

Financial statements and independent auditors' report

Office of Hawaiian Affairs
State of Hawaii

June 30, 2005

Office of Hawaiian Affairs
State of Hawaii

C O N T E N T S

	Page
Introduction	1
Independent Auditors' Report	3
Management's Discussion and Analysis	5
Financial statements	
Governmental Funds – Balance Sheets/Government-wide Statements of Net Assets	12
Governmental Funds – Statements of Revenues, Expenditures, and Changes in Fund Balances/Government-wide Statements of Activities	14
Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis), General Fund	16
Notes to Financial Statements	17

Office of Hawaiian Affairs
State of Hawaii

INTRODUCTION

Year ended June 30, 2005

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:

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 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, 2005, 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, 2005, 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 opinions.

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, 2005, 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 N 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, 2005. 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 November 30, 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

Board of Trustees of Office of Hawaiian Affairs
State of Hawaii

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 cursive script, reading "Grant Stewart" followed by a flourish.

Honolulu, Hawaii
November 30, 2005

Office of Hawaiian Affairs
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS

Years ended June 30, 2005

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, 2005 and 2004. While the audit report presents only the financial activities for the fiscal year ended June 30, 2005, the management discussion and analysis will address both this year and the 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, 2005 by \$404,312,070 (presented as “total net assets”). Of this amount, \$376,886,485 is reported as “unrestricted”, while \$25,484,597 is reported as “restricted-federal funds” and \$1,940,988 is reported as “invested in capital assets, net of related debt.” 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.” 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 \$23,046,512 (a 6.0% increase) in fiscal year 2005. This was primarily due to investment income and gains experienced on the OHA's Native Hawaiian Trust Fund (NHTF). OHA's total net assets, increased by \$36,232,349 (a 10.5% increase) in fiscal year 2004. This was primarily due to gain experienced on the fair value of OHA's NHTF.

Governmental Funds Financial Statements Highlights

Governmental Funds – Fund Balances – As of the close of fiscal year 2005, OHA's governmental funds reported an ending fund balance of \$403,737,314. Of this total amount, \$384,855,589 represents the unreserved fund balances with 93.7% being in the Public Land Trust Fund. Of this \$384,855,589, \$22,941,976 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, \$665,709 is designated for Hawaiian projects; and \$4,510,000 is designated for subsequent year's expenditures, leaving \$352,708,485 as undesignated. This \$352,708,485 is roughly 87.4% of the total fund balance at the end of fiscal year 2005.

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.

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, investment income and net gains/losses on Native Hawaiian Revolving Loan Fund (NHRLF), and operating grants), and general revenues (investment income and net gains/losses on investments, 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 assist in determining whether there will be adequate financial resources available to meet the current needs of OHA.

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

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 \$404,312,070 at the end of fiscal year 2005, compared to \$381,265,558 at the end of fiscal year 2004.

The largest portion of OHA's net assets (93.2% and 92.9% at June 30, 2005 and 2004, 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, 2005 and 2004 is as follows:

	2005	2004
Capital assets	\$ 2,097,979	\$ 2,324,531
Other assets	407,536,988	383,181,412
Total assets	<u>\$409,634,967</u>	<u>\$385,505,943</u>
Other liabilities	\$ 3,791,772	\$ 3,392,346
Long-term liabilities	1,531,125	848,039
Total liabilities	5,322,897	4,240,385
Invested in capital assets, net of related debt	1,940,988	2,324,531
Restricted – federal funds	25,484,597	24,691,826
Unrestricted	<u>376,886,485</u>	<u>354,249,201</u>
Total net assets	<u>404,312,070</u>	<u>381,265,558</u>
Total liabilities and net assets	<u>\$409,634,967</u>	<u>\$385,505,943</u>

A portion of OHA's net assets (0.5% and 0.6% at June 30, 2005 and 2004, 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 2005 and 2004, OHA is able to report a positive balance in its category of government-wide net assets.

Changes in Net Assets

OHA's net assets recognized in fiscal year 2005 increased by \$23,046,512 or 6.0% from the prior year. Approximately 22.8% of OHA's total revenue came from the Public Land Trust, while 14.9% came from dividend and interest income, 55.5% came from net investment gains, and 5.4% resulted from Legislative appropriations. This is in direct contrast to revenue amounts from fiscal year 2003 to fiscal year 2004. In 2004, its net assets were 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, 69.1% came from net investment gains, and 4.5% resulted from Legislative appropriations. This change was due to market fluctuations incurred during the year, and the continuance of further diversifying the investment portfolio to attain long term asset allocation targets.

Summarized financial information of OHA's statement of changes in net assets for the fiscal years ended June 30, 2005 and 2004 is as follows:

	<u>2005</u>	<u>2004</u>
Revenues:		
Program revenues:		
Operating grants	\$ 319,208	\$ 321,056
Charges for services	63,118	92,381
Dividend and interest income	607,434	586,402
Net investment gains (losses)	(87,008)	(516,690)
General revenues:		
Appropriations, net of lapses	2,498,960	2,489,829
Public land trust	10,631,224	9,915,962
Dividend and interest income	6,339,036	3,508,407
Net investment gains (losses)	25,963,215	39,021,376
Newspaper ads	59,109	51,459
Donations and other	33,746	96,206
Non-imposed fringe benefits	193,811	186,193
Total revenues	<u>46,621,853</u>	<u>55,752,581</u>
Expenses:		
Current divisions:		
Board of Trustees	1,600,433	1,731,115
Support Services	8,716,897	7,939,757
Beneficiary Advocacy	12,632,579	9,223,394
Depreciation	625,432	625,966
Total expenses	<u>23,575,341</u>	<u>19,520,232</u>
CHANGES IN NET ASSETS	<u>\$23,046,512</u>	<u>\$36,232,349</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 2005, OHA's governmental funds reported an ending fund balance of \$403,737,314. Of this amount, approximately \$384,855,589, or 95.3%, is unreserved funds, broken down as follows: 5.7% for Native Hawaiian Revolving Loans, 1.0% for Fannie Mae Loan Program, .007% for Other Grants, 0.2% for Hawaiian projects, 1.1% for subsequent years expenditures, and 87.3% undesignated. Reserved fund balances accounted for \$18,881,725, or 4.7% of the total fund balance, broken down as follows: 1.7% for encumbrances, 2.9% for notes receivable, and 0.1% for prepaid expenses and security deposits.

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%, is 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

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, real estate, and the tourism industry, 2005 ended with a strong performance similar to that shown in 2004.

Hawaii's tourism industry saw almost 7.1 million visitors in 2005, a 7.2% increase over 2004. Of the 7.1 million visitors, 70% were made up of domestic air visitors and 30% from international and other air travel. The average length of stay in 2005 also increased to 9.97 from 9.89 days in 2004.

The growth rate in employment, personal income, and tax collections surpassed expectations and is indicative of the continuing system-wide expansion of Hawaii's economy. In addition, federal spending and the level of construction remains strong and allows for positive future investment activity.

Hawaii had the lowest unemployment rate in the nation in September 2004 of 2.9 percent. Except for Forestry and Fishing, Utilities and Information, all other sectors experienced quarterly increases in earnings.

Hawaii's tax revenues to the State General Fund increased 16.2% to 1.1 billion for third quarter 2005 compared to the third quarter 2004. The overall quarterly increase was due to 9.6% increase in domestic arrivals and 1.7% increase in international arrivals. Hotel occupancy rates increased 2.9% points to 84.4% for the quarter.

Construction activity remained positive in the third quarter which signifies sustained strong building activity. Construction jobs increased 9.7% to 32,950 jobs. The total number of bankruptcy filing increased by 15.8% in the second quarter 2005 compared to second quarter 2004. The increase in Chapter 7 filing was primarily attributed to the stiffening of the bankruptcy law.

Hawaii continues to anticipate solid growth for tourism, personal income, and wage and salary employment for 2006. Projections of economic growth for the mainland U.S., Hawaii's primary visitor market, are reasonably strong while Japan is projected to grow but at a slower rate.

The visitor industry, federal spending, and private construction remain strong. Building permit levels are still averaging over \$200 million per month, which depicts a healthy construction sector and foreseeable future.

The future of Hawaii remains linked to the mainland and Japanese economies. The GDP growth in 2005 was 3.5% for the U.S. and 2.0% for Japan. Growth in 2006 is expected to be 3.3% for the U.S. and 1.9% for Japan.

Hawaii's projected inflation rate for 2005 and 2006 have been 3.4% and 3.3%, respectively, which was caused by recent increases in the housing and energy prices.

In March 2003, OHA's investment advisors were awarded contracts in accordance with the NHTF investment policy statement. Upon commencement of the contracts, the combined value of the NHTF portfolio was approximately \$257 million. As of June 30, 2005 the Trust has grown to a net value of \$354 million (with net accretions in Fiscal Year 2003/2004 of \$41.5 million and \$55.4 million in Fiscal Year 2004/2005). This growth is a reflection of the very able management of the fund that permits OHA to fund Native Hawaiian needs through grants and initiatives that would otherwise be unavailable. Assuming current economic conditions continue these efforts will be sustained and OHA will provide \$8.7 million directly from the trust in the 2005/2006 fiscal year plus another \$2.6 million for legislative mandates which directly benefit Native Hawaiians.

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, 2005

ASSETS	Governmental Funds				Adjustments (note K)	Government- wide statement of net assets	
	General Fund	Special Revenue Funds					
		Public Land Trust	Federal Grants	Other			
Petty cash	\$ 20,000	\$ -	\$ -	\$ -	\$ 20,000	\$ -	\$ 20,000
Cash in State Treasury	419,617	10,813,044	984,511	665,709	12,882,881		12,882,881
Cash in banks	-	4,468,805	-	-	4,468,805	-	4,468,805
Cash held by investment manager	-	1,342,495	52,019	-	1,394,514	-	1,394,514
Accounts receivable	-	280,339	-	3,598	283,937	7,902	291,839
Interest and dividends receivable	-	228,193	155,073	-	383,266	-	383,266
Prepaid and other assets	30,179	235,597	13,277	-	279,053	-	279,053
Notes receivable - due within one year	-	874,000	372,000	-	1,246,000	-	1,246,000
Notes receivable - due after one year	-	9,395,734	1,132,184	-	10,527,918	-	10,527,918
Security deposits	-	44,215	1,803	-	46,018	-	46,018
Investments	-	353,054,718	22,941,976	-	375,996,694	-	375,996,694
Capital assets - net	-	-	-	-	-	2,097,979	2,097,979
TOTAL	\$ 469,796	\$ 380,737,140	\$ 25,652,843	\$ 669,307	\$ 407,529,086	\$2,105,881	\$ 409,634,967

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs
State of Hawaii

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

June 30, 2005

LIABILITIES AND FUND BALANCES/NET ASSETS	Governmental Funds					Adjustments (note K)	Government- wide statement of net assets
	General Fund	Special Revenue Funds			Total		
		Public Land Trust	Federal Grants	Other			
LIABILITIES:							
Accounts payable and accrued liabilities	\$ 162,897	\$ 3,438,441	\$ 64,034	\$ 2,188	\$ 3,667,560	\$ -	\$ 3,667,560
Due to State of Hawaii	20,000	-	104,212	-	124,212	-	124,212
Long-term liabilities:							
Due within one year	-	-	-	-	-	232,592	232,592
Due after one year	-	-	-	-	-	1,298,533	1,298,533
Total liabilities	182,897	3,438,441	168,246	2,188	3,791,772	1,531,125	5,322,897
FUND BALANCES/NET ASSETS:							
Fund balances:							
Reserved for encumbrances	293,860	6,286,279	202,597	-	6,782,736	(6,782,736)	-
Reserved for notes receivable	-	10,269,734	1,504,184	-	11,773,918	(11,773,918)	-
Reserved for prepaid expenses and security deposits	30,179	279,812	15,080	-	325,071	(325,071)	-
Unreserved:							
Designated for Native Hawaiian revolving loans	-	-	22,941,976	-	22,941,976	(22,941,976)	-
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	-	-	-	665,709	665,709	(665,709)	-
Designated for subsequent year's expenditures	-	4,510,000	-	-	4,510,000	(4,510,000)	-
Undesignated	(37,140)	351,952,874	791,341	1,410	352,708,485	(352,708,485)	-
Total fund balances	286,899	377,298,699	25,484,597	667,119	403,737,314	(403,737,314)	-
Total liabilities and fund balances	\$ 469,796	\$ 380,737,140	\$ 25,652,843	\$ 669,307	\$ 407,529,086		
Net assets:							
Invested in capital assets, net of related debt						1,940,988	1,940,988
Restricted - federal funds						25,484,597	25,484,597
Unrestricted						376,886,485	376,886,485
Total net assets						\$ 404,312,070	\$ 404,312,070

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, 2005

	Governmental Funds				Total	Adjustments (note K)	Government- wide Statement of Activities
	General Fund	Special Revenue Funds		Other			
	Public Land Trust	Federal Grants					
Expenditures/expenses:							
Current divisions:							
Board of Trustees	\$ 46,326	\$ 1,467,756	\$ -	\$ -	\$ 1,514,082	\$ 86,351	\$ 1,600,433
Support services	1,117,232	7,697,804	46,163	57,203	8,918,402	(201,505)	8,716,897
Beneficiary advocacy	1,620,963	11,364,984	56,266	-	13,042,213	(409,634)	12,632,579
Depreciation	-	-	-	-	-	625,432	625,432
Total expenditures/expenses	2,784,521	20,530,544	102,429	57,203	23,474,697	100,644	23,575,341
Program revenues:							
Charges for services	-	-	55,541	7,577	63,118	-	63,118
Operating grants and contributions							
Operating grants	-	-	319,208	-	319,208	-	319,208
Dividend and interest income	-	-	607,434	-	607,434	-	607,434
Investment losses	-	-	(87,008)	-	(87,008)	-	(87,008)
Total program revenues	-	-	895,175	7,577	902,752	-	902,752
Net program (expenses) revenue	(2,784,521)	(20,530,544)	792,746	(49,626)	(22,571,945)	(100,644)	(22,672,589)
General revenues:							
Appropriations, net of lapses	2,498,960	-	-	-	2,498,960	-	2,498,960
Public land trust	-	10,798,706	-	-	10,798,706	(167,482)	10,631,224
Dividend and interest income	-	6,339,036	-	-	6,339,036	-	6,339,036
Investment gains	-	25,963,215	-	-	25,963,215	-	25,963,215
Newspaper advertisements	-	-	-	59,109	59,109	-	59,109
Donations and other	-	33,716	25	5	33,746	-	33,746
Non-imposed fringe benefits	193,811	-	-	-	193,811	-	193,811
Total general revenues	2,692,771	43,134,673	25	59,114	45,886,583	(167,482)	45,719,101
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES/CHANGE IN NET ASSETS (carried forward)	\$ (91,750)	\$ 22,604,129	\$ 792,771	\$ 9,488	\$ 23,314,638	\$ (268,126)	\$ 23,046,512

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, 2005

	Governmental Funds				Adjustments (note K)	Government- wide Statement of Activities	
	General Fund	Special Revenue Funds					
	Public Land Trust	Federal Grants	Other	Total			
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES/CHANGE IN NET ASSETS (brought forward)	\$ (91,750)	\$ 22,604,129	\$ 792,771	\$ 9,488	\$ 23,314,638	\$ (268,126)	\$ 23,046,512
Fund balance/net assets:							
Beginning 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>
End of year	<u>\$ 286,899</u>	<u>\$ 377,298,699</u>	<u>\$ 25,484,597</u>	<u>\$ 667,119</u>	<u>\$ 403,737,314</u>	<u>\$ 574,756</u>	<u>\$ 404,312,070</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, 2005

	<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	34,992	34,351	35,286	(935)
Support services	1,662,823	956,936	960,969	(4,033)
Beneficiary advocacy	<u>834,832</u>	<u>1,541,360</u>	<u>1,533,908</u>	<u>7,452</u>
Total expenditures	<u>2,532,647</u>	<u>2,532,647</u>	<u>2,530,163</u>	<u>2,484</u>
EXCESS OF REVENUES OVER EXPENDITURES	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,484</u>	<u>\$ (2,484)</u>

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs
State of Hawaii

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

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, 2005 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

Office of Hawaiian Affairs
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

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, 2005 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
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

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, 2005 are as follows:

Native Hawaiian and Hawaiian persons	90%
Agencies	9
Other	<u>1</u>
	<u>100%</u>

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 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 Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE B – 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, 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, 2005 from the budgetary basis to GAAP basis are as follows:

Excess of revenues over expenditures – actual (budgetary basis)	\$ 2,484
Reserve for encumbrances	293,860
Accrued payables and payroll	83,408
Prepaid expenditures not recognized for budgetary purposes – net of prior-year accruals	(9,469)
Expenditures for liquidation of prior-year encumbrances	(428,346)
Lapse of cash to State General Fund	<u>(33,687)</u>
Excess (deficiency) of revenues over expenditures – actual (GAAP basis)	<u>\$ (91,750)</u>

NOTE C – APPROPRIATIONS

OHA is authorized to transfer appropriation amounts and 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 183, SLH 2003 authorizes a total of \$2,532,647 general funds, and \$5,051,293 trust funds for OHA’s programs for fiscal year 2005.

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

Office of Hawaiian Affairs
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE D – CASH (continued)

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, 2005, OHA's deposits with financial institutions totaled \$4,540,824, and had corresponding bank balances of \$4,520,963. The portion of the bank balances covered by FDIC insurance totaled \$121,977 in 2005; the remainder was uninsured and uncollateralized.

NOTE E – NOTES RECEIVABLE

Notes receivable at June 30, 2005 consist of the following:

Loans Receivable serviced by First Hawaiian Bank (of which, \$5,138,912 is guaranteed by DHHL)	\$ 9,812,476
Native Hawaiian Revolving Loan Fund	2,908,784
Other	<u>2,049,379</u>
Total	14,770,639
Less allowance for doubtful accounts	<u>(2,996,721)</u>
Net	11,773,918
Amounts due within one year	<u>1,246,000</u>
Amounts due after one year	<u><u>\$10,527,918</u></u>

NOTE F – INVESTMENTS

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

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

Office of Hawaiian Affairs
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE F – INVESTMENTS (continued)

Investments (current and long-term) at June 30, 2005 and their maturities were as follows:

Investment type	FUND	Fair value	Investment maturities (in years)	
			Less than 1	1-5
U.S. treasuries	NHRLF	\$ 3,897,691	\$ 3,212,707	\$ 684,984
U.S. agencies	NHRLF	19,044,285	4,061,250	14,983,035
Other mutual funds	NHTF	94,604,284	94,604,284	–
Pooled investments	NHTF	62,810,161	62,810,161	–
Limited partnerships	NHTF	167,124,350	167,124,350	–
Real estate investments	NHTF	11,982,694	11,982,694	–
Other	NHTF	16,533,229	16,533,229	–
Total securities		375,996,694	360,328,675	15,668,019
Money market funds (not considered securities)	MIX	1,394,514	1,394,514	–
Total investments		<u>\$377,391,208</u>	<u>\$361,723,189</u>	<u>\$15,668,019</u>

For all investments held in accordance with OHA's NHTF investment policy, funds are managed by investment advisors who are responsible for the prudent management of all assets subject to their oversight and are involved in all key decisions, such as management 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 Trust Fund.

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

Interest Rate Risk

As a means to limit the amount of exposure to fair value losses arising from 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	3 years
U.S. agencies	3 years

Office of Hawaiian Affairs
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE F – INVESTMENTS (continued)

The duration of the investment portfolio, under normal market conditions, range between +/- 50% of the investment policy benchmark.

Credit Risk

Pursuant to 45 C.F.R. 1336.72(a), “any portion of the revolving loan fund that is not required for expenditure must be invested in obligations of the United States or in obligations guaranteed or insured by the United States.” At June 30, 2005, credit rates for all securities of government agencies were rated at Aaa/AAA.

Concentration of 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 10% of the total portfolio, at the time of purchase, in any one issue.

NOTE G – CAPITAL ASSETS

Capital assets activities for the year ended June 30, 2005 are as follow:

	July 1, 2004	Additions	Retirements/ transfer	June 30, 2005
Capital assets not being depreciated:				
Land	\$ 84,100	\$ –	\$ –	\$ 84,100
Total capital assets not being depreciated	84,100	–	–	84,100
Capital assets being depreciated:				
Buildings	1,045,141	–	–	1,045,141
Leasehold improvements	451,319	39,827	–	491,146
Machinery, equipment, furniture and fixtures	3,271,734	362,304	(29,317)	3,604,721
Total capital assets being depreciated	4,768,194	402,131	(29,317)	5,141,008
Less accumulated depreciation	(2,527,763)	(625,432)	26,066	(3,127,129)
Capital assets being depreciated – net	2,240,431	(223,301)	(3,251)	2,013,879
Capital assets – net	<u>\$ 2,324,531</u>	<u>\$(223,301)</u>	<u>\$ (3,251)</u>	<u>\$ 2,097,979</u>

Office of Hawaiian Affairs
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE H – CAPITAL LEASE

In March 2005, OHA entered into an agreement to lease equipment which requires monthly payments of \$4,068 beginning in March 2005 and ending in March 2009. The present value of the minimum lease payments at the beginning of the lease term, was \$166,975. OHA records the equipment as an asset which is depreciated over the term of the lease and reported in the financial statements as depreciation. As of June 30, 2005, the related accumulated depreciation is \$10,436 and the net book value is \$156,539.

Fiscal year ending June 30,	
2006	\$ 48,816
2007	48,816
2008	48,816
2009	<u>36,612</u>
Total minimum lease payments	183,060
Less implicit interest of 8.25%	<u>(26,069)</u>
Present value of minimum lease payments (obligation under capital lease)	156,991
Less current portion	<u>(37,252)</u>
	<u><u>\$119,739</u></u>

NOTE I – TERM LIABILITIES

Long-term liabilities for the year ended June 30, 2005 are as follows:

	July 1, 2004	Increases	Decreases	June 30, 2005	Amounts due within one year	Amounts due after one year
Accrued vacation	\$ 659,902	\$460,418	\$(352,473)	\$ 767,847	\$195,340	\$ 572,507
Accrued workers' compensation	460,026	146,261	–	606,287	–	606,287
Capital lease obligation	–	166,975	(9,984)	156,991	37,252	119,739
	<u>\$1,119,928</u>	<u>\$773,654</u>	<u>\$(362,457)</u>	<u>\$1,531,125</u>	<u>\$232,592</u>	<u>\$1,298,533</u>

Office of Hawaiian Affairs
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE J – 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, 2005 are as follows:

Fiscal year ending June 30,	
2006	\$ 554,000
2007	605,000
2008	602,000
2009	<u>357,000</u>
Total	<u><u>\$2,118,000</u></u>

Rent expense (including taxes and common area maintenance) under operating leases totaled \$868,000 for the year ended June 30, 2005.

In August 1998, OHA entered into a 35 year lease with the State of Hawaii, Department of Land and Natural Resources (DLNR) for the use of the premises known as the Old Waialua Court House situated in Waialua, Hawaii. Lease rent is gratis, however, OHA pays for all operating and repair costs associated with maintaining the property. OHA subleases 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.

NOTE K – 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	\$403,737,314
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	7,902
Net capital assets used in governmental activities are not financial resources and therefore are not reported in the funds	2,097,979
Long-term liabilities not due and payable in the current period and therefore not reported in the funds:	
Accrued vacation	(767,847)
Accrued workers' compensation	(606,287)
Capital lease	<u>(156,991)</u>
Subtotal	<u>(1,531,125)</u>
Total net assets – government-wide	<u><u>\$404,312,070</u></u>

Office of Hawaiian Affairs
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE K – 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	\$ 23,314,638
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 expense. This is the amount by which capital outlays exceeded depreciation and related debt during the year	(383,543)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds. This amount includes \$7,902 of Ceded Land Revenue.	7,902
Revenues that were recorded in 2004 government-wide financial statements but recorded in 2005 governmental funds	(175,384)
Expenses that were recorded in 2004 government-wide financial statements but recorded in 2005 governmental funds	537,105
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds:	
Accrued vacation	(107,945)
Accrued workers' compensation	(146,261)
Subtotal	<u>(254,206)</u>
Changes in net assets – government-wide	<u><u>\$ 23,046,512</u></u>

Office of Hawaiian Affairs
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE L – 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.

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. Contribution by OHA for the fiscal year ended June 30, 2005 was approximately \$426,000. The contribution rate for the fiscal year ended June 30, 2005 was 10.82%.

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 96813-2980 or by calling (808) 586-1735.

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. OHA's share of the expense for post-retirement health care and life insurance benefits for the fiscal year ended June 30, 2005 was approximately \$1,000.

Office of Hawaiian Affairs
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE L – EMPLOYEE BENEFITS (continued)

3. Sick Leave

Accumulated sick leave as of June 30, 2005 was approximately \$1,423,000. 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.

NOTE M – 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 \$193,811 for the fiscal year ended June 30, 2005, have been reported as revenues and expenditures of OHA's General Fund.

NOTE N – 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 \$4,000,000 coverage limit, Bankers' Professional Liability insurance with a \$50,000 deductible and \$3,000,000 coverage limit, and commercial and excess liability insurance for property owned 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, 2005. 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, 2005 that approximated \$606,000.

Office of Hawaiian Affairs
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE N – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

2. Department of Education Settlement Agreement

On May 4, 2000, OHA entered into a Compromise and Settlement Agreement (Agreement) with the State of Hawaii, Department of Education (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, 2004, OHA has disbursed \$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 not-for-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, 2005, OHA's project team has been working with the various parties involved in the project to move it to completion so that OHA can exit at the appropriate time and to advise the OHA Board of Trustees accordingly.

4. Ceded Lands – Public Land Trust

At June 30, 2005, *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. Briefs have been filed. No date for oral argument has been set and no decision has been rendered. The case is currently pending before the Hawai'i State Supreme Court.

At June 30, 2005, *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 Hawai'i Supreme Court's decision in *OHA v. State 1*. OHA disagreed that the decision rendered by the Hawai'i Supreme Court on September 12, 2001 in *OHA v. State 1* required 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.

Office of Hawaiian Affairs
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

NOTE N – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

4. Ceded Lands – Public Land Trust (continued)

Both of the foregoing 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. At June 30, 2005, the case was still pending before the Ninth Circuit Court of Appeals and the ultimate results of this lawsuit cannot presently be determined. Subsequently, the Ninth Circuit Court of Appeals ruled, affirming in part, reversing in part, and remanding to the district for its further action.

6. 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 financial position of OHA.

In October 2005, a lawsuit was filed in the United States District Court of the District of Hawai'i by five Native Hawaiians against two former OHA trustees and the current OHA trustees alleging that OHA is wrongfully expending its trust fund monies on all Hawaiian beneficiaries and not just exclusively on those beneficiaries with 50% or more blood quantum. As Plaintiffs are seeking injunctive relief to enjoin and restrain OHA from certain expenditures of its trust funds as well as a declaratory judgment with regard to certain legal issues, OHA does not presently believe there are contingent liabilities.

NOTE O – RELATED PARTY TRANSACTIONS

Besides property leased from DLNR discussed in Note J, Executive Order 3724 granted OHA a set aside of land located in Kekaha, Waimea, Kauai, Hawaii (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. OHA leases the Kekaha Armory to a not-for-profit organization for a maximum period of 66 years commencing on November 2000, unless sooner terminated, for \$1 per year to utilize such property for purposes in accordance with the Executive Order.

