	2,894,609	507,440	(130,315)	3,271,734
Total capital assets being depreciated	4,329,087	569,422	(130,315)	4,768,194
Less accumulated depreciation	(2,022,763)	(625,966)	120,966	(2,527,763)
Capital assets being depreciated – net	2,306,324	(56,544)	(9,349)	2,240,431
Capital assets – net	<u>\$ 2,557,609</u>	<u>\$ (56,544)</u>	<u>\$(176,534)</u>	<u>\$ 2,324,531</u>

NOTE H – TERM LIABILITIES

Long-term liabilities for the year ended June 30, 2004 are as follows:

	July 1, 2003	Increases	Decreases	June 30, 2004	Amounts due within one year	Amounts due after one year
Accrued vacation	\$ 584,730	\$347,061	\$(271,889)	\$ 659,902	\$271,889	\$388,013
Accrued workers' compensation	460,026	–	–	460,026	–	460,026
Long-term liabilities	<u>\$1,044,756</u>	<u>\$347,061</u>	<u>\$(271,889)</u>	<u>\$1,119,928</u>	<u>\$271,889</u>	<u>\$848,039</u>

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE I – LEASES

OHA leases office space and equipment under various noncancelable operating leases expiring through June 2009. Future minimum payments under all leases as of June 30, 2004 are as follows:

Fiscal year ending June 30,	
2005	\$ 608,300
2006	592,000
2007	590,300
2008	587,400
2009	<u>349,700</u>
Total	<u><u>\$2,727,700</u></u>

Rent expense (including taxes and common area maintenance) under operating leases totaled \$818,000 for the year ended June 30, 2004.

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

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

Total fund balance – governmental funds	\$380,422,676
Amounts reported for governmental activities in the statement of net assets are different because:	
Revenues in the statement of activities that do not provide current financial resources and therefore the related receivable is not included in the funds:	
Ceded land revenue	<u>175,384</u>
Subtotal	175,384
Net capital assets used in governmental activities are not financial resources and therefore are not reported in the funds	2,324,531
Long-term liabilities not due and payable in the current period and therefore not reported in the funds:	
Accrued expenses	(537,105)
Accrued vacation	(659,902)
Accrued workers' compensation	<u>(460,026)</u>
Subtotal	<u>(1,657,033)</u>
Total net assets – government-wide	<u><u>\$381,265,558</u></u>

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE J – RECONCILIATIONS OF GOVERNMENT-WIDE AND GOVERNMENTAL FUNDS  
FINANCIAL STATEMENTS (continued)

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

Net changes in fund balances – total governmental funds \$ 36,941,978

Amounts reported for governmental activities in the statement  
of activities is different because:

Governmental funds report capital outlays as expenditures.  
However, in the statement of activities, the cost of those  
assets is allocated over their estimated useful lives and  
reported as depreciation expense. This amount includes  
the net additions for capital outlay of \$402,237  
offset by depreciation expense of \$625,966 and loss  
on disposal of capital assets of \$9,349.

(233,078)

Revenues in the statement of activities that do not provide  
current financial resources are not reported as revenues in the  
funds. This amount includes \$175,384 of Ceded Land Revenue.

175,384

Revenues that were recorded in 2003 government-wide  
financial statements but recorded in 2004 governmental  
funds

(39,658)

Some expenses reported in the statement of activities do  
not require the use of current financial resources and  
therefore are not reported as expenditures in the  
governmental funds:

Accrued expenses

(537,105)

Accrued vacation

(75,172)

Changes in net assets – government-wide

\$ 36,232,349

NOTE K – EMPLOYEE BENEFITS

1. Defined Benefit Pension Plans

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

Office of Hawaiian Affairs  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE K – EMPLOYEE BENEFITS (continued)

1. Defined Benefit Pension Plans (continued)

The ERS is composed of a contributory retirement plan and a noncontributory retirement 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, automatically become members of the noncontributory plan. Both 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 5 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 salary, 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 remaining amounts necessary to pay contributory plan benefits when due. In the noncontributory plan, employees may elect normal retirement at age 62 with 10 years of credited service or at age 55 with 30 years of credit service, or elect early retirement at age 55 with 20 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life, of 1.25% of their average final salary, 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 all amounts necessary to pay noncontributory plan benefits when due.

The ERS issues a publicly available financial report that included financial statements and required supplementary information. That report may be obtained by writing to the Employees' Retirement System, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813-2929 or by calling (808) 586-1660.

2. Post-Retirement Health Care and Life Insurance Benefits

In addition, the State of Hawaii Employer-Union Benefits Trust Fund ("EUTF") provides certain health care (medical, prescription drug, vision and dental) and life insurance benefits for retired employees. 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 laid out by 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 10 years of service. Information on OHA's share of the total EUTF post-retirement health care and life insurance benefits expense is not available.

3. Sick Leave

Accumulated sick leave as of June 30, 2004 was approximately \$1,239,000. 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.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE L – NON-IMPOSED EMPLOYEE FRINGE BENEFITS

Payroll fringe benefit costs of 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 \$186,193 for the fiscal year ended June 30, 2004, have been reported as revenues and expenditures of OHA's General Fund.

NOTE M – RISK MANAGEMENT AND CONTINGENT LIABILITIES

1. Workers' Compensation and Other Self-Insurance Liabilities

OHA is self-insured for property, excess liability, and criminal losses. This includes, but is not limited to claims for workers' compensation, automobile, and tort. The State Attorney General may review any claim against the State and may refer claims to the Comptroller for informal resolution.

The Comptroller may compromise or settle a claim within the purview of HRS Chapter 41D-8 for an amount not exceeding \$15,000, and the Comptroller may pay the claim without review by the Attorney General. The Comptroller may compromise or settle a tort claim not within the purview of HRS Chapter 41D-8 for \$10,000 or less without the necessity of court approval, and the Comptroller may pay the claim. Typically, these claims are delegated by the Comptroller to the risk management office of the Department of Accounting and General Services.

All other claims are handled by the Department of the Attorney General. The State has transferred risk by purchasing additional insurance to cover catastrophic loss. Under the State Risk Management and Insurance Administration (HRS 41D), OHA has access to insurance coverage for personal injury and property damage liability, including automobile and public errors and omissions, policies in force with a \$2,000,000 deductible and annual aggregate of \$23,000,000 per occurrence. To further mitigate risk to the Native Hawaiian Trust Fund, OHA purchases Public Officials and Employment Practices Liability insurance with a \$250,000 deductible and \$1,000,000 coverage limit, Bankers' Professional Liability insurance with a \$50,000 deductible and \$3,000,000 coverage limit, and excess general liability insurance, for any property owned by OHA or required by lease agreements entered into, with a \$1,000 deductible and \$2,000,000 coverage limit.

Several claims have been filed against OHA during the year ended June 30, 2004. Although OHA has recorded an estimated loss for such claims, as well as from any unasserted claims, the ultimate results may differ from OHA's estimates, due to the subjectivity of the data used by OHA to compute these amounts. OHA has accrued a liability for workers' compensation and other self-insurance claims at June 30, 2004 that approximated \$460,000.

2. Department of Education Settlement Agreement

On May 4, 2000, OHA entered into a Compromise and Settlement Agreement ("Agreement") with the Department of Education, State of Hawaii ("DOE"), in which the DOE agreed to form a partnership for the support of the DOE's Hawaiian Language Immersion Program ("HLIP"). Although OHA is not responsible for the education, operation, management, supervision, or any other aspect of the HLIP, OHA has agreed to provide matching funding up to \$500,000 each year for five years beginning July 1, 2000. As of June 30,

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE M – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

2. Department of Education Settlement Agreement (continued)

2004, OHA has dispersed \$203,431 in settlement of the first year of the program. In February 2005, OHA subsequently disbursed \$167,935 and \$369,170 for the second and third year of the program.

3. Hina-malailena Joint Use Agreement

In 1995, OHA entered into a Joint Use Agreement (“Agreement”) with Hina-malailena, a non-profit corporation, for the purpose of developing a commercial center in Hana, Maui. Also in 1995, OHA and Hina-malailena received, as co-recipients, \$1,760,000 of federal funds from the U.S. Department of Commerce, Economic Development Administration (“EDA”). The entire amount was recorded in the accounting records of Hina-malailena.

Terms of the Agreement state that Hina-malailena is to be responsible for substantially all duties required to construct and complete the project, including but not limited to overseeing management of all construction and service contracts, ensuring that all EDA requirements are satisfied, and obtaining all necessary permits and approvals. However, in the event of default by Hina-malailena, OHA may elect to take control of the project.

During fiscal year 2000, OHA became aware that Hina-malailena would not be able to complete the project. As of June 30, 2004, OHA had assembled a working group whose function is to develop a plan to move the project forward and exit the project at the appropriate time and to advise the OHA Board of Trustees accordingly.

4. Ceded Lands – Public Land Trust

At June 30, 2004, *Office of Hawaiian Affairs v. Housing and Community Development Corporation of Hawai‘i, fka Office of Hawaiian Affairs v. Housing Finance and Development Corporation*, Hawaii Supreme Court No. 25570 (Civil No. 94-4207-11), was still an active case. This lawsuit was originally filed in 1994 to enjoin the sale of ceded lands until the claims of the Native Hawaiians were resolved by the government. In December, 2002, the lower court issued its opinion and OHA appealed. The case is currently pending before the Hawai‘i State Supreme Court.

At June 30, 2004, *Office of Hawaiian Affairs v. Hawai‘i Housing Authority*, Civil No. 95-2682-07 was still stayed. On January 11, 2000, all proceedings in this suit were stayed pending the Hawaii Supreme Court's decision in *OHA v. State 1*. OHA disagrees that the decision on September 12, 2001 in *OHA v. State 1* requires the dismissal of the claims in *OHA v. HHA* which relates to the valuation of 5 parcels transferred to HHA for affordable public housing units. The stay is still in effect.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2004

NOTE M – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

4. Ceded Lands – Public Land Trust (continued)

Both cases could have a potential financial impact relative to ceded land holdings. If the State is permitted to sell ceded lands, future ceded land revenue will ultimately be diminished. The present value of any land sale proceeds versus the future value of an annuity stream could have a significant long-term financial impact.

5. Civil Complaints

A motion to dismiss the *Arakaki v. Lingle* lawsuit, Ninth Circuit No. 04-15306 (Civil No. 02-00139-SOM-KSC), was filed by Defendant OHA in December, 2003 and the dismissal was granted by the United States District Court in January, 2004. Plaintiff Arakaki et al. appealed in February, 2004. Oral argument was held on November, 2004 but no decision has been issued. The case is still pending before the Ninth Circuit Court of Appeals and the ultimate results of this lawsuit cannot presently be determined.

6. Litigation

OHA is 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 financial position of OHA.