

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

Financial Statements
June 30, 2013

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Office of Hawaiian Affairs, State of Hawai'i

Letter from the Chief Executive Officer
Year Ended June 30, 2013

To the Board of Trustees of the Office of Hawaiian Affairs

It is my pleasure to present to you, the Financial Statements and Report of Independent Certified Public Accountants of the Office of Hawaiian Affairs (OHA) for the fiscal year ended June 30, 2013. This report has been prepared by the Resource Management Line of Business. Responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures, rests with OHA. I believe the information, as presented, is fairly stated in all material aspects; that it is presented in a manner designed to fairly set forth the financial position and results of operations of OHA as measured by the financial activity of its various funds; and that all the information necessary to enable the reader to gain the maximum understanding of OHA's financial affairs has been included.

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

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

THE REPORTING ENTITY

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

GASB Statement No. 14, *The Financial Reporting Entity*, establishes standards for defining and reporting on the financial reporting entity. The financial reporting entity consists of OHA as the primary government, as well as other organizations for which the primary government is financially responsible as component units. Based on the common governance and the financial obligations that OHA has made to fund Ho'okele Pono LLC and Hi'ilei Aloha LLC and its subsidiaries, it has been classified as blended component units. As a result, the financial results of Ho'okele Pono LLC and Hi'ilei Aloha LLC and its subsidiaries through December 31, 2012 have been included in the financial statements of OHA for the year ended June 30, 2013.

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DIVISIONS

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

The title and objective of each division are listed below:

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

PURPOSE OF THE REPORT AND DEFINITIONS

The purpose of the financial audit was to enable the independent auditors to form opinions on to the financial statement of the Office of Hawaiian Affairs as of June 30, 2013, and for the year then ended. The auditors' report represents the conclusion of the independent auditors regarding the fairness of the presentations, in conformity with accounting principles generally accepted in the United States of America, set forth in the financial statements and is used to communicate such conclusion to interested parties.

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

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

EMPOWERING HAWAIIANS

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

HO'OKAHUA WAIWAI

Economic Self-Sufficiency

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

'ĀINA

Land & Water

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

MO'OMEHEU

Culture

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

MAULI OLA

Health

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

EA

Governance

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

HO'ONA'AUAO

Education

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

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In addition, we continued to fulfill our promise to the State Department of Hawaiian Home Lands, providing \$3 million annually over 30 years to pay the debt service on its infrastructure improvement – an example of how Hawaiian-focused agencies can, and must, work hand-in-hand to leverage assets toward a common goal. This is just part of the nearly \$12 million in grants OHA awarded in fiscal year 2013 to improve, among other things, the health, education, housing, and economic conditions of Native Hawaiians.

FACTORS AFFECTING FINANCIAL CONDITION

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

Sources of Funding

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

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

State of the Local Economy

Hawai'i's Gross Domestic Product ("GDP") increased by over 1.5% in 2012 and is forecasted to grow by 2.9% in 2013. In 2012, Hawaii's economy benefited from record annual growth in both visitor numbers and visitor expenditures. Visitor arrivals increased by over 10% in comparison to 2011 and visitor spending increased by over 18% with much of the growth coming from Asia. Hawai'i's unemployment rate fell to 5.1% at the end of December 2012, down from the 6% figure reported a year earlier and was below the national unemployment rate of 7.8%. Local price inflation (+2.4% in 2012) remains an obstacle as higher prices in healthcare, energy, and housing drove down real personal income growth in 2012. Hawai'i's economy could also face headwinds from decreases in State and Federal government spending as well as a possible slowdown in the global economy.

State of the National Economy

The US economy continues to recover from the 2008-2009 recession as key economic indicators are showing signs of improvement. The US Federal Reserve has initiated a third round of quantitative easing to keep interest rates low and support investment and consumption. Following the actions of the

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Federal Reserve, the US housing market has begun to show signs of growth and the US equity markets are approaching historic highs. However, even with the improvement of key economic indicators, US economic growth still faces headwinds domestically and abroad. Domestically, unemployment remains elevated and the country's GDP growth rate is expected to be below its long-term average of 3% through at least 2013. Political strife between Democrats and Republicans has also threatened the economic recovery as both parties disagree on key issues and are using the federal budget and national debt ceiling as bargaining chips. Abroad, the European-sovereign debt crisis has improved as central bank and government actions have calmed some of the concerns and fears seen in 2011. However, there are still structural challenges such as high unemployment and low-growth that will take years to overcome. In Asia, China's growth is expected to slow as the country transitions from an export, production, and investment based economy to a domestic consumer based economy.

OHA's Investments

OHA's investment portfolio reported a 9.85% return in fiscal year 2013, but underperformed its strategic benchmark by 60 basis points, or 0.60%, on a net-of-fees basis. OHA's global equity portfolio reported stellar performance and beat its benchmark by 59 basis points with a reported return of 17.67%. The global equity market rally during the year was primarily driven by the accommodative monetary policies of the US Federal Reserve and other central banks. OHA's global credit portfolio also outperformed its benchmark while global real assets underperformed. The overall underperformance of the Trust Fund during the year was primarily driven by OHA's alternative assets portfolio.

CLOSING COMMENTS

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

Respectfully submitted,

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



A Hawaii Limited Liability Partnership

Independent Auditor's Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information as well as the budgetary comparison for the general fund of the Office of Hawaiian Affairs (OHA), State of Hawai'i, as of and for the year ended June 30, 2013, which collectively comprise OHA's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement. We did not audit the consolidated financial statements of Hi'ilei Aloha LLC and its wholly-owned subsidiaries Hi'ipaka LLC and Hi'ipoi LLC (collectively, "Hi'ilei") and Ho'okele Pono LLC, blended component units, which represents 0.36% of assets and 5.56% of revenues of the governmental funds. Those financial statements were audited by another auditor whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for Hi'ilei and Ho'okele Pono LLC, is based solely on the reports of the other auditor. The consolidated financial statements of Hi'ilei and Ho'okele Pono LLC were not audited in accordance with *Government Auditing Standards*.

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the OHA, as of June 30, 2013, and the respective changes in financial position and the respective budgetary comparison of the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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

Other Information

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated February 7, 2014, on our consideration of OHA's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the OHA's internal control over financial reporting and compliance.

KMH LLP

KMH LLP

Honolulu, Hawai'i
February 7, 2014

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Management's Discussion and Analysis - Unaudited
As of and for the Year Ended June 30, 2013

As management of OHA, we offer the following narrative overview and analysis to readers of our financial statements. While the financial statements and notes present only the financial activities for the fiscal year ended June 30, 2013, management discussion and analysis will address both this year and the year ended June 30, 2012.

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

FINANCIAL HIGHLIGHTS

Government-wide Financial Statements Highlights

Statement of Net Position – The assets of OHA exceeded its liabilities at fiscal year ended June 30, 2013 by \$613,093,035 (presented as “total net position”). Of this amount, \$356,274,639 is reported as “unrestricted”, while \$27,784,204 is reported as “restricted-federal funds” and \$229,034,192 is reported as “invested in capital assets, net of related debt.” The assets of OHA exceeded its liabilities at fiscal year ended June 30, 2012 by \$599,113,695 (presented as “total net position”). Of this amount, \$544,467,424 is reported as “unrestricted”, while \$27,654,608 is reported as “restricted-federal funds” and \$26,991,663 is reported as “invested in capital assets, net of related debt.” Unrestricted net position represents the amount available to be used to meet OHA's ongoing obligations to beneficiaries and creditors. Restricted assets represent amounts that have legal requirements on their use.

Statement of Activities – OHA's total net position, increased by \$13,979,340 (a 2.33% increase) in fiscal year 2013. This was primarily due to revenue from interest and investment earnings in the amount of approximately \$35 million.

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

Governmental Funds Financial Statements Highlights

Governmental Funds – Fund Balances – In fiscal year 2013, OHA's governmental funds reported an ending fund balance of \$385,610,555. Of this total amount, \$630,840, or 0.16% is classified as nonspendable for prepaid expenses and security deposits. Restricted fund balance totaled \$27,780,242 or 7.20%, broken down as follows: 99.94% for Native Hawaiian Revolving Loan Fund program of which \$13,410,186 relates to the long-term portion of outstanding loans, and 0.06% restricted for State Proviso programs and the remainder for other federal programs administered by OHA. \$40,711,267 or 10.56% is

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classified as committed, based on the Board of Trustees' resolution to commit these funds towards the debt service of DHHL-issued revenue bonds. Assigned fund balance comprises 82.08% or \$316,509,436 of fund balance, broken down as follows: \$12,897,172 or 4.08% has been encumbered, \$1,626,689 or 0.51% represents the non-current portion of outstanding loans and \$301,985,575 or 95.41% is available for future expenditures. Negative unassigned fund balance amounts included in the General and Federal Funds will be covered by fiscal year 2014 appropriations and grant draws, respectively.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

Government-wide Financial Statements

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

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

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

It also includes the results of its blended component units, Ho'okele Pono LLC and Hi'ilei Aloha LLC and its wholly-owned subsidiaries, through its separate fiscal year end, December 31, 2012. Ho'okele Pono LLC and Hi'ilei Aloha LLC have been included as blended component units due to the common governing body.

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

Governmental Funds Financial Statements

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

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

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

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

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so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and the governmental activities. These reconciliations are presented in Note 13 to the financial statements.

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

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

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

The governmental funds financial statements are followed by a budgetary comparison statement, which compares the general fund's original budget, final budget, and actual amounts prepared on a budgetary basis. A reconciliation between the actual general fund revenues and expenditures compared to the general fund revenues and expenditures prepared for budgetary purposes is included in Note 3 to the financial statements. The *Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis), General Fund* can be found on page 21.

Notes to Financial Statements

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

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GOVERNMENT-WIDE FINANCIAL ANALYSIS

Statement of Net Position

Summarized financial information of OHA's *Statement of Net Position* as of June 30, 2013 and 2012 is as follows:

	<u>2013</u>	<u>2012</u>
Assets:		
Capital assets	\$ 252,198,625	\$ 27,225,075
Other assets	<u>395,093,374</u>	<u>582,288,232</u>
Total assets	<u><u>\$ 647,291,999</u></u>	<u><u>\$ 609,513,307</u></u>
Liabilities:		
Other liabilities	\$ 9,482,819	\$ 8,465,608
Long-term liabilities	<u>24,716,145</u>	<u>1,934,004</u>
Total liabilities	<u>34,198,964</u>	<u>10,399,612</u>
Net position:		
Invested in capital assets, net of related debt	229,034,192	26,991,663
Restricted – Federal funds	27,784,204	27,654,608
Unrestricted	<u>356,274,639</u>	<u>544,467,424</u>
Total net position	<u>613,093,035</u>	<u>599,113,695</u>
Total liabilities and net position	<u><u>\$ 647,291,999</u></u>	<u><u>\$ 609,513,307</u></u>

As noted earlier, net position may serve over time as a useful indicator of a government's financial position. OHA's net position totaled \$613,093,035 at the end of fiscal year 2013, compared to \$599,113,695 at the end of fiscal year 2012, representing an increase of 2.33% or \$13,979,340.

Unrestricted funds represent the largest portion of OHA's net position (58.11% and 90.88% at June 30, 2013 and 2012, respectively) and are comprised of resources that may be used to meet OHA's ongoing obligations to beneficiaries and creditors. This also includes internally imposed assignments of resources.

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Statement of Activities

Summarized financial information of OHA's *Statement of Activities* for the fiscal years ended June 30, 2013 and 2012 is as follows:

	<u>2013</u>	<u>2012</u>
Revenues:		
Program revenues:		
Operating grants	\$ 403,052	\$ 430,055
Charges for services	767,097	618,929
Interest and investment earnings	19,560	102,566
General revenues:		
Appropriations, net of lapses	2,353,001	2,314,338
Public Land Trust	19,029,735	215,100,000
Interest and investment earnings (losses)	35,089,035	(4,764,619)
Newspaper ads	80,356	102,040
Donations and other	1,137,786	378,693
Hi'ilei Aloha LLC	3,233,561	2,562,821
Non-imposed fringe benefits	191,152	183,305
Total revenues	<u>62,304,335</u>	<u>217,028,128</u>
Expenses:		
Current divisions:		
Board of Trustees	2,085,809	1,958,462
Support Services	18,102,738	15,928,185
Beneficiary Advocacy	22,503,694	24,343,621
Depreciation	1,351,099	506,173
Ho'okele Pono LLC	376,339	216,466
Hi'ilei Aloha LLC	3,909,405	3,938,462
Total expenses	<u>48,329,084</u>	<u>46,891,369</u>
Net transfers (to)/from other funds	<u>4,089</u>	<u>548,043</u>
Changes in net position	<u>\$ 13,979,340</u>	<u>\$ 170,684,802</u>

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OHA's net position increased by \$13,979,340 during the year. Key elements of this increase compared to the prior are as follows:

Public Land Trust revenue decreased by \$196,070,265 from the prior year, primarily due to a settlement related to outstanding ceded land revenues in prior year. On April 11, 2012, the State of Hawai'i approved Senate Bill 2783, which conveyed approximately 30 acres of land in the Kaka'ako Makai area valued at \$200 million.

Total revenues interest and investment earnings increased by \$39,770,428 from the prior year primarily due to improved market conditions during the first, second, and third quarter of fiscal year 2013. Although dividend and interest income, net investment gains related to program revenues decreased by \$83,006, general revenue interest and investment earnings increased by \$39,853,654.

General revenues, donations and others, increased by \$759,093 from prior year primarily due to the acceptance of a 20.75 acre property donation in the ahupua'a of Palauea, between Kīhei and Makena in southeast Maui, valued at approximately \$896,000.

Increases in net position were offset by an increase in expenses in fiscal year 2013 of \$1,437,715. This change was comprised of an increase of \$844,296 in depreciation expense and an increase of \$592,789 related to OHA operations, including its blended component units. The overall increase in expenses related to operations was primarily due to the costs related to properties acquired during the year. Support services expenses increased by \$2,174,553 from prior year while beneficiary advocacy expenses decreased by \$1,839,927 primarily due to the reallocation of certain programmatic expenses between functions during the year. The \$844,296 increase in depreciation expense was primarily due to the properties that were acquired during the year.

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

GOVERNMENTAL FUNDS FINANCIAL ANALYSIS

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

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

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Management's Discussion and Analysis - Unaudited
As of and for the Year Ended June 30, 2013

At the close of fiscal year 2013, OHA's governmental funds reported an ending fund balance of \$385,610,555. Fund balance was segregated in to the following categories: Nonspendable, Restricted, Committed, Assigned and Unassigned.

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

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

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

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

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

At the close of fiscal year 2012, OHA's governmental funds reported an ending fund balance of \$373,822,624. Fund balance was segregated in to the following categories: Nonspendable, Restricted, Committed, Assigned and Unassigned.

Nonspendable fund balance totaled \$1,185,629, or 0.31% due to amounts related to prepaid expenses and security deposits.

Restricted fund balance amounted \$27,687,123 or 7.40%, and was comprised of the following: \$27,638,137 or 99.82% for Native Hawaiian Revolving Loan Fund program of which 14,165,790 relates to the long-term portion of outstanding loans, and \$48,986 or 0.18% restricted for State Proviso programs and the remainder for other federal programs administered by OHA.

Committed fund balance amounted to \$41,341,044 or 11.06% based on the Board of Trustees' resolution to commit these funds towards the debt service of DHHL-issued revenue bonds.

Assigned fund balance amounted to \$303,665,942 or 81.22% and was comprised of the following: \$12,938,690 or 4.26% was encumbered, \$2,176,903 or 0.72% represents the non-current portion of outstanding loans and \$288,550,349 or 95.02% is available for future expenditures.

Office of Hawaiian Affairs, State of Hawai'i

Management's Discussion and Analysis - Unaudited
As of and for the Year Ended June 30, 2013

Unassigned fund balance was (\$19,733) and was covered by fiscal year 2013 appropriations.

OHA's governmental funds experienced an increase of \$11,787,931 in fund balance during fiscal year 2013.

CAPITAL ASSETS AND LONG-TERM LIABILITIES

OHA's investment in capital assets amounted to \$252,198,625 and \$27,225,075, net of depreciation, as of June 30, 2013 and 2012, respectively. Capital assets include land, building, leasehold improvements, equipment and software development.

	<u>2013</u>	<u>2012</u>
Land	\$226,965,802	\$ 24,358,454
Construction in progress	316,860	-
Buildings and improvements	26,206,217	3,172,067
Equipment	4,998,553	4,811,139
Accumulated Depreciation	<u>(6,288,807)</u>	<u>(5,116,585)</u>
Totals	<u>\$252,198,625</u>	<u>\$ 27,225,075</u>

The increase in capital assets is primarily due to the land and building received as settlement for outstanding ceded land revenues, approximately \$200 million, and the acquisition of commercial property in the amount of approximately \$21 million. Additional information regarding OHA's capital assets can be found in Note 9 to the financial statements.

OHA's long-term liabilities include notes payable, accrued vacation, accrued workers' compensation, and capital lease obligation. The increase in long-term liabilities is primarily due to the debt incurred, approximately \$23 million, to finance the acquisition and renovation of commercial property during the year. Additional information about OHA's long-term liabilities can be found in Note 12 to the financial statements.

REQUEST FOR INFORMATION

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

Office of Hawaiian Affairs
Attn: Chief Financial Officer
560 N. Nimitz Hwy, Suite 200
Honolulu, Hawai'i 96817

Office of Hawaiian Affairs, State of Hawai'i

Governmental Funds - Statement of Net Position/Government-Wide Statement of Net Position
June 30, 2013

Assets	Governmental Funds							Adjustments (Note 13)	Government- wide Statement of Net Assets
	Special Revenue Funds						Total		
	General Fund	Public Land Trust	Federal Grants	Other	Ho'okele Pono LLC	Hi'ilei Aloha LLC			
Petty cash	\$ -	\$ 700	\$ -	\$ -	\$ -	\$ 3,650	\$ 4,350	\$ -	\$ 4,350
Cash in State Treasury	393,615	4,426,988	-	-	-	-	4,820,603	-	4,820,603
Cash in banks	-	9,347,809	4,862,332	709,124	234,876	727,854	15,881,995	-	15,881,995
Cash held by investment manager	-	551,307	4,227,438	-	-	-	4,778,745	-	4,778,745
Restricted cash	-	-	70,051	-	-	-	70,051	-	70,051
Accounts receivable	-	5,061,807	88,084	44,797	70,558	295,011	5,560,257	-	5,560,257
Due from other fund	-	454,654	-	-	-	-	454,654	-	454,654
Interest and dividends receivable	-	247,333	45,095	-	-	-	292,428	-	292,428
Inventory, prepaid items and other assets	35,929	481,217	3,962	-	2,300	107,432	630,840	-	630,840
Notes receivable - due within one year	-	721,056	4,176,559	-	-	-	4,897,615	-	4,897,615
Notes receivable - due after one year	-	1,626,689	13,410,186	-	-	-	15,036,875	-	15,036,875
Investments	-	341,098,603	1,566,358	-	-	-	342,664,961	-	342,664,961
Capital assets - net	-	-	-	-	-	-	-	252,198,625	252,198,625
Total assets	\$ 429,544	\$ 364,018,163	\$ 28,450,065	\$ 753,921	\$ 307,734	\$ 1,133,947	\$ 395,093,374	\$ 252,198,625	\$ 647,291,999

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i

Governmental Funds - Statement of Net Position/Government-Wide Statement of Net Position (continued)
June 30, 2013

Liabilities and Fund Balances/Net Assets	Governmental Funds							Adjustments (Note 13)	Government- wide Statement of Net Assets
	Special Revenue Funds						Total		
	General Fund	Public Land Trust	Federal Grants	Other	Ho'okele Pono LLC	Hi'ilei Aloha LLC			
Accounts payable and accrued liabilities	\$ 74,978	\$ 7,511,026	\$ 61,207	\$ 8,236	\$ 179,308	\$ 452,762	\$ 8,287,517	\$ -	\$ 8,287,517
Due to State of Hawaii	-	590,648	150,000	-	-	-	740,648	-	740,648
Due to other fund	-	-	454,654	-	-	-	454,654	-	454,654
Long-term liabilities:									
Due within one year	-	-	-	-	-	-	-	916,164	916,164
Due after one year	-	-	-	-	-	-	-	23,799,981	23,799,981
Total liabilities	74,978	8,101,674	665,861	8,236.00	179,308	452,762	9,482,819	24,716,145	34,198,964
Fund balances/net assets									
Fund balances									
Nonspendable -									
Inventory, prepaid items & security deposits	35,929	481,217	3,962	-	2,300	107,432	630,840	(630,840)	-
Restricted for:									
Beneficiary advocacy	-	-	17,574	-	-	-	17,574	(17,574)	-
Native Hawaiian loan programs	-	-	14,352,482	-	-	-	14,352,482	(14,352,482)	-
Long-term portion of notes receivable	-	-	13,410,186	-	-	-	13,410,186	(13,410,186)	-
Committed to -									
DHHL-issued revenue bonds	-	40,711,267	-	-	-	-	40,711,267	(40,711,267)	-
Assigned to:									
Support services	130,213	4,888,933	-	-	-	-	5,019,146	(5,019,146)	-
Beneficiary advocacy	209,654	7,668,372	-	745,685	-	-	8,623,711	(8,623,711)	-
Ho'okele Pono LLC	-	-	-	-	126,126	-	126,126	(126,126)	-
Hi'ilei Aloha LLC	-	-	-	-	-	573,753	573,753	(573,753)	-
Long-term portion of notes receivable	-	1,626,689	-	-	-	-	1,626,689	(1,626,689)	-
Public Land Trust	-	300,540,011	-	-	-	-	300,540,011	(300,540,011)	-
Unassigned	(21,230)	-	-	-	-	-	(21,230)	21,230	-
Total fund balances	354,566	355,916,489	27,784,204	745,685	128,426	681,185	385,610,555	(385,610,555)	-
Total liabilities and fund balances	\$ 429,544	\$ 364,018,163	\$ 28,450,065	\$ 753,921	\$ 307,734	\$ 1,133,947	\$ 395,093,374		
Net Position:									
Invested in capital assets, net of related debt								229,034,192	229,034,192
Restricted - federal funds								27,784,204	27,784,204
Unrestricted								356,274,639	356,274,639
Total net position								\$ 613,093,035	\$ 613,093,035

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i

Governmental Funds - Statement of Revenues, Expenditures, and Changes in Fund Balances/Government-Wide Statement of Activities
Year Ended June 30, 2013

	Governmental Funds						Adjustments (Note 13)	Government-wide Statement of Activities	
	Special Revenue Funds								
	General Fund	Public Land Trust	Federal Grants	Other	Ho'okele Pono LLC	Hi'ilei Aloha LLC			Total
Expenditures/Expenses:									
Current divisions:									
Board of trustees	\$ 41,069	\$ 2,044,740	\$ -	\$ -	\$ -	\$ -	\$ 2,085,809	\$ -	\$ 2,085,809
Support services	2,230,388	40,143,477	877,636	434	-	-	43,251,935	(25,149,197)	18,102,738
Beneficiary advocacy	116,124	22,363,884	-	23,686	-	-	22,503,694	-	22,503,694
Depreciation	-	-	-	-	-	-	-	1,351,099	1,351,099
Ho'okele Pono LLC	-	-	-	-	376,339	-	376,339	-	376,339
Hi'ilei Aloha LLC	-	-	-	-	-	4,380,816	4,380,816	(471,411)	3,909,405
Total expenditures/expenses	2,387,581	64,552,101	877,636	24,120	376,339	4,380,816	72,598,593	(24,269,509)	48,329,084
Program Revenues:									
Charges for services	-	-	767,097	-	-	-	767,097	-	767,097
Operating grants	-	-	222,722	-	180,330	-	403,052	-	403,052
Interest and investment earnings	-	-	17,413	2,147	-	-	19,560	-	19,560
Total program revenues	-	-	1,007,232	2,147	180,330	-	1,189,709	-	1,189,709
Net program expenditures/expenses	(2,387,581)	(64,552,101)	129,596	(21,973)	(196,009)	(4,380,816)	(71,408,884)	24,269,509	(47,139,375)
General Revenues:									
Appropriations, net of lapses of \$17,871	2,353,001	-	-	-	-	-	2,353,001	-	2,353,001
Public Land Trust	-	19,029,735	-	-	-	-	19,029,735	-	19,029,735
Interest and investment earnings	-	35,089,035	-	-	-	-	35,089,035	-	35,089,035
Newspaper advertisements	-	-	-	80,356	-	-	80,356	-	80,356
Donations and other	-	171,301	-	70,085	-	-	241,386	896,400	1,137,786
Hi'ilei Aloha LLC	-	-	-	-	-	3,233,561	3,233,561	-	3,233,561
Non-imposed fringe benefits	191,152	-	-	-	-	-	191,152	-	191,152
Total general revenues	2,544,153	54,290,071	-	150,441	-	3,233,561	60,218,226	896,400	61,114,626
Excess of revenues (deficiency) over expenditures/expenses	156,572	(10,262,030)	129,596	128,468	(196,009)	(1,147,255)	(11,190,658)	25,165,909	13,975,251
Other Financing (Uses) Sources:									
Proceeds from debt	-	22,974,500	-	-	-	-	22,974,500	(22,974,500)	-
Net transfers (to) from other funds	-	(1,437,839)	-	9,720	203,757	1,228,451	4,089	-	4,089
Net change in fund balance/net position	156,572	11,274,631	129,596	138,188	7,748	81,196	11,787,931	2,191,409	13,979,340
Fund Balances/Net Position:									
Beginning of year	197,994	344,641,858	27,654,608	607,497	120,678	599,989	373,822,624	225,291,071	599,113,695
End of year	\$ 354,566	\$ 355,916,489	\$ 27,784,204	\$ 745,685	\$ 128,426	\$ 681,185	\$ 385,610,555	\$ 227,482,480	\$ 613,093,035

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i

Statement of Revenues and Expenditures - Budget and Actual (Budgetary Basis), General Fund
 Year Ended June 30, 2013

	Original Budget	Final Budget	Actual (budgetary basis)	Variance
Revenues -				
State appropriations, net of lapses	\$ 2,370,872	\$ 2,370,872	\$ 2,353,001	\$ (17,871)
Total revenues	2,370,872	2,370,872	2,353,001	(17,871)
Expenditures:				
Board of Trustees	28,435	28,435	29,664	(1,229)
Support services	700,159	700,159	1,094,066	(393,907)
Beneficiary advocacy	1,642,278	1,642,278	1,248,721	393,557
Total expenditures	2,370,872	2,370,872	2,372,451	(1,579)
DEFICIENCY OF REVENUES UNDER EXPENDITURES	\$ -	\$ -	\$ (19,450)	\$ (19,450)

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2013

1. Financial Reporting Entity

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

Hi'ilei Aloha LLC and Ho'okele Pono LLC, Hawai'i limited liability companies formed by OHA in September 2007 and May 2010, respectively, are presented as blended component units due to the common governing bodies with the primary government. The results of Hi'ilei Aloha LLC and its wholly-owned subsidiaries and Ho'okele Pono as of December 31, 2012, their fiscal year ends, have been included in the financial statements. For the period January 1, 2013 through June 30, 2013, Hi'ilei Aloha LLC and Ho'okele Pono LLC have not entered into any significant or unusual transactions.

Hi'ilei Aloha LLC and its wholly-owned subsidiaries, Hi'ipaka LLC and Hi'ipoi LLC are exempt from federal income tax under Sections 501 (a) and 501 (c)3 of the Internal Revenue Code. Ho'okele Pono LLC is also exempt from federal income taxes under Section 501 (a) and 501 (c)3 of the Internal Revenue Code.

2. Significant Accounting Policies

a. Basis of Presentation

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

b. Governmental Funds Financial Statements

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

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2013

2. Significant Accounting Policies (continued)

b. Governmental Funds Financial Statements (continued)

Expenditures are generally recorded when a liability is incurred as under accrual accounting. Modifications to the accrual basis of accounting include the employees' vested annual leave, workers' compensation, and capital lease obligations which are recorded as expenditures when utilized or paid. The amount of accumulated annual leave unpaid, accrued workers' compensation, and capital lease obligations at June 30, 2013 have been reported only in the government-wide financial statements.

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

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

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

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

Special Revenue Funds – These funds include OHA's proceeds and income from the Public Land Trust as defined in Chapter 10, Hawai'i Revised Statutes, as well as the proceeds and income of the Native Hawaiian Rights Fund, the Native Hawaiian Revolving Loan Fund (NHRLF) and other grants included in the Federal Grants Fund. Expenditures reflect those from the specific grant or designated fund and from other OHA Board of Trustee appropriations of the Public Land Trust Funds. Hi'ilei Aloha LLC and Ho'okele Pono LLC have also been accounted for as special revenue funds.

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

Notes to the Basic Financial Statements
June 30, 2013

2. Significant Accounting Policies (continued)

c. Government-Wide Financial Statements

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

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

d. Investments

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

e. Inventory and Prepaid Items

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

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

Notes to the Basic Financial Statements
June 30, 2013

2. Significant Accounting Policies (continued)

f. Capital Assets

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

Buildings and leasehold improvements	30 years
Furniture, fixtures, and equipment	5 years

g. Accrued Vacation and Compensatory Pay

OHA accrues all vacation and compensatory pay at current salary rates; including additional amounts for certain salary-related expenses associated with the payment of compensated absences, in accordance with GASB Codification Section C60, Compensated Absences. The June 30, 2013 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.

h. Risk Management

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

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2013

2. Significant Accounting Policies (continued)

i. Governmental Funds – Fund Balance

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

Nonspendable Fund Balance

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

Restricted Fund Balance

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

Committed Fund Balance

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

Assigned Fund Balance

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

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2013

2. Significant Accounting Policies (continued)

i. Governmental Funds – Fund Balance (continued)

Unassigned Fund Balance

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

Stabilization Arrangements

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

OHA's Fiscal Reserve is comprised of lapsed fiscal year funding for its Public Land Trust budget. The Public Land Trust fiscal year budget is subject to Trustee approval prior to the start of each fiscal year. Use of Fiscal Reserve funding is subject to Board of Trustee approval and may be used to cover any current year funding shortfalls. As of June 30, 2013, OHA had approximately, \$8.2 million in its Fiscal Reserve.

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

Notes to the Basic Financial Statements
June 30, 2013

2. Significant Accounting Policies (continued)

j. Encumbrances

Encumbrances against budgeted appropriations are recorded upon the execution of contracts or purchase orders. Such encumbrances have been classified by expenditure division (i.e. Board of Trustees, Support services, Beneficiary advocacy) by fund balance classification (i.e. Restricted, Committed, Assigned) in the governmental funds financial statements. The related expenditure is reported in the period in which the liability is incurred. Encumbrances as of June 30, 2013 consist of the following:

	<u>Encumbrances</u>
General Fund	\$ 339,867
Public Land Trust	12,557,305
Federal Grants	307,089
Other	<u>14</u>
	<u><u>\$ 13,204,275</u></u>

k. Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from estimates.

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2013

2. Significant Accounting Policies (continued)

l. Concentrations of Credit Risk

The financial instruments that potentially expose OHA to concentrations of credit risk consist principally of its investments and receivables. See Note 8 for a discussion of credit risk of OHA's investments. OHA extends credit to native Hawaiian and Hawaiian persons and agencies that use OHA's funds for the betterment of Native Hawaiians and Hawaiians. The mix of notes receivable at June 30, 2013 are as follows:

Native Hawaiian and Hawaiian persons	95.1%
Agencies	4.5%
Other	<u>0.4%</u>
	<u>100.0%</u>

m. Notes Receivables

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

n. Recent Accounting Pronouncements

In March 2012, the GASB issued GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* (GASB 65). This Statement reclassifies, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as revenues and expenses, certain items that were previously reported as assets and liabilities. The provisions of GASB 65 are effective for periods beginning after December 15, 2012. Management is currently assessing the impact of this Statement on its financial position and results of operations and has not determined if the adoption will have a material effect on its financial statements.

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

Notes to the Basic Financial Statements
June 30, 2013

2. Significant Accounting Policies (continued)

n. Recent Accounting Pronouncements (continued)

In June 2012, GASB issued Statement No. 68 (GASB 68), *Accounting and Reporting for Pensions (an amendment of GASB Statement No. 27)*. GASB 68 amends the accounting guidance related to employers' accounting for pension plans administered through trusts or similar arrangements and requires the recognition of a liability for the employers' accumulated obligation for pension benefits. GASB 68 also provides additional guidance regarding the recognition of annual costs of pension benefits and revises the disclosure requirements for the notes to the financial statements and required supplementary information. GASB 68 will be effective for the OHA's financial statements for the year ending June 30, 2015. Management does not believe the adoption of this Statement will have a material effect on its financial statements.

In April 2013, the GASB issued Statement No. 70, *Accounting and Reporting for Nonexchange Financial Guarantees*. This Statement requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. This Statement requires a government that has issued an obligation guaranteed in a nonexchange transaction to recognize revenue to the extent of the reduction in its guaranteed liabilities. This Statement also requires a government that is required to repay a guarantor for making a payment on a guaranteed obligation or legally assuming the guaranteed obligation to continue to recognize a liability until legally released as an obligor. The provisions of this Statement are effective for periods beginning after June 15, 2013. Management does not believe the adoption of this Statement will have a material effect on its financial statements.

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Notes to the Basic Financial Statements
June 30, 2013

3. Biennial Budget

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

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

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

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

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Notes to the Basic Financial Statements
June 30, 2013

3. Biennial Budget (continued)

Adjustments necessary to reconcile the results of operations for the year ended June 30, 2013 from the budgetary basis to GAAP basis are as follows:

Deficiency of revenues under expenditures – actual (budgetary basis)	\$ (19,450)
Reserve for encumbrances at June 30	339,867
Prior year reserve for encumbrances	(57,100)
Prepaid expenditures not recognized for budgetary purposes – net of prior-year accruals	(12,569)
Expenditures for liquidation of prior-year encumbrances	<u>(94,176)</u>
Excess of revenues over expenditures – actual (GAAP) basis	<u>\$ 156,572</u>

4. Appropriations

OHA is authorized to transfer appropriation amounts and staffing positions between programs for operating purposes, provided that a report of all transfers are made to the State Legislature prior to convening of the next legislative session. Act 95, Sessions Laws of Hawai'i (SLH) 2011 authorizes a total of \$2,370,872 in general funds.

5. Cash

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

OHA's cash included in State pooled funds is fully collateralized with securities held by third-party agents in the State's name, as required by the Hawai'i Revised Statutes, Section 38-8. At June 30, 2013, OHA's cash held in the State Treasury totaled \$4,820,603.

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Notes to the Basic Financial Statements
June 30, 2013

5. Cash (continued)

OHA holds cash in banking institutions held outside of the State Treasury to maximize investment returns in accordance with Hawai'i Revised Statutes, Section 10-5. At June 30, 2013, OHA did not have balances that exceed Federal Deposit Insurance Corporation (FDIC) insurance limits. Balances may at times, however, exceed the FDIC's insurance limits.

At December 31, 2012, Hi'ilei Aloha LLC had deposits totaling \$727,854 with a corresponding bank balance of \$665,036. Hi'ilei Aloha LLC and its wholly-owned subsidiaries, Hi'ipaka LLC and Hi'ipoi LLC maintain separate legal entity cash accounts with a financial institution in the State of Hawai'i. Balances are insured up to \$250,000 per account holder by the FDIC. Balances may at times, however, exceed the FDIC's insurance limits.

At December 31, 2012, Ho'okele Pono LLC did not have bank balances that exceed FDIC insurance limits. Balances may at times, however, exceed the FDIC's insurance limits.

6. Inventory, Prepaid Items and Other Assets

At June 30, 2013, OHA did not maintain inventory. At December 31, 2012, Ho'okele Pono LLC, did not maintain inventory. At December 31, 2012, Hi'ilei Aloha LLC, had inventory totaling \$64,777 which consisted of items held for sale.

At June 30, 2013, OHA had prepaid items totaling \$521,108. At December 31, 2012, Hi'ilei Aloha LLC, and Ho'okele Pono LLC had prepaid items totaling \$42,655 and \$2,300, respectively.

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Notes to the Basic Financial Statements
June 30, 2013

7. Notes Receivable

Notes receivable at June 30, 2013 consist of the following:

Loan receivable serviced by First Hawaiian Bank (of which \$1,426,312 is guaranteed by Department of Hawaiian Home Lands (DHHL))	\$ 1,881,104
Native Hawaiian Revolving Loan Fund	18,405,768
Other	<u>1,590,320</u>
Total	21,877,192
Less allowance for doubtful accounts	<u>(1,942,702)</u>
Net	19,934,490
Amounts due within one year	<u>(4,897,615)</u>
Amounts due after one year	<u><u>\$ 15,036,875</u></u>

8. Investments

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

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Notes to the Basic Financial Statements
June 30, 2013

8. Investments (continued)

Investments as of June 30, 2013 and their maturities were as follows:

Investment type	Fund	Fair value	Investment maturities (in years)	
			Less than one	One thru five
Mutual funds	NHTF	\$ 143,326,526	\$ 143,326,526	\$ -
Common trust funds	NHTF	61,880,223	61,880,223	-
Commingled funds	NHTF	49,663,592	49,663,592	-
Private equity	NHTF	41,063,920	-	41,063,920
Hedge funds	NHTF	39,846,942	39,846,942	-
Private debt	NHTF	5,317,400	-	5,317,400
U.S. treasuries	NHRLF	984,929	-	984,929
U.S. agencies	NHRLF	581,429	-	581,429
Total investments		342,664,961	294,717,283	47,947,678
Money market funds (not considered investments)	Various	4,778,745	4,778,745	-
Total		<u>\$ 347,443,706</u>	<u>\$ 299,496,028</u>	<u>\$ 47,947,678</u>

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

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Notes to the Basic Financial Statements
June 30, 2013

8. Investments (continued)

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

a. Foreign Currency Risk

To diversify the NHTF portfolio against market fluctuations, OHA's investment policy allows for investments in foreign countries. As of June 30, 2013, OHA's foreign currency risks are as follows:

Investment Type	Currency	Value (US Dollar)
Mutual funds	Various	\$ 143,326,526
Common trust funds	Various	61,880,223
Commingled funds	Various	49,663,592
Private equity	Euro	40,943,920
Hedge funds	Various	39,846,942
Private debt	Various	5,317,400
Total		<u>\$ 340,978,603</u>

b. Interest Rate Risk

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

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

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

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Notes to the Basic Financial Statements
June 30, 2013

8. Investments (continued)

c. Credit Risk

Pursuant to 45 C.P.R. 1336.72(a), "any portion of the revolving loan fund that is not required for expenditure must be invested in obligations of the United States or in obligations guaranteed or insured by the United States." At June 30, 2013, credit rates for all securities of government agencies were rated at Aaa (Moody's) or AAA (Standard & Poor's).

d. Concentration of Credit Risk

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

9. Capital Assets

On July 1, 2012, title to approximately 30 acres of land in the Kaka'ako Makai area on the island of Oahu valued at \$200 million, was conveyed to OHA. A receivable for this amount was booked as of June 30, 2012 and was converted to capital assets during the year ended June 30, 2013. OHA has retained the current property manager and will continue to honor existing tenant leases.

On August 20, 2012, OHA acquired the Gentry Pacific Design Center (the Center), located in Honolulu from GPP, LLC for approximately \$21 million. The acquisition was financed through a loan with a third party financial institution (Note 12). OHA has retained the current property manager and will continue to honor existing leases.

On September 13, 2012, OHA agreed to accept a 20.75 acre property donation that will be maintained as a cultural preserve in the ahupua'a of Palauea, between Kīhei and Makena in southeast Maui. The fair value of the property is approximately \$896,000. OHA intends to enter into a management agreement with the University of Hawai'i Maui College, which will develop a cultural preservation plan for the site.

On December 10, 2012, approximately 516 acres of Ag-1 (Restricted Agriculture) zoned land located in central Oahu was acquired from the Galbraith Trust through a negotiated sale price of \$25 million for four clusters. OHA contributed \$3 million for Cluster 1, with the additional funding for the remaining Clusters coming from the Trust for Public Land, the Army Compatible Use Buffer program (ACUB) and the City & County Clean Water & Natural Lands Fund.

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Notes to the Basic Financial Statements
June 30, 2013

9. Capital Assets (continued)

OHA intends to preserve and protect the Kukaniloko, which is located on the zoned land, by providing a buffer against future incompatible development in the area, explore the development compatible agricultural uses and other programmatic initiatives, and contribute to Hawaii's food self-sufficiency, preservation of open space and watershed lands and overall community planning goals for central Oahu.

OHA's capital assets activities during the year ended June 30, 2013 was as follows:

	Balance July 1, 2012	Additions	Deductions	Balance June 30, 2013
Capital assets not depreciated:				
Land	\$ 11,354,633	\$ 202,607,348	\$ -	\$ 213,961,981
Construction in progress	-	316,860	-	316,860
Total capital assets not depreciated	<u>11,354,633</u>	<u>202,924,208</u>	<u>-</u>	<u>214,278,841</u>
Capital assets being depreciated:				
Buildings	1,041,304	22,659,052	-	23,700,356
Leasehold improvements	620,310	14,911	-	635,221
Furniture, fixtures and equipment	4,215,680	255,731	(97,535)	4,373,876
Total capital assets being depreciated	5,877,294	22,929,694	(97,535)	28,709,453
Less accumulated depreciation	<u>(4,587,708)</u>	<u>(1,094,683)</u>	<u>96,871</u>	<u>(5,585,520)</u>
Capital assets being depreciated - net	<u>1,289,586</u>	<u>21,835,011</u>	<u>(664)</u>	<u>23,123,933</u>
Capital assets, net	<u>\$ 12,644,219</u>	<u>\$ 224,759,219</u>	<u>\$ (664)</u>	<u>\$ 237,402,774</u>

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Notes to the Basic Financial Statements
June 30, 2013

9. Capital Assets (continued)

Hi'ilei Aloha LLC's capital assets activities as of December 31, 2012 are as follows:

	Balance January 1, 2012	Additions	Deductions	Balance December 31, 2012
Capital assets not depreciated:				
Land	\$ 13,003,821	\$ -	\$ -	\$ 13,003,821
Total capital assets not depreciated	<u>13,003,821</u>	<u>-</u>	<u>-</u>	<u>13,003,821</u>
Capital assets being depreciated:				
Buildings	968,388	-	-	968,388
Leasehold improvements	542,065	360,187	-	902,252
Furniture, fixtures and equipment	<u>595,459</u>	<u>159,230</u>	<u>(130,012)</u>	<u>624,677</u>
Total capital assets being depreciated	2,105,912	519,417	(130,012)	2,495,317
Less accumulated depreciation	<u>(528,877)</u>	<u>(256,416)</u>	<u>82,006</u>	<u>(703,287)</u>
Capital assets being depreciated - net	<u>1,577,035</u>	<u>263,001</u>	<u>(48,006)</u>	<u>1,792,030</u>
Capital assets, net	<u>\$ 14,580,856</u>	<u>\$ 263,001</u>	<u>\$ (48,006)</u>	<u>\$ 14,795,851</u>

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Notes to the Basic Financial Statements
June 30, 2013

10. Capital Leases

OHA leases photocopiers and mail postage meter machines for all offices. Capital leases are recorded as assets and liabilities and amortized over the term of the lease agreement by use of the straight line method. The amortization of assets recorded under capital leases is included with depreciation expenses. As of June 30, 2013, assets recorded under capital lease included in machinery, equipment, furniture and fixtures is \$304,678 and related amortization is \$143,933.

At June 30, 2013, the current portion of minimum lease payments is \$61,102 and the long-term obligation is \$128,831. Below are minimum lease payments through 2018 and the computation of the current and long-term capital lease obligation:

Fiscal year ending June 30,	
2014	\$ 66,514
2015	65,030
2016	51,920
2017	15,055
2018	<u>691</u>
Total minimum lease payments	199,210
Less interest	<u>(9,277)</u>
Present value of minimum lease payments	189,933
Less current portion	<u>(61,102)</u>
Long-term capital lease obligation	<u><u>\$ 128,831</u></u>

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2013

11. Operating Leases

OHA leases office space and equipment under various noncancelable operating leases through March 2033. Future minimum payments under all leases as of June 30, 2013 are as follows:

Fiscal year ending June 30,	
2014	\$ 293,000
2015	373,000
2016	33,000
2017	9,000
2018	1
Thereafter	<u>15</u>
Total	<u>\$ 708,016</u>

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

Rent expense (including taxes and common area maintenance) under all operating leases was approximately \$1,367,000 for the year ended June 30, 2013.

Hi'ilei Aloha LLC leases office space for its office located in Honolulu, Hawai'i, from OHA, under a lease that expires February 2014, and contains a renewal option of twelve months. Base rent is approximately \$40,884 per year, plus a proportionate share of building operating expenses and general excise tax. It previously leased a poi factory and an adjoining office in Kaua'i, under a lease that was assigned to a separate tax-exempt organization effective December 31, 2012.

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Notes to the Basic Financial Statements
June 30, 2013

11. Operating Leases (continued)

Future minimum payment obligations under all leases as of December 31, 2012 are approximately as follows:

Year ending December 31,	
2013	\$ 40,900
2014	6,900
	<hr/>
Total	<u>\$ 47,800</u>

Rent expense under operating leases totaled approximately \$65,800 for the year ended December 31, 2012.

Portions of Kaka'ako Makai (Note 9) and the Center (Note 9) are currently leased under operating lease arrangements that expire through 2042 and 2018, respectively. For the year ended June 30, 2013, rental revenue from Kaka'ako Makai and the Center amounted to approximately \$1,509,000 and \$2,441,000, respectively, and are recorded in the financial statements under General Revenues in the PLTF.

As of June 30, 2013, approximate minimum future lease rentals under non-cancellable operating leases are as follows:

Fiscal year ending June 30,	
2014	\$ 1,746,500
2015	1,319,500
2016	1,080,500
2017	781,500
2018	683,700
2019-2023	2,841,000
2024-2028	2,153,100
2029-2033	2,153,100
2034-2038	1,804,700
2039-2042	1,442,800
	<hr/>
Total	<u>\$ 16,006,400</u>

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Notes to the Basic Financial Statements
June 30, 2013

12. Long-Term Liabilities

On August 14, 2012, OHA entered into a \$21,370,000 long term note payable to finance the purchase of the Center (Note 9). The interest rate is fixed at 3.35%. The note is due in full on September 1, 2022 and is collateralized by a mortgage lien on the Center, assignment of OHA's right, title and interest as landlord in and to any rents under tenant leases and rental agreements on the Center and security interest in all furniture, fixtures, and equipment. On July 26, 2013 the agreement was modified to increase the interest rate to 3.6% and include certain financial covenants. Future principal and interest payments are as follows:

Year ending June 30,	Principal	Interest	Total
2014	\$ -	\$ 725,838	\$ 725,838
2015	-	725,838	725,838
2016	455,914	720,097	1,176,011
2017	561,514	701,748	1,263,262
2018	580,866	682,376	1,263,242
2019-2023	19,771,706	2,621,380	22,393,086
Total	<u>\$ 21,370,000</u>	<u>\$ 6,177,277</u>	<u>\$ 27,547,277</u>

On June 28, 2013 OHA entered into a \$6,758,000 line of credit to finance the renovation of the Center (Note 9). OHA had drawn \$1,604,500 as of June 30, 2013. The interest rate is contingent upon certain elections by OHA. The line of credit is due in full on June 28, 2023. The line of credit is collateralized by all investment property and financial assets held in certain investment accounts. There were no principal payments made as of June 30, 2013. The line of credit is also subject to certain financial covenants. At June 30, 2013, OHA was in compliance with those covenants. Future principal and interest payments are as follows:

Year ending June 30,	Principal	Interest	Total
2014	\$ -	\$ 20,056	\$ 20,056
2015	-	20,056	20,056
2016	-	20,056	20,056
2017	-	20,056	20,056
2018	200,563	57,661	258,224
2019-2023	1,403,937	193,041	1,596,978
Total	<u>\$ 1,604,500</u>	<u>\$ 330,926</u>	<u>\$ 1,935,426</u>

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Notes to the Basic Financial Statements
June 30, 2013

12. Long-Term Liabilities (continued)

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

Long-term liabilities for the year ended June 30, 2013 are as follows:

	Balance July 1, 2012	Additions	Reductions	Balance June 30, 2013	Amount due within one year	Amount Due after one year
Accrued vacation	\$ 1,521,605	\$ 714,819	\$ (744,257)	\$ 1,492,167	\$ 855,062	\$ 637,105
Workers' compensation	178,987	716	(120,158)	59,545	-	59,545
Capital lease obligation	233,412	13,455	(56,934)	189,933	61,102	128,831
Notes payable	-	21,370,000	-	21,370,000	-	21,370,000
Line of credit	-	1,604,500	-	1,604,500	-	1,604,500
Long- term liabilities	<u>\$ 1,934,004</u>	<u>\$23,703,490</u>	<u>\$ (921,349)</u>	<u>\$24,716,145</u>	<u>\$ 916,164</u>	<u>\$ 23,799,981</u>

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

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

Total fund balance – governmental funds	\$ 385,610,555
Amounts reported for governmental activities in the statement of net position is different because:	
Net capital assets used in governmental activities are not current financial resources and therefore are not reported in the funds	252,198,625
Long-term liabilities not due and payable in the current period and therefore not reported in the funds:	
Accrued vacation	(1,492,167)
Accrued workers' compensation	(59,545)
Capital lease obligation	(189,933)
Note payable	(21,370,000)
Line of credit payable	(1,604,500)
Subtotal	<u>(24,716,145)</u>
Total net position – government-wide	<u>\$ 613,093,035</u>

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Notes to the Basic Financial Statements
June 30, 2013

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

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

Net change in fund balances – total governmental funds	\$ 11,787,931
Amounts reported for governmental activities in the statement of activities is different because:	
Governmental funds report capital outlays and capital lease payments as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation and amortization expense.	
Expenditures for capital assets	25,476,919
Add current year depreciation and other changes	<u>(1,351,099)</u>
	24,125,820
The net effect of other miscellaneous transactions involving capital assets.	
Donations of capital assets	896,400
Loss on disposal of capital assets	<u>(48,670)</u>
	847,730
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	29,438
Accrued workers' compensation	119,442
Capital lease obligation	43,479
Note payable	(21,370,000)
Line of credit payable	<u>(1,604,500)</u>
Subtotal	<u>(22,782,141)</u>
Changes in net position – government-wide	<u><u>\$ 13,979,340</u></u>

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2013

14. Employee Benefits

a. Defined Benefit Pension Plans

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

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

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

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

In the hybrid plan, employees may elect normal retirement at age 62 with five years of credited service or at age 55 with 30 years of credited service, or elect early retirement at age 55, with 20 years of credited service.

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Notes to the Basic Financial Statements
June 30, 2013

14. Employee Benefits (continued)

a. Defined Benefit Pension Plans (continued)

Such employees are entitled to retirement benefits, payable monthly for life, of 2% of their AFC, as defined for each year of credited service. Benefits fully vest on reaching five years of service, retirement benefits are actuarially reduced for early retirement. Covered hybrid plan employees are required by State statute to contribute 6.0% of their salary to the plan; OHA is required by State statute to contribute the amounts determined by actuarial valuations.

Contributions by OHA for the fiscal years ending June 30, 2013, 2012, and 2011 were approximately \$1,354,000; \$1,324,000; and \$1,225,000, respectively. The contribution rate for the fiscal years ending June 30, 2013, 2012, and 2011 was 15.0%. The ERS issues a publicly available financial report that includes financial statements and required supplementary information.

The ERS issues a publically 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, Hawai'i 96813-2980 or by calling (808) 586-1735.

b. Post-Retirement Health Care and Life Insurance Benefits

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

OHA's annual other postemployment benefit (OPEB) cost is allocated by the State based on a percentage of OHA's payroll. The State has elected not to allocate an additional share of its annual required contribution to OHA. As such, OHA has not recorded a liability for OPEB as of June 30, 2013. OHA contributed approximately \$926,000 in OPEB expenses for the fiscal year ended June 30, 2013.

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Notes to the Basic Financial Statements
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14. Employee Benefits (continued)

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

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

c. Trustee Retirement Plan

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

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

Hi'ilei Aloha LLC and Ho'okele Pono LLC offer 401(k) profit sharing plans. Employees become eligible upon six (6) months of employment and may contribute to the plan to the extent allowed by law. Hi'ilei Aloha LLC and Ho'okele Pono match employees' contributions up to a specified percentage of salary. For the year ended December 31, 2012, contribution expense amounted to \$51,265 and \$2,480 for Hi'ilei Aloha LLC and Ho'okele Pono LLC, respectively.

e. Sick Leave

Accumulated sick leave amounted to \$2,592,494 as of June 30, 2013. Sick leave accumulates at the rate of 14 hours for each month of service, as defined, without limit. Sick pay can be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for sick leave is recorded in the accompanying financial statements.

15. Non-Imposed Employee Fringe Benefits

Payroll fringe benefit costs for employees of OHA funded by state appropriations (general fund) are assumed by the State and are not charged to OHA's operating funds. These costs, totaling \$191,152 for the fiscal year ended June 30, 2013, have been reported as revenues and expenditures of OHA's general fund.

Office of Hawaiian Affairs, State of Hawai'i

Notes to the Basic Financial Statements
June 30, 2013

16. Risk Management and Contingent Liabilities

a. Workers' Compensation and Other Self-Insurance Liabilities

As a state agency, OHA participates in the state's risk management program. The State maintains certain insurance coverage to satisfy bond indenture agreements as well as for other purposes, but is substantially self-insured for all other perils. The State records a liability for risk financing and insurance related losses, including incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies. In addition to the state coverage, OHA purchases Public Officials and Employment Practices Liability insurance, Bankers' Professional Liability insurance, and general and excess liability for property owned or required by lease agreements entered into.

The State is self-insured for workers' compensation. Accordingly, OHA is liable for workers' compensation claims filed by its employees. Liabilities for workers' compensation claims are established if information indicates that it is probable that liabilities have been incurred and the amount of those claims can be reasonably estimated. In fiscal 2013 OHA purchased a third party workers' compensation policy, but was still liable for outstanding claims related to periods in which OHA was self-insured. The workers' compensation reserve approximated \$60,000 at June 30, 2013. The estimated losses will be paid from the NHTF.

b. Ceded Lands - Public Land Trust

In *Office of Hawaiian Affairs v. Hawai'i Housing Authority* ("OHA v. HHA"), Civil No. 95-2682-07, all proceedings of the lawsuit were stayed on January 11, 2000 pending the Hawai'i Supreme Court's decision in *Office of Hawaiian Affairs v. State of Hawai'i* ("OHA v. State I"), Docket No. 07-1372. OHA disagreed that the decision rendered by the Hawai'i Supreme Court on September 12, 2001 in *OHA v. State I* required the dismissal of the claims in *OHA v. HHA* (which relates to the valuation of five parcels transferred to HHA for affordable public housing units). OHA had sued for new appraisals and further payment but the State of Hawai'i counterclaimed alleging that the amounts paid were in error. On July 1, 2012, the State of Hawai'i conveyed the Kaka'ako Makai, valued at \$200 million, to OHA, settling all claims relating to amounts past due for the pro rata share of ceded land revenues. This case will have no further financial impact. There has been no financial impact to the current fixed sum for OHA's pro rata share of the revenues from the Hawai'i State Legislature.

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Notes to the Basic Financial Statements
June 30, 2013

16. Risk Management and Contingent Liabilities (continued)

c. Civil Complaints

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

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

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

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

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Notes to the Basic Financial Statements
June 30, 2013

16. Risk Management and Contingent Liabilities (continued)

d. Threatened Litigation

On October 30 2013, a former employee submitted a Charge of Discrimination with the Hawaii Civil Rights Commission and the Equal Employment Opportunity Commission. Mediation is currently scheduled for February 2014.

e. Quiet Title Litigation

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

As of June 30, 2013, OHA is currently evaluating its potential interest in 27 quiet title actions. OHA continues to monitor this action for any potential escheated interest.

f. Litigation

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

g. Hi'ilei Aloha LLC

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

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Notes to the Basic Financial Statements
June 30, 2013

17. Related Party Transactions

OHA receives a portion of ceded land revenues from various state agencies. In June 2006, Act 178 was passed which laid the foundation for a quarterly guaranteed ceded land revenue stream of \$3,775,000, totaling \$15,100,000 per year. The total received during the year ended June 30, 2013 was \$15,100,000 as reported in the financial statements under general revenue, public land trust. As of June 30, 2013, there was no related receivables reported in the financial statements under the PLTF.

Besides property leased from DLNR, as discussed in Note 11, Executive Order 3724 granted OHA a set aside of land located in Kekaha, Kaua'i (Kekaha Armory), to be used for Hawaiian cultural and educational purposes in which OHA would control and manage the property. OHA is responsible for all maintenance costs associated with the property. Upon cancellation of the Executive Order and/ or in the event of non-use for a continuous period of one year, for purposes described above, the property will revert back to DLNR, free of all liens and encumbrances. Unless sooner terminated, OHA leases the Kekaha Armory to a not-for-profit organization for a maximum period of 65 years commencing on November 2000, for \$1 per year to utilize such property for purposes in accordance with the Executive Order.

Payments made to Hi'ilei Aloha LLC and Ho'okele Pono LLC, during fiscal year 2013 totaled \$1,432,208, resulting in a net operating transfer in on the fund financial statements. The blended component units and each of the respective subsidiaries are legally separate reporting entity from OHA as discussed in Note 1.

In December 2008, OHA and DHHL mutually agreed to a collaborative financing arrangement to provide funds for DHHL's use in the planning, design and construction of infrastructure for homesteads for native Hawaiians on properties owned and controlled by DHHL, in fulfillment of OHA's mission to better the conditions of native Hawaiians. OHA's obligation under the agreement was to pay DHHL an annual fee not to exceed \$3,000,000 for 30 years. For the year ended June 30, 2013, OHA remitted \$3,000,000 to DHHL and amounts have been presented as beneficiary advocacy expenditures in the PLTF; governmental funds – statement of revenues, expenditures, and changes in fund balances. As of June 30, 2013, OHA has committed \$40,711,267 of its fund balances for future payments to DHHL.

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Notes to the Basic Financial Statements
June 30, 2013

17. Related Party Transactions (continued)

On April 11, 2012, the State of Hawai'i approved Senate Bill 2783 (SB 2783). SB 2783 conveyed approximately 30 acres of land in the Kaka'ako Makai area on the island of Oahu valued at approximately \$200 million. Title was conveyed to OHA on July 1, 2012.

18. Subsequent Events

OHA has evaluated subsequent events through February 7, 2014, the date on which the financial statements were available to be issued.