

Financial statements and independent auditors' report

**Office of Hawaiian Affairs**

**State of Hawai'i**

June 30, 2006

Office of Hawaiian Affairs  
State of Hawai'i

CONTENTS

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

Office of Hawaiian Affairs  
State of Hawai'i

INTRODUCTION

Year ended June 30, 2006

**GENERAL**

*Organization* – Office of Hawaiian Affairs (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.

The purposes of OHA include the following:

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

**DIVISIONS**

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

The title and objective of each division are listed below:

Division title	Division objectives
1. Board of Trustees	To work for the betterment of all Hawaiians by setting policy in response to the concerns and interest of the beneficiaries, in order to ensure the well being of Native Hawaiians; to protect their rights and entitlements in their homeland; to assist them to achieve self-determination and self-governance; and to nurture and honor their culture.
2. Support Services	To work for the betterment of conditions of all Hawaiians by providing leadership, guidance, direction, and executive oversight. OHA seeks to excel among 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 an opinion as to the financial position of Office of Hawaiian Affairs at June 30, 2006, and the results of its operations for the year then ended. The auditors' report represents the conclusion of the independent auditors regarding the fairness of the presentations, in conformity with accounting principles generally accepted in the United States of America, set forth in the financial statements and is used to communicate such conclusion to interested parties.

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

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

Independent Auditors' Report

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

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Office of Hawaiian Affairs (OHA), State of Hawai'i, as of and for the year ended June 30, 2006, which collectively comprise OHA's basic financial statements as listed in the table of contents. These financial statements are the responsibility of OHA's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

As discussed in Note A, the financial statements of the Office of Hawaiian Affairs, State of Hawai'i, are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawai'i that is attributable to the transactions of OHA. They do not purport to, and do not, present fairly the financial position of the State of Hawai'i as of June 30, 2006 and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of OHA, as of June 30, 2006, and the respective changes in financial position thereof and the respective budgetary comparison for the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

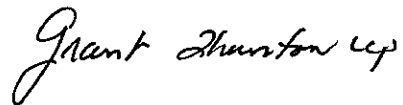
As discussed in note N to the basic financial statements, OHA is self-insured for workers' compensation, automobile, and general liabilities. Several claims were filed against OHA during the year ended June 30, 2006. Although OHA has recorded an estimated loss for such claims, as well as from any unasserted claims, the ultimate results may differ from OHA's estimates, due to the subjectivity of the data used by OHA to compute these amounts.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated December 4, 2006 on our consideration of OHA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

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



Honolulu, Hawaii  
December 4, 2006

Office of Hawaiian Affairs  
State of Hawai'i

MANAGEMENT'S DISCUSSION AND ANALYSIS

Years ended June 30, 2006

As management of the Office of Hawaiian Affairs (OHA), we offer readers of OHA's financial statements this narrative overview and analysis of the financial activities of OHA for the fiscal years ended June 30, 2006 and 2005. While the audit report presents only the financial activities for the fiscal year ended June 30, 2006, the management discussion and analysis will address both this year and the year ended June 30, 2005.

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

**FINANCIAL HIGHLIGHTS**

**Government-wide Financial Statements Highlights**

*Statements of Net Assets* – The assets of OHA exceeded its liabilities at fiscal year ended June 30, 2006 by \$454,159,204 (presented as “total net assets”). Of this amount, \$412,439,886 is reported as “unrestricted”, while \$26,089,587 is reported as “restricted-federal funds” and \$15,629,731 is reported as “invested in capital assets, net of related debt.” The assets of OHA exceeded its liabilities at fiscal year ended June 30, 2005 by \$404,312,070 (presented as “total net assets”). Of this amount, \$376,886,485 is reported as “unrestricted”, while \$25,484,597 is reported as “restricted-federal funds” and \$1,940,988 is reported as “invested in capital assets, net of related debt.” Unrestricted net assets represent the amount available to be used to meet OHA's ongoing obligations to beneficiaries and creditors. Restricted assets represent amounts that have legal requirements on their use.

*Changes in Net Assets* – OHA's total net assets, increased by \$49,847,134 (a 12.3% increase) in fiscal year 2006. This was primarily due to investment income and gains experienced on the OHA's Native Hawaiian Trust Fund (NHTF). Another contributing factor is an increase in ceded land receipts due to the passage of Act 178 (SB2948) where OHA receives \$15,100,000 per year beginning in fiscal year 2006 and \$17,500,000 for fiscal years 2001-2005 paid in fiscal year 2006. OHA's total net assets, increased by \$23,046,512 (a 6.0% increase) in fiscal year 2005. This was primarily due to investment income and gains experienced on the OHA's Native Hawaiian Trust Fund (NHTF).

**Governmental Funds Financial Statements Highlights**

*Governmental Funds – Fund Balances* – At the close of fiscal year 2006, OHA's governmental funds reported an ending fund balance of \$440,162,266. Of this total amount, \$422,987,084 represents the unreserved fund balances with 93.9% being in the Public Land Trust Fund. Of this \$422,987,084, \$23,257,055 is designated for the Native Hawaiian Revolving Loan Fund, \$4,000,000 is designated for the Fannie Mae Loan Program; \$29,419 is designated for other grants, \$693,801 is designated for Hawaiian projects; and \$13,057,000 is designated for subsequent year's expenditures, leaving \$381,949,809 as undesignated. This \$381,949,809 is roughly 86.7% of the total fund balance at the end of fiscal year 2006.

At the close of fiscal year 2005, OHA's governmental funds reported an ending fund balance of \$403,737,314. Of this total amount, \$384,855,589 represents the unreserved fund balances with 93.7% being in the Public Land Trust Fund. Of this \$384,855,589, \$22,941,976 is designated for the Native Hawaiian Revolving Loan Fund, \$4,000,000 is

designated for the Fannie Mae Loan Program; \$29,419 is designated for other grants, \$665,709 is designated for Hawaiian projects; and \$4,510,000 is designated for subsequent year's expenditures, leaving \$352,708,485 as undesignated. This \$352,708,485 is roughly 87.4% of the total fund balance at the end of fiscal year 2005.

## OVERVIEW OF THE FINANCIAL STATEMENTS

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

### Government-wide Financial Statements

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

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

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

The government-wide financial statements are reflected on the right hand side of the "Adjustments" column of each of the governmental funds financial statements.

### Governmental Funds Financial Statements

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



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

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

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

OHA has two types of governmental funds that are presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures, and changes in fund balances. OHA's two types of governmental funds are General Fund and Special Revenue Funds. The Special Revenue Funds are the Public Land Trust Fund, Federal Grants Fund, and Other Fund.

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

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

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

### **Notes to Financial Statements**

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

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

### Statement of Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. OHA's net assets totaled \$454,159,204 at the end of fiscal year 2006, compared to \$404,312,070 at the end of fiscal year 2005.

The largest portion of OHA's net assets (90.8% and 93.2% at June 30, 2006 and 2005, respectively) represents resources that may be used to meet OHA's ongoing obligations to beneficiaries and creditors. Internally imposed designations of resources are not presented as restricted net assets.

Summarized financial information of OHA's statement of net assets as of June 30, 2006 and 2005 is as follows:

	2006	2005
Capital assets	\$ 15,749,470	\$ 2,097,979
Other assets	449,266,276	407,536,988
Total assets	<u>\$465,015,746</u>	<u>\$409,634,967</u>
Other liabilities	\$ 9,104,010	\$ 3,791,772
Long-term liabilities	1,752,532	1,531,125
Total liabilities	10,856,542	5,322,897
Invested in capital assets, net of related debt	15,629,731	1,940,988
Restricted – federal funds	26,089,587	25,484,597
Unrestricted	412,439,886	376,886,485
Total net assets	<u>454,159,204</u>	<u>404,312,070</u>
Total liabilities and net assets	<u>\$465,015,746</u>	<u>\$409,634,967</u>

A portion of OHA's net assets (3.4% and 0.5% at June 30, 2006 and 2005, respectively) reflects its investment in capital assets such as land, building, leasehold improvements, equipment and software development, less any related debt used to acquire those assets that are still outstanding. OHA uses these capital assets to provide services to beneficiaries; consequently, these assets are not available for future spending. Although OHA's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt, if any, must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

At the end of fiscal years 2006 and 2005, OHA is able to report a positive balance in its category of government-wide net assets.

### Changes in Net Assets

OHA's net assets recognized in fiscal year 2006 increased by \$49,847,134 or 12.3% from the prior year. Approximately 39.9% of OHA's total revenue came from the Public Land Trust, while 15.0% came from dividend and interest income, 28.1% came from net investment gains, and 3.4% resulted from Legislative appropriations. Expenditures increased by approximately \$8 million mainly due to an increase in programmatic expenditures related to education, governance and preservation and conservation of land efforts. Revenue increased by \$35 million,

mainly attributed to the passage of Act 178 which augmented public land trust revenues by approximately \$22 million (as discussed in Note O), and from the recognition of approximately \$10 million contributed capital (as discussed in Note G).

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

Summarized financial information of OHA's statement of changes in net assets for the fiscal years ended June 30, 2006 and 2005 is as follows:

	2006	2005
Revenues:		
Program revenues:		
Operating grants	\$ 325,945	\$ 319,208
Contributions	10,105,258	—
Charges for services	53,892	63,118
Dividend and interest income	859,118	607,434
Net investment gains (losses)	(350,366)	(87,008)
General revenues:		
Appropriations, net of lapses	2,755,011	2,498,960
Public land trust	32,591,931	10,631,224
Dividend and interest income	11,417,954	6,339,036
Net investment gains (losses)	23,275,048	25,963,215
Newspaper ads	72,107	59,109
Donations and other	185,323	33,746
Non-imposed fringe benefits	229,089	193,811
Total revenues	81,520,310	46,621,853
Expenses:		
Current divisions:		
Board of Trustees	1,779,504	1,600,433
Support Services	10,762,388	8,716,897
Beneficiary Advocacy	18,498,605	12,632,579
Depreciation	632,679	625,432
Total expenses	31,673,176	23,575,341
CHANGES IN NET ASSETS	<u>\$49,847,134</u>	<u>\$23,046,512</u>

## GOVERNMENTAL FUNDS FINANCIAL ANALYSIS

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

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

At the close of fiscal year 2006, OHA's governmental funds reported an ending fund balance of \$440,162,266. Of this amount, approximately \$422,987,084, or 96.1%, is unreserved funds, broken down as follows: 5.3% for Native Hawaiian Revolving Loans, 0.9% for Fannie Mae Loan Program, 0.01% for Other Grants, 0.2% for Hawaiian projects, 3.0% for subsequent years' expenditures, and 86.7% undesignated. Reserved fund balances accounted for \$17,175,182, or 3.9% of the total fund balance, broken down as follows: 1.7% for encumbrances, 2.1% for notes receivable, and 0.1% for prepaid expenses and security deposits.

At the close of fiscal year 2005, OHA's governmental funds reported an ending fund balance of \$403,737,314. Of this amount, approximately \$384,855,589, or 95.3%, is unreserved funds, broken down as follows: 5.7% for Native Hawaiian Revolving Loans, 1.0% for Fannie Mae Loan Program, .007% for Other Grants, 0.2% for Hawaiian projects, 1.1% for subsequent years expenditures, and 87.3% undesignated. Reserved fund balances accounted for \$18,881,725, or 4.7% of the total fund balance, broken down as follows: 1.7% for encumbrances, 2.9% for notes receivable, and 0.1% for prepaid expenses and security deposits.

## ECONOMIC FACTORS

Hawai'i's real economic growth continues to decelerate in 2006 resulting in declining residential sales and construction commitments. Unusual wet weather experienced in February and March 2006 led to an increase in the unemployment rate, however, by the end of second quarter, the unemployment rate averaged 2.7% compared to 2.8% in 2005. Despite fluctuations due to weather, Hawai'i's unemployment rate still remains the lowest in the nation.

In the second quarter of 2006, Hawai'i experienced an increase in the civilian labor force totaling 648,050 people, up 2.6% or 16,500 people from second quarter 2005. Year to date, the civilian employment was up 3.0%.

Much of Hawai'i's economic growth continues to come from construction, real estate, and the tourism industry. It is expected that investments in construction will continue to show signs of growth due to an increase of 24.7% from 2005 to 2006 in building authorizations that is expected to continue to the end of 2007.

Hawai'i's tourism industry saw an increase of approximately 300,000 visitors totaling 7.4 million visitors in 2006 versus 7.1 million in 2005. Of the 7.4 million visitors, 67% were made up of domestic air visitors and 33% from international and other air travel. Although the average length of stay in 2006 decreased to 9.14 days from 9.97 days in 2005, total expenditures increased by approximately 6%.

Hawai'i's inflation rate at the end of fiscal year 2006 was 5.8% and is projected to decrease to approximately 4.5% in 2007. Much of the increase at the end of fiscal year 2006 was due to volatile increases in housing and energy which are expected to decelerate to a normal level. In 2007, visitor arrivals and real personal income is anticipated to increase by 2.4% and 2.0%, respectively.

In March 2003, OHA's investment advisors were awarded contracts in accordance with the NHTF investment policy statement. Upon commencement of the contracts, the combined value of the NHTF portfolio was approximately

\$257 million. As of June 30, 2006 the Trust has grown to a net value of \$368 million (with net accretions in Fiscal 2006 of \$16.4 million and \$55.4 million in Fiscal Year 2005).

Positive economic projections combined with continued market increases will allow OHA to directly benefit Native Hawaiian needs through grants and initiatives that would otherwise be unavailable.

#### **REQUEST FOR INFORMATION**

Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Office of Hawaiian Affairs; Treasury and Other Services; 711 Kapi'olani Boulevard, Suite 500; Honolulu, HI 96813.

Office of Hawaiian Affairs  
State of Hawai'i

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

June 30, 2006

ASSETS	Governmental Funds					Adjustments (note K)	Government- wide Statement of Net Assets
	General Fund	Special Revenue Funds			Total		
		Public Land Trust	Federal Grants	Other			
Petty cash	\$ 20,000	-	\$ -	-	\$ 20,000	\$ -	\$ 20,000
Cash in State Treasury	633,464	35,417,804	1,178,353	696,415	37,926,036	-	37,926,036
Cash in banks	-	3,006,129	-	-	3,006,129	-	3,006,129
Cash held by investment manager	-	54,092	103,460	-	157,552	-	157,552
Accounts receivable	-	5,311,264	-	10,895	5,322,159	-	5,322,159
Interest and dividends receivable	-	313,613	208,113	-	521,726	-	521,726
Prepaid and other assets	20,565	247,654	31,618	-	299,837	-	299,837
Notes receivable - due within one year	-	749,508	406,455	-	1,155,963	-	1,155,963
Notes receivable - due after one year	-	7,121,483	1,055,651	-	8,177,134	-	8,177,134
Security deposits	-	48,941	1,803	-	50,744	-	50,744
Investments	-	369,371,941	23,257,055	-	392,628,996	-	392,628,996
Capital assets - net	-	-	-	-	-	15,749,470	15,749,470
TOTAL	\$ 674,029	\$ 421,642,429	\$ 26,242,508	\$ 707,310	\$ 449,266,276	\$ 15,749,470	\$ 465,015,746

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs  
State of Hawai'i

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

June 30, 2006

LIABILITIES AND FUND BALANCES/NET ASSETS	Governmental Funds				Adjustments (note K)	Government- wide Statement of Net Assets
	General Fund	Special Revenue Funds				
		Public Land Trust	Federal Grants	Other		
LIABILITIES:						
Accounts payable and accrued liabilities	\$ 404,754	\$ 8,526,335	\$ 25,105	\$ -	\$ 8,956,194	\$ 8,956,194
Due to State of Hawaii	20,000	-	127,816	-	147,816	147,816
Long-term liabilities:						
Due within one year	-	-	-	-	-	-
Due after one year	-	-	-	-	-	-
Total liabilities	424,754	8,526,335	152,921	-	9,104,010	10,856,542
FUND BALANCES/NET ASSETS:						
Fund balances:						
Reserved for encumbrances	268,730	7,133,104	87,056	2,614	7,491,504	-
Reserved for notes receivable	-	7,870,991	1,462,106	-	9,333,097	-
Reserved for prepaid expenses and security deposits	20,565	296,595	33,421	-	350,581	-
Unreserved:						
Designated for Native Hawaiian revolving loans	-	-	23,257,055	-	23,257,055	-
Designated for Fannie Mae Loan Program	-	4,000,000	-	-	4,000,000	-
Designated for other grants	-	-	29,419	-	29,419	-
Designated for Hawaiian projects	-	-	-	693,801	693,801	-
Designated for subsequent year's expenditures	-	13,057,000	-	-	13,057,000	-
Undesignated	(40,020)	380,758,404	1,220,530	10,895	381,949,809	-
Total fund balances	249,275	413,116,094	26,089,587	707,310	440,162,266	-
Total liabilities and fund balances	\$ 674,029	\$ 421,642,429	\$ 26,242,508	\$ 707,310	\$ 449,266,276	
Net assets:						
Invested in capital assets, net of related debt					15,629,731	15,629,731
Restricted - federal funds					26,089,587	26,089,587
Unrestricted					412,439,886	412,439,886
Total net assets					\$ 454,159,204	\$ 454,159,204

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs  
State of Hawai'i

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

Year ended June 30, 2006

	General Fund	Governmental Funds			Total	Adjustments (note K)	Government- wide Statement of Activities
		Public Land Trust	Federal Grants	Other			
Expenditures/expenses:							
Current divisions:							
Board of Trustees	\$ 43,840	\$ 1,694,147	\$ -	\$ -	\$ 1,737,987	\$ 41,517	\$ 1,779,504
Support services	1,113,710	9,677,150	46,245	49,724	10,886,829	(124,441)	10,762,388
Beneficiary advocacy	1,864,174	30,376,916	237,354	-	32,478,444	(13,979,839)	18,498,605
Depreciation	-	-	-	-	-	632,679	632,679
Total expenditures/expenses	3,021,724	41,748,213	283,599	49,724	45,103,260	(13,430,084)	31,673,176
Program revenues:							
Charges for services	-	-	53,892	-	53,892	-	53,892
Operating grants and contributions	-	-	325,945	-	325,945	-	325,945
Contributions	-	10,105,258	-	-	10,105,258	-	10,105,258
Dividend and interest income	-	-	859,118	-	859,118	-	859,118
Investment losses	-	-	(350,366)	-	(350,366)	-	(350,366)
Total program revenues	-	10,105,258	888,589	-	10,993,847	-	10,993,847
Net program (expenses) revenue	(3,021,724)	(31,642,955)	604,990	(49,724)	(34,109,413)	13,430,084	(20,679,329)
General revenues:							
Appropriations, net of lapses	2,755,011	-	-	-	2,755,011	-	2,755,011
Public land trust	-	32,599,833	-	-	32,599,833	(7,902)	32,591,931
Dividend and interest income	-	11,417,954	-	-	11,417,954	-	11,417,954
Investment gains	-	23,275,048	-	-	23,275,048	-	23,275,048
Newspaper advertisements	-	-	-	72,107	72,107	-	72,107
Donations and other	-	167,515	-	17,808	185,323	-	185,323
Non-imposed fringe benefits	229,089	-	-	-	229,089	-	229,089
Total general revenues	2,984,100	67,460,350	-	89,915	70,534,365	(7,902)	70,526,463
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES/CHANGE IN NET ASSETS (carried forward)	\$ (37,624)	\$ 35,817,395	\$ 604,990	\$ 40,191	\$ 36,424,952	\$ 13,422,182	\$ 49,847,134

The accompanying notes are an integral part of this statement.



Office of Hawaiian Affairs  
State of Hawai'i

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

Year ended June 30, 2006

	Governmental Funds					Government- wide Statement of Activities
	General Fund	Special Revenue Funds			Total	
		Public Land Trust	Federal Grants	Other		
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES/CHANGE IN NET ASSETS (brought forward)	\$ (37,624)	\$ 35,817,395	\$ 604,990	\$ 40,191	\$ 36,424,952	\$ 49,847,134
Fund balance/net assets:						
Beginning of year	286,899	377,298,699	25,484,597	667,119	403,737,314	404,312,070
End of year	\$ 249,275	\$ 413,116,094	\$ 26,089,587	\$ 707,310	\$ 440,162,266	\$ 454,159,204

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs  
State of Hawai'i

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

Year ended June 30, 2006

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual (budgetary basis)</u>	<u>Variance</u>
Revenues:				
State appropriations, net of lapses	<u>\$ 2,866,279</u>	<u>\$ 2,866,279</u>	<u>\$ 2,781,610</u>	<u>\$ (84,669)</u>
Total revenues	<u>2,866,279</u>	<u>2,866,279</u>	<u>2,781,610</u>	<u>(84,669)</u>
Expenditures:				
Board of Trustees	34,206	34,206	32,816	1,390
Support services	963,488	971,080	956,761	14,319
Beneficiary advocacy	<u>1,868,585</u>	<u>1,860,993</u>	<u>1,792,033</u>	<u>68,960</u>
Total expenditures	<u>2,866,279</u>	<u>2,866,279</u>	<u>2,781,610</u>	<u>84,669</u>
EXCESS OF REVENUES OVER EXPENDITURES	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs  
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Financial Statement Presentation and Basis of Accounting

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

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

*Government-wide Financial Statements* – The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

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

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include the employees' vested annual leave which is recorded as an expenditure when utilized or paid. The amount of accumulated annual leave unpaid at June 30, 2006 has been reported only in the government-wide financial statements.

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 State Legislature.

Office of Hawaiian Affairs  
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

*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 and other grants. Expenditures reflect those from the specific grant or designated fund and from other Board appropriations of Public Land Trust funds.

2. Investments

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

3. Capital Assets

Capital assets acquired for general organization purposes are recorded as expenditures in the governmental funds financial statements. Donated fixed assets are recorded at estimated fair value at the time received. Depreciation expense is recorded in the government-wide financial statements. Buildings, equipment, and improvements are depreciated on the straight-line method over their estimated useful lives. There is no depreciation recorded for land and work-in-progress.

4. Accrued Vacation

OHA accrues all vacation and compensatory pay at current salary rates, including additional amounts for certain salary-related expenses associated with the payment of compensated absences, in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. The June 30, 2006 balance includes fringe benefits computed at the rate of 7.65% of accrued vacation and compensatory pay. Accrued vacation is reported as an expense when earned in the government-wide financial statements, but not reported as an expenditure in the governmental funds financial statements, as current financial resources are not used.

5. Risk Management

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

6. Governmental Funds – Fund Balance Reserves and Designations

The governmental funds financial statements present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditure or (2) legally segregated for a specific future use.

The reserves for related assets such as inventories and prepayments are examples of the former. Reserves for encumbrances, contracts, and other specific purposes are examples of the latter. The governmental funds' designation of fund balance reflects tentative plans for future use of financial resources.

Office of Hawaiian Affairs  
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

7. Encumbrances

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

8. Use of Estimates

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

9. Concentrations of Credit Risk

The financial instruments that potentially expose OHA to concentrations of credit risk consist principally of notes receivable. OHA extends credit to Native Hawaiian and Hawaiian persons and agencies who use OHA's funds for the betterment of Native Hawaiians and Hawaiians. The mix of notes receivable at June 30, 2006 are as follows:

Native Hawaiian and Hawaiian persons	88%
Agencies	11
Other	1
	<hr/>
	100%

NOTE B – BIENNIAL BUDGET

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

- *The Budget* – In the fall of each odd-numbered fiscal year, OHA's Administration drafts the program and budget recommendations that will be the basis for OHA's biennium budget request. Once approved by the Board, the budget is submitted directly to the State Legislature prior to its convening. The budget is generally constructed around OHA's operations (offices) and programs (divisions) and states programmatic objectives, expected outcomes, and financial requirements. The budget also shows the proportion of funding requested from general funds to be appropriated by the Legislature and from trust funds appropriated by OHA's Board of Trustees.

Office of Hawaiian Affairs  
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

NOTE B – BIENNIAL BUDGET (continued)

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

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

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

Adjustments necessary to reconcile the results of operations for the year ended June 30, 2006 from the budgetary basis to GAAP basis are as follows:

Excess of revenues over expenditures – actual (budgetary basis)	\$ –
Reserve for encumbrances at June 30	268,730
Prior year reserve for encumbrances	(86,532)
Accrued payables and payroll	107,720
Prepaid expenditures not recognized for budgetary purposes – net of prior-year accruals	(9,613)
Expenditures for liquidation of prior-year encumbrances	(291,331)
Lapse to State General Fund	<u>(26,598)</u>
Deficiency of revenues over expenditures – actual (GAAP basis)	<u>\$ (37,624)</u>

NOTE C – APPROPRIATIONS

OHA is authorized to transfer appropriation amounts and positions between programs for operating purposes, provided that a report of all transfers are made to the State Legislature prior to convening of the next legislative session. Act 109, SLH 2005 authorizes a total of \$2,866,279 general funds, and \$5,312,924 trust funds for OHA's programs for fiscal year 2006.

Office of Hawaiian Affairs  
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

NOTE D – CASH

The State maintains a cash pool that is used by all agencies. OHA's portion of this pool is indicated on the Governmental Funds Balance Sheet as "Cash in State Treasury." The Hawai'i Revised Statutes authorize Director of Finance to invest in obligations of or guaranteed by the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally-insured financial institutions. OHA's cash included in State pooled funds is fully collateralized with securities held by third-party agents in the State's name, as required by the Hawai'i Revised Statutes Section 38-8. At June 30, 2006, OHA's deposits with financial institutions totaled \$3,129,589, and had corresponding bank balances of \$3,089,752. The portion of the bank balances covered by FDIC insurance totaled \$120,763 in 2006; the remainder was uninsured and uncollateralized.

NOTE E – NOTES RECEIVABLE

Notes receivable at June 30, 2006 consist of the following:

Loans receivable serviced by First Hawaiian Bank (of which, \$3,902,588 is guaranteed by DHHL)	\$ 7,605,816
Native Hawaiian Revolving Loan Fund	2,782,106
Other	<u>1,815,695</u>
Total	12,203,617
Less allowance for doubtful accounts	<u>(2,870,520)</u>
Net	9,333,097
Amounts due within one year	<u>(1,155,963)</u>
Amounts due after one year	<u>\$ 8,177,134</u>

NOTE F – INVESTMENTS

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

OHA's investment policy allows for the following investments:

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

Office of Hawaiian Affairs  
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

NOTE F – INVESTMENTS (continued)

Investments (current and long-term) at June 30, 2006 and their maturities were as follows:

Investment type	FUND	Fair value	Investment maturities (in years)	
			Less than 1	1-5
U.S. treasuries	NHRLF	\$ 3,335,393	\$ —	\$ 3,335,393
U.S. agencies	NHRLF	19,921,661	6,698,725	13,222,936
Other mutual funds	NHTF	19,390,220	19,390,220	—
Pooled investments	NHTF	64,513,101	64,513,101	—
Limited partnerships	NHTF	177,053,375	177,053,375	—
Real estate investments	NHTF	9,471,880	9,471,880	—
Other	NHTF	98,943,366	98,943,366	—
Total securities		392,628,996	376,070,667	16,558,329
Money market funds (not considered securities)	MIX	157,552	157,552	—
Total investments		<u>\$392,786,548</u>	<u>\$376,228,219</u>	<u>\$16,558,329</u>

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

**Foreign Currency Risk**

In an effort to diversify the NHTF portfolio against market fluctuations, OHA's investment policy allows for investments in foreign countries. As of June 30, 2006, OHA's foreign currency risks are as follows:

Investment type	Currency	Value (US dollar)
Private Equity, LLP	EURO	\$ 509,416
Limited Partnership	Various	\$25,409,475



Office of Hawaiian Affairs  
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

NOTE F – INVESTMENTS (continued)

**Foreign Currency Risk (continued)**

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

**Interest Rate Risk**

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

<u>Type of investment</u>	<u>Maximum maturity</u>
U.S. treasuries	5 years
U.S. agencies	5 years

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

**Credit Risk**

Pursuant to 45 C.F.R. 1336.72(a), "any portion of the revolving loan fund that is not required for expenditure must be invested in obligations of the United States or in obligations guaranteed or insured by the United States." At June 30, 2006, credit rates for all securities of government agencies were rated at Aaa/AAA.

**Concentration of Risk**

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

Office of Hawaiian Affairs  
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

NOTE G – CAPITAL ASSETS

Capital assets activities for the year ended June 30, 2006 are as follows:

	July 1, 2005	Additions	Retirements/ transfer	June 30, 2006
Capital assets not being depreciated:				
Land	\$ 84,100	\$13,003,820	\$ –	\$13,087,920
Total capital assets not being depreciated	84,100	13,003,820	–	13,087,920
Capital assets being depreciated:				
Buildings	1,045,141	1,046,300	–	2,091,441
Leasehold improvements	491,146	48,099	–	539,245
Machinery, equipment, furniture and fixtures	3,604,721	196,514	(99,373)	3,701,862
Total capital assets being depreciated	5,141,008	1,290,913	(99,373)	6,332,548
Less accumulated depreciation	(3,127,129)	(632,679)	88,810	(3,670,998)
Capital assets being depreciated – net	2,013,879	658,234	(10,563)	2,661,550
Capital assets – net	<u>\$ 2,097,979</u>	<u>\$13,662,054</u>	<u>\$ (10,563)</u>	<u>\$15,749,470</u>

On June 30, 2006, OHA acquired fee title to the Waimea Ahupua'a (Waimea Valley) on the north shore of the island of O'ahu to protect in perpetuity the cultural and natural resources on the property. The property was acquired with easements including a transportation easement owned by the Department of Defense for a portion of "Drum Road" that connects Helemano Plantation with the Kahuku Training Area and a conservation easement prohibiting development incompatible with conservation issued by OHA to the City and Department of Land and Natural Resources.

The acquisition was funded by OHA in conjunction with other governmental agencies. Total amounts contributed by other agencies are reflected in the governmental funds statement of revenues, expenditures, and changes in fund balances as contributions totaling \$10,105,258.

As part of the above acquisition, \$1,000,000 was paid by OHA on behalf of the National Audubon Society (Audubon). Pursuant to a Memorandum of Understanding between OHA and Audubon, Audubon will remain as lessee, operator, and manager of the Waimea Valley for a period of time to be determined. Both parties also agree to diligently and in good faith negotiate a new lease agreement mutually satisfactory to both parties, and upon execution of a new lease, Audubon shall reimburse OHA in full. For the year ended June 30, 2006, the \$1,000,000 is reflected as an expenditure on the statement of revenues, expenditures, and changes in fund balances and included in capital assets on the government-wide statement of net assets.

Office of Hawaiian Affairs  
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

NOTE H – CAPITAL LEASE

In March 2005, OHA entered into an agreement to lease equipment which requires monthly payments of \$4,068 beginning in March 2005 and ending in March 2009. The present value of the minimum lease payments at the beginning of the lease term was \$166,975. OHA records the equipment as an asset which is depreciated over the term of the lease and reported in the financial statements as depreciation. As of June 30, 2006, the related accumulated depreciation is \$52,180 and the net book value is \$114,795.

Fiscal year ending June 30,	
2007	\$ 48,816
2008	48,816
2009	<u>36,612</u>
Total minimum lease payments	134,244
Less implicit interest of 8.25%	<u>(14,505)</u>
Present value of minimum lease payments (obligation under capital lease)	119,739
Less current portion	<u>(40,444)</u>
	<u><u>\$ 79,295</u></u>

NOTE I – TERM LIABILITIES

Long-term liabilities for the year ended June 30, 2006 are as follows:

	July 1, 2005	Increases	Decreases	June 30, 2006	Amounts due within one year	Amounts due after one year
Accrued vacation	\$ 767,847	\$453,063	\$(332,854)	\$ 888,056	\$290,625	\$ 597,431
Accrued workers' compensation	606,287	138,450	–	744,737	–	744,737
Capital lease obligation	156,991	–	(37,252)	119,739	40,444	79,295
Long-term liabilities	<u>\$1,531,125</u>	<u>\$591,513</u>	<u>\$(370,106)</u>	<u>\$1,752,532</u>	<u>\$331,069</u>	<u>\$1,421,463</u>

Office of Hawaiian Affairs  
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

NOTE J – LEASES

OHA leases office space and equipment under various noncancelable operating leases expiring through June 2009. Future minimum payments under all leases as of June 30, 2006 are approximated as follows:

Fiscal year ending June 30,	
2007	\$ 671,000
2008	656,000
2009	<u>390,000</u>
Total	<u>\$1,717,000</u>

Rent expense (including taxes and common area maintenance) under operating leases totaled \$873,379 for the year ended June 30, 2006.

In August 1998, OHA entered into a 35 year lease with the State of Hawai'i, Department of Land and Natural Resources (DLNR) for the use of the premises known as the Old Waialua Court House situated in Waialua, Hawai'i. 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.

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

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

Total fund balance – governmental funds	\$440,162,266
Amounts reported for governmental activities in the statement of net assets are different because:	
Net capital assets used in governmental activities are not financial resources and therefore are not reported in the funds	15,749,470
Long-term liabilities not due and payable in the current period and therefore not reported in the funds:	
Accrued vacation	(888,056)
Accrued workers' compensation	(744,737)
Capital lease	<u>(119,739)</u>
Subtotal	<u>(1,752,532)</u>
Total net assets – government-wide	<u>\$454,159,204</u>

Office of Hawaiian Affairs  
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

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

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

Net changes in fund balances – total governmental funds	\$36,424,952
Amounts reported for governmental activities in the statement of activities is different because:	
Governmental funds report capital outlays and capital lease payments as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation and related debt during the year	13,688,743
Revenues that were recorded in 2005 government-wide financial statements but recorded in 2006 governmental funds	(7,902)
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	(120,209)
Accrued workers' compensation	(138,450)
Subtotal	<u>(258,659)</u>
Changes in net assets – government-wide	<u>\$49,847,134</u>

NOTE L – EMPLOYEE BENEFITS

1. Defined Benefit Pension Plans

All full-time employees of OHA are eligible to participate in the Employees' Retirement System of the State of 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 and a noncontributory retirement plan. Eligible employees who were in service and a member of the existing contributory plan on June 30, 1984, were given an option to remain in the existing plan or join the noncontributory plan, effective January 1, 1985. All new eligible employees hired after June 30, 1984, automatically become members of the noncontributory plan. Both plans provide death and disability benefits and cost of living increases. Benefits are established by state statute. In the contributory plan, employees may elect normal retirement at age 55 with 5 years of credited

Office of Hawaiian Affairs  
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

NOTE L – EMPLOYEE BENEFITS (continued)

1. Defined Benefit Pension Plans (continued)

service or elect early retirement at any age with 25 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life, of 2% of their average final salary, as defined, for each year of credited service. Benefits fully vest on reaching five years of service; retirement benefits are actuarially reduced for early retirement. Covered contributory plan employees are required by State statute to contribute 7.8% of their salary to the plan; OHA is required by state statute to contribute the remaining amounts necessary to pay contributory plan benefits when due. In the noncontributory plan, employees may elect normal retirement at age 62 with 10 years of credited service or at age 55 with 30 years of credit service, or elect early retirement at age 55 with 20 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life, of 1.25% of their average final salary, as defined, for each year of credited service. Benefits fully vest on reaching 10 years of service; retirement benefits are actuarially reduced for early retirement. OHA is required by state statute to contribute all amounts necessary to pay noncontributory plan benefits when due. Contribution by OHA for the fiscal year ended June 30, 2006 was approximately \$721,000. The contribution rate for the fiscal year ended June 30, 2006 was 10.82%.

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

2. 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. OHA's contributions for retiree health and group life insurance benefits are subject to the State law governing the EUTF. The EUTF pays for some or all of these benefits for eligible employees, in accordance with the guidelines laid out by state law. The EUTF also reimburses Medicare expenses of retirees and qualified spouses who are at least 62 years of age and have at least 10 years of service. OHA's share of the expense for post-retirement health care and life insurance benefits for the fiscal year ended June 30, 2006 was approximately \$1,000.

3. Sick Leave

Accumulated sick leave as of June 30, 2006 was approximately \$1,618,000. Sick leave accumulates at the rate of 14 hours for each month of service, as defined, without limit. Sick pay can be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for sick leave is recorded in the accompanying financial statements.

Office of Hawaiian Affairs  
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

NOTE M – NON-IMPOSED EMPLOYEE FRINGE BENEFITS

Payroll fringe benefit costs for employees of OHA funded by state appropriations (general fund) are assumed by the state and are not charged to OHA's operating funds. These costs, totaling \$229,089 for the fiscal year ended June 30, 2006, have been reported as revenues and expenditures of OHA's general fund.

NOTE N – RISK MANAGEMENT AND CONTINGENT LIABILITIES

1. Workers' Compensation and Other Self-Insurance Liabilities

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

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

All other claims are handled by the Department of the Attorney General. The State has transferred risk by purchasing additional insurance to cover catastrophic loss. Under the State Risk Management and Insurance Administration (HRS 41D), OHA has access to insurance coverage for personal injury and property damage liability, including automobile and public errors and omissions, policies in force with a \$4,000,000 self-insured retention and annual aggregate of \$10,000,000 per occurrence. To further mitigate risk to the Native Hawaiian Trust Fund, OHA purchases Public Officials and Employment Practices Liability insurance with a \$250,000 deductible and \$4,000,000 coverage limit, Bankers' Professional Liability insurance with a \$50,000 deductible and \$3,000,000 aggregate coverage limit, and general and excess liability insurance for property owned or required by lease agreements entered into. The general liability insurance has a \$5,000 deductible with an aggregate coverage limit of \$2,000,000 and the excess liability has an aggregate coverage limit of \$3,000,000.

Several claims have been filed against OHA during the year ended June 30, 2006. Although OHA has recorded an estimated loss for such claims, as well as from any unasserted claims, the ultimate results may differ from OHA's estimates, due to the subjectivity of the data used by OHA to compute these amounts. OHA has accrued a liability for workers' compensation at June 30, 2006 that approximated \$745,000.

2. Department of Education Settlement Agreement

On May 4, 2000, OHA entered into a Compromise and Settlement Agreement (Agreement) with the State of Hawai'i, Department of Education (DOE), in which the DOE agreed to form a partnership for the support of the DOE's Hawaiian Language Immersion Program (HLIP). Although OHA is not responsible for the education, operation, management, supervision, or any other aspect of the HLIP, OHA has agreed to provide

Office of Hawaiian Affairs  
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

NOTE N – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

2. Department of Education Settlement Agreement (continued)

matching funds up to \$500,000 each year for five years beginning July 1, 2000. In 2006, OHA was presented with final invoices from the DOE totaling approximately \$531,000. As of June 30, 2006, invoices were in the process of being reviewed prior to issuing payment. Payment is expected to be made in December 2006 which will result in final closure of this settlement.

3. Hina-Mälailena Joint Use Agreement

In 1995, OHA entered into a Joint Use Agreement (Agreement) with Hina-Mälailena, a not-for-profit corporation, for the purpose of developing a commercial center in Häna, Maui. Also in 1995, OHA and Hina-Mälailena received, as co-recipients, \$1,760,000 of federal funds from the U.S. Department of Commerce, Economic Development Administration (EDA). The entire amount was recorded in the accounting records of Hina-Mälailena.

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

During fiscal year 2000, OHA became aware that Hina-Mälailena would not be able to complete the project. As of June 30, 2006, OHA's project team is currently working with the various parties involved in the project to move it towards completion.

4. Ceded Lands – Public Land Trust

*Office of Hawaiian Affairs v. Housing and Community Development Corporation of Hawai'i, fka Office of Hawaiian Affairs v. Housing Finance and Development Corporation*, Hawai'i Supreme Court No. 25570 (Civil No. 94-4207-11) was originally filed in 1994 to enjoin the sale of ceded lands until the claims of the Native Hawaiians were resolved by the government. In December 2002, the lower court issued its opinion and OHA appealed. At June 30, 2006, briefs have been filed. The case is still active currently pending before the Hawai'i State Supreme Court with no set date for oral argument and no decision rendered.

On January 11, 2000, all proceedings of the *Office of Hawaiian Affairs v. Hawai'i Housing Authority*, Civil No. 95-2682-07 suit were stayed pending the Hawai'i Supreme Court's decision in *OHA v. State 1*. OHA disagreed that the decision rendered by the Hawai'i Supreme Court on September 12, 2001 in *OHA v. State 1* required the dismissal of the claims in *OHA v. HHA* (which relates to the valuation of 5 parcels transferred to HHA for affordable public housing units). At June 30, 2006, the case remains stayed.



Office of Hawaiian Affairs  
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

NOTE N – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

4. Ceded Lands – Public Land Trust (continued)

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

5. Civil Complaints

In *Arakaki v. Lingle*, Civil No. 02-00139-SOM-KSC, District of Hawai'i, Ninth Circuit No. 04-15306, U.S. Supreme Court No. 988 & 1128, the Plaintiffs challenged the constitutionality of the Office of Hawaiian Affairs relying on the Equal Protection Clause of the United States Constitution and the Civil Rights Act, 28 U.S.C. 1983. The complaint was filed in March 2002 and sought declaratory and injunctive relief and attorneys' fees. The District Court dismissed all claims.

The Plaintiffs appealed to the Ninth Circuit Court of Appeals. On August 30, 2005, the Ninth Circuit Court of Appeals affirmed all the holdings of the District Court except that it reversed the District Court on the dismissal based on the political questions and allowed the *Arakaki* Plaintiffs to proceed – in their capacity as state taxpayers – with their complaint challenging the expenditure of state tax-generated funds to support some of OHA's programs. In October 2005, the *Arakaki* Plaintiffs filed a Petition for Panel or En Banc Rehearing which was denied.

On February 2, 2006, the State of Hawai'i filed a petition for certiorari. On March 3, 2006, the *Arakaki* Plaintiffs filed a Petition for Writ of Certiorari. On June 12, 2006, the United States Supreme Court granted the Petition filed by the State, vacated the judgment, and remanded the case for further proceedings in light of *DaimlerChrysler Corp. v. Cuno*, 547 U.S. (2006) and denied the Petition filed by the *Arakaki* Plaintiffs.

*DaimlerChrysler Corp. v. Cuno* did not permit state taxpayer standing as the basis for bringing a federal lawsuit. The Ninth Circuit ordered the parties to submit Supplemental Briefs. All parties complied. As of June 30, 2006, no ruling has been issued by the Ninth Circuit.

In October 2005, a lawsuit, *Virgil Day, et. al. v. Haunani Apoliona, et. al.*, Civil No. CV05 00649 ACK BMK, was filed in the United States District Court of the District of Hawai'i by five Native Hawaiians against two former OHA trustees and the current OHA trustees alleging that OHA is wrongfully expending its trust fund monies on all Hawaiian beneficiaries and not just exclusively on those beneficiaries with 50% or more blood quantum. Plaintiffs were seeking injunctive relief to enjoin and restrain OHA from certain expenditures of its trust funds as well as a declaratory judgment with regard to certain legal issues. Subsequent to June 30, 2006, the case was dismissed by a federal judge on jurisdictional grounds. Plaintiffs filed a notice of appeal with the United States Court of Appeals for the Ninth Circuit. At this time, OHA does not believe that it is legally responsible for any contingent liabilities.

Office of Hawaiian Affairs  
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

NOTE N – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

6. Litigation

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

NOTE O – RELATED PARTY TRANSACTIONS

OHA receives a portion of ceded land revenues from various state agencies. In June 2006, Act 178 was passed which provided OHA \$17.5 million for amounts received from the use of lands in the public land trust that the legislature determined were underpaid between July 1, 2001 through June 30, 2005. Act 178 also laid the foundation for a quarterly guaranteed revenue stream of \$3,775,000, totaling \$15.1 million per year. Total received during the year ended June 30, 2006 was approximately \$32.6 million as reported in the financial statements under general revenue, public land trust.

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

As mentioned in Note G, OHA and several parties purchased the Waimea Ahupua'a on June 30, 2006. Of the total \$10,105,258 contributed revenue, DLNR's portion towards OHA's acquisition of the property was \$1,600,000.

NOTE P – SUBSEQUENT EVENT

In a continuing effort to preserve cultural and natural resources and to protect traditional and customary Native Hawaiian rights, OHA requested and was awarded a grant in the amount of \$3,350,000 from the U.S. Department of Agriculture, Forest Service for the acquisition of two contiguous parcels of land, totaling approximately 25,000 acres, located in the Puna district of the island of Hawai'i, known as Wao Kele O Puna (Wao Kele). Although the grant was awarded in April 2006, OHA acquired fee title to Wao Kele in July 2006 to protect the cultural and natural resources on the property and to maintain the property as a forest reserve. In addition to working with other entities to plug and to abandon the geothermal well located on the property, OHA will be negotiating with DLNR to continue the management of the parcels as a forest reserve designated under Chapter 183, HRS (Forest Reserves, Water Development, Zoning). The recognition of land acquisition and related federal grant revenue received will be reported in the subsequent financial statements.