

Financial Statements and Report of Independent Certified
Public Accountants

Office of Hawaiian Affairs
State of Hawai‘i

June 30, 2011

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Office of Hawaiian Affairs
State of Hawai'i

LETTER FROM THE CHIEF EXECUTIVE OFFICER

Year ended June 30, 2011

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, 2011. 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) Codification Section 2200 Comprehensive Annual Financial Report, 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 Codification Section 2200, 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 Hi'ilei Aloha LLC and its subsidiaries, it has been classified as a blended component unit. As a result, the financial results of Hi'ilei Aloha LLC and its subsidiaries through December 31, 2010 have been included in the financial statements of OHA for the year ended June 30, 2011.

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, 2011, 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.

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 2010-2016 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:

KAHUA 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.

In addition, we continued to fulfill our promise to the State Department of Hawaiian Home Lands, providing \$3 million annually over 30 years for housing for native Hawaiians – 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 more than \$12 million in grants OHA awarded in fiscal year 2011 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 updated 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, is closely tied to the national economy.

State of the Local Economy

Hawai'i's tourism industry led the local economic recovery in 2010 with visitor arrivals and visitor spending increasing by 8.7% and 11.7%, respectively. While local job growth showed signs of recovery in 2011, the overall State of Hawai'i unemployment rate continued to linger above 6.0%, albeit much lower than the national average. Local inflation outpaced real personal income growth by nearly 2.0% in 2010, and the same is expected in 2011. The tourism and hospitality sector is expected to continue driving the economic recovery in Hawai'i, but at a slower pace.

State of the National Economy

The U.S. government continued to implement expansionary economic policies in an effort to improve the state of the economy in 2011. Despite low interest rates and various stimulus packages, the U.S. unemployment rate remains high and the housing industry continues to be depressed. Boosted by strong corporate earnings, the U.S. equity market recovered significantly since the trough of the recession, but market volatility remains high due to sovereign fiscal challenges and political uncertainties around the world. The economic contractions and the sovereign debt crisis around the world are likely to keep any growth in the U.S. relatively modest in the near future.

OHA's Investments

OHA's investment portfolio showed a 19.36% gain in fiscal year 2011 driven primarily by strong global equities performance. The NHTF trailed the strategic benchmark slightly by 73 basis points, or 0.73%, on a net-of-fees basis. OHA's equities portfolio showed the largest gain at 30.65%, followed by commodities at 26.06%, and the public real estate investments at 25.94%. OHA's fixed income portfolio returned 6.69% during the year, while OHA's hedge fund investments showed a -1.87% return. Overall, the NHTF ranked in the top 44th percentile in comparison to other endowment and foundations.

OHA underwent a manager search and evaluation process during the year to reconsider its manager line-up and select the most suitable investment advisors for OHA's portfolio. At the end of fiscal year 2011, OHA selected two new investment advisors, JP Morgan and Commonfund, to manage a portion of the NHTF and terminated Russell Investments. OHA also selected State Street Bank and Trust as its new Custodian to safeguard OHA's assets.

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,

Clyde W. Nāmu'ō
Chief Executive Officer, Office of Hawaiian Affairs

Report of Independent Certified Public Accountants

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 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, 2011, 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 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"), a blended component unit, which represent 0.1% of assets and 2.6% 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, is based solely on the report of the other auditor.

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. The consolidated financial statements of Hi'ilei were not audited in accordance with *Government Auditing Standards*. 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 and the report of the other auditor provide 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 as well as budgetary comparison for the general fund 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, 2011 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.

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

In our opinion, based on our audit and the report of the other auditor, 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, 2011, and the respective changes in financial position and the budgetary comparison for the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 15, 2011 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 8 through 15 is not a required part of the basic financial statements but is supplementary information required by the accounting principles generally accepted in the United State of America. 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 Letter from the Chief Executive Officer, 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.

PKF Pacific Hawaii LLP

Honolulu, Hawaii
December 15, 2011

Office of Hawaiian Affairs
State of Hawai'i

MANAGEMENT'S DISCUSSION AND ANALYSIS

Year ended June 30, 2011

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, 2011, management discussion and analysis will address both this year and the year ended June 30, 2010.

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 Assets – The assets of OHA exceeded its liabilities at fiscal year ended June 30, 2011 by \$428,428,431 (presented as “total net assets”). Of this amount, \$373,686,411 is reported as “unrestricted”, while \$27,894,651 is reported as “restricted-federal funds” and \$26,847,369 is reported as “invested in capital assets, net of related debt.” The assets of OHA exceeded its liabilities at fiscal year ended June 30, 2010 by \$381,170,716 (presented as “total net assets”). Of this amount, \$326,170,788 is reported as “unrestricted”, while \$28,221,110 is reported as “restricted-federal funds” and \$26,778,818 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.

Statement of Activities – OHA's total net assets, increased by \$47,257,715 (a 12.40% increase) in fiscal year 2011. This was primarily due to investment gains experienced in OHA's Native Hawaiian Trust Fund (NHTF) with improved overall market conditions in fiscal year 2011. OHA's total net assets, increased by \$17,952,048 (a 4.94% increase) in fiscal year 2010. This was primarily due to the performance of investments in OHA's Native Hawaiian Trust Fund (NHTF).

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

Governmental Funds Financial Statements Highlights

New Accounting Pronouncement – GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* – In fiscal year 2011, OHA adopted this new accounting standard which establishes new categories for fund balance reporting. As a result, OHA Governmental Funds – Balance Sheet reports fund balance using the categories of *Nonspendable*, *Restricted*, *Committed*, *Assigned*, and *Unassigned*. Whereas the fiscal year 2010 Governmental Funds – Balance Sheet uses the categories of *Reserved* and *Unreserved* with sub-categories of *Designated* and *Undesignated*.

Additional information regarding OHA's adoption of GASB Statement No. 54 can be found in Note A to the financial statements.

Governmental Funds – Fund Balances – In fiscal year 2011, OHA's governmental funds reported an ending fund balance of \$403,505,210. Of this total amount, \$647,851 or 0.16% is classified as nonspendable for prepaid expenses and security deposits. Restricted fund balance totaled \$28,061,841 or 6.95%, broken down as follows: 99.14% for Native Hawaiian Revolving Loan Fund program of which \$5,330,127 relates to the long-term portion of

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Year ended June 30, 2011

outstanding loans, and 0.86% restricted for State Proviso programs and for other federal programs administered by OHA. \$81,000,000 or 20.07% is classified as committed, based on the Board of Trustees' resolution to commit these funds towards the debt service of DHHL-issued revenue bonds. Assigned fund balance comprises 72.83% or \$293,856,325 of fund balance, broken down as follows: 5.00% or \$14,681,566 has been encumbered, \$2,774,693 or 0.94% represents the non-current portion of outstanding loans and 94.06% or \$276,400,066 is available for future expenditures. Negative unassigned fund balance amounts included in the General and Federal Funds will be covered by fiscal year 2012 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 Assets* presents all of OHA'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).

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).

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Year ended June 30, 2011

It also includes the results of its blended component unit, Hi'ilei Aloha LLC and its wholly-owned subsidiaries, through its separate fiscal year end, December 31, 2010. Hi'ilei Aloha LLC and its wholly-owned subsidiaries have been included as a blended component unit 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 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 L 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 unit, Hi'ilei Aloha LLC and its wholly-owned subsidiaries, has also been classified as a special revenue fund. The basic governmental funds financial statements can be found to the left of the "adjustments" column, preceding the government-wide financial statements.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Year ended June 30, 2011

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 B to the financial statements.

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*.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Statement of Net Assets

Summarized financial information of OHA's *Statement of Net Assets* as of June 30, 2011 and 2010 is as follows:

	<u>2011</u>	<u>2010</u>
Assets:		
Capital assets	\$ 26,987,107	\$ 26,936,605
Other assets	<u>419,956,135</u>	<u>383,994,072</u>
Total assets	<u><u>\$446,943,242</u></u>	<u><u>\$410,930,677</u></u>
Liabilities:		
Other liabilities	\$ 16,450,925	\$ 27,771,363
Long-term liabilities	<u>2,063,886</u>	<u>1,988,598</u>
Total liabilities	<u>18,514,811</u>	<u>29,759,961</u>
Net assets:		
Invested in capital assets, net of related debt	26,847,369	26,778,818
Restricted – Federal funds	27,894,651	28,221,110
Unrestricted	<u>373,686,411</u>	<u>326,170,788</u>
Total net assets	<u>428,428,431</u>	<u>381,170,716</u>
Total liabilities and net assets	<u><u>\$446,943,242</u></u>	<u><u>\$410,930,677</u></u>

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. OHA's net assets totaled \$428,428,431 at the end of fiscal year 2011, compared to \$381,170,716 at the end of fiscal year 2010, representing an increase of 12.40% or \$47,257,715.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Year ended June 30, 2011

Unrestricted funds represent the largest portion of OHA's net assets (87.22% and 85.57% at June 30, 2011 and 2010, 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.

Statement of Activities

Summarized financial information of OHA's *Statement of Activities* for the fiscal years ended June 30, 2011 and 2010 is as follows:

	2011	2010
Revenues:		
Program revenues:		
Operating grants	\$ 922,868	\$ 357,057
Charges for services	433,204	388,043
Interest and investment earnings	188,085	354,026
General revenues:		
Appropriations, net of lapses	2,311,873	2,307,596
Public Land Trust	15,100,000	15,100,000
Interest and investment earnings	68,061,676	37,829,842
Newspaper ads	106,651	94,973
Donations and other	685,682	453,466
Hi'ilei Aloha LLC	2,306,531	1,514,403
Non-imposed fringe benefits	214,301	215,621
Total revenues	90,330,871	58,615,027
Expenses:		
Current divisions:		
Board of Trustees	1,750,028	1,672,848
Support services	13,449,526	12,048,600
Beneficiary advocacy	23,081,861	23,776,131
Depreciation	454,734	413,518
Hi'ilei Aloha LLC	3,594,267	3,007,695
Total expenses	42,330,416	40,918,792
Net transfers (to)/from other funds	(742,740)	255,813
Changes in net assets	\$47,257,715	\$ 17,952,048

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Year ended June 30, 2011

OHA's net assets increased by \$47,257,715 during the year. Key elements of this increase compared to the prior are as follows:

General revenues interest and investment earnings increased by \$30,065,893 from the prior year, due primarily to continued improvement in the market through the first three quarters of fiscal year 2011. Although dividend and interest income, net investment gains decreased by \$165,941, general revenue interest and investment earnings increased by \$30,231,834 from the prior year.

During the reporting period, OHA's blended component unit, Hi'iilei Aloha LLC, recognized \$115 of interest income which is also included as interest and investment earnings, recorded as general revenues. This was a decrease of \$70 from the prior year. Hi'iilei Aloha LLC is a legally separate reporting entity from OHA as discussed in Note A to the financial statements.

Increases in net assets noted above are offset by an increase in expenses in fiscal year 2011 of \$1,411,624. Of this increase, \$825,052 relates to OHA operations. Differences noted between Current Divisions in fiscal years 2011 and 2010 are primarily due to OHA's strategic realignment with the adoption of the 2010-2016 Strategic Plan which resulted in a reallocation of costs. Major components of the fiscal year 2011 increases are a result of a computer system upgrade of \$384,552 included in support services and costs incurred of \$530,618 related to the administration of a federal grant to provide telecommunication equipment rural communities included in beneficiary advocacy.

\$586,572 of the \$1,411,624 increase is attributed to the operations of OHA's blended component unit, Hi'iilei Aloha LLC and subsidiaries. The increase costs incurred are directly related to increased operations which have yielded an increase of revenues of \$792,128. With assistance from OHA, Hi'iilei Aloha LLC and subsidiaries continues progress towards self-sustainability.

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 2011, OHA's governmental funds reported an ending fund balance of \$403,505,210. Of this total amount, \$647,851, or 0.16% is classified as nonspendable for prepaid expenses and security deposits. Restricted fund balance totaled \$28,061,841 or 6.95%, broken down as follows: 99.14% for Native Hawaiian Revolving Loan Fund program of which \$5,330,127 relates to the long-term portion of outstanding loans, and 0.86% restricted for State Proviso programs and for other federal programs administered by OHA. \$81,000,000 or 20.07% is classified as committed, based on the Board of Trustees' resolution to commit these funds towards the debt service of DHHL-issued revenue bonds. Assigned fund balance comprises 72.83% or \$293,856,325 of fund balance, broken down as follows: 5.00% or \$14,681,566 has been encumbered, \$2,774,693 or 0.94% represents the

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Year ended June 30, 2011

non-current portion of outstanding loans and 94.06% or \$276,400,066 is available for future expenditures. Negative unassigned fund balance amounts included in the General and Federal Funds will be covered by fiscal year 2012 appropriations and grant draws, respectively.

At the close of fiscal year 2010, OHA's governmental funds reported an ending fund balance of \$356,222,709. Of this total amount, \$615,008, or 0.17% is classified as nonspendable for prepaid expenses and security deposits. Restricted fund balance totaled \$28,743,057 or 8.07%, broken down as follows: 97.94% for Native Hawaiian Revolving Loan Fund program of which \$5,884,738 relates to the long-term portion of outstanding loans, and 2.06% restricted for State Proviso programs and for other federal programs administered by OHA. \$84,000,000 or 23.58% is classified as committed, based on the Board of Trustees' resolution to commit these funds towards the debt service of DHHL-issued revenue bonds. Assigned fund balance comprises 68.25% or \$243,117,551 of fund balance, broken down as follows: 6.13% or \$14,897,266 has been encumbered, \$3,439,162 or 0.97% represents the non-current portion of outstanding loans and 92.46% or \$224,781,123 is available for future expenditures. Negative unassigned fund balance amounts included in the General and Federal Funds will be covered by fiscal year 2011 appropriations and grant draws, respectively.

OHA's governmental funds experienced an increase of \$47,282,501 and \$17,648,745 in fund balance during fiscal year 2011 and 2010, respectively.

CAPITAL ASSETS AND LONG-TERM LIABILITIES

OHA's and Hi'ilei Aloha LLC's investment in capital assets amounted to \$26,987,107 and \$26,936,605, net of depreciation, as of June 30, 2011 and 2010, respectively. Capital assets include land, building, leasehold improvements, equipment and software development.

	2011	2010
Land	\$24,358,454	\$24,358,454
Buildings and improvements	2,957,534	2,878,851
Equipment	4,805,444	4,508,576
Accumulated depreciation	(5,134,325)	(4,809,276)
Totals	\$26,987,107	\$26,936,605

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

OHA's long-term liabilities include accrued vacation, accrued workers' compensation, accrued trustee retirement plan obligation, accrued lease guarantee obligation and capital lease obligation. Additional information about OHA's long-term liabilities can be found in Note J to the financial statements.

Office of Hawaiian Affairs
State of Hawai'i

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Year ended June 30, 2011

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
711 Kapi'olani Boulevard, Suite 500
Honolulu, Hawai'i 96813

Office of Hawaiian Affairs
State of Hawai'i

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

June 30, 2011

ASSETS	Governmental Funds					Adjustments (Note L)	Government- wide Statement of Net Assets
	General Fund	Public Land Trust	Federal Grants	Other	Hi'ilei Aloha LLC		
Petty cash	\$ -	\$ 700	\$ -	\$ -	\$ 3,350	\$ -	\$ 4,050
Cash in State Treasury	399,535	-	-	-	-	-	399,535
Cash in banks	-	4,976,701	991,784	739,329	437,784	-	7,145,598
Cash held by investment manager	-	1,742,127	1,177,232	-	-	-	2,919,359
Accounts receivable	-	39,425,159	221,154	9,877	43,985	-	39,700,175
Interest and dividends receivable	-	654,318	94,059	-	-	-	748,377
Inventory, prepaid items and other assets	59,586	517,493	20,114	-	117,460	-	714,653
Notes receivable - due within one year	-	576,807	1,936,956	-	-	-	2,513,763
Notes receivable - due after one year	-	2,774,693	5,330,127	-	-	-	8,104,820
Security deposits	-	605	-	-	973	-	1,578
Investments	-	339,335,904	18,368,323	-	-	-	357,704,227
Capital assets - net	-	-	-	-	-	26,987,107	26,987,107
TOTAL	\$ 459,121	\$ 390,004,507	\$ 28,139,749	\$ 749,206	\$ 603,552	\$ 26,987,107	\$ 446,943,242

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, 2011

LIABILITIES AND FUND BALANCES/NET ASSETS	Governmental Funds					Total	Adjustments (Note L)	Government- wide Statement of Net Assets
	General Fund	Public Land Trust	Federal Grants	Other	Hi'ilei Aloha LLC			
LIABILITIES								
Accounts payable and accrued liabilities	\$ 185,348	\$ 15,743,793	\$ 245,098	\$ -	\$ 276,686	\$ 16,450,925	\$ -	\$ 16,450,925
Long-term liabilities								
Due within one year	-	-	-	-	-	-	878,855	878,855
Due after one year	-	-	-	-	-	-	1,185,031	1,185,031
Total liabilities	185,348	15,743,793	245,098	-	276,686	16,450,925	2,063,886	18,514,811
FUND BALANCES/NET ASSETS								
Fund balances								
Nonspendable								
Prepaid items & security deposits	59,586	518,098	20,114	-	50,053	647,851	(647,851)	-
Restricted for:								
Beneficiary advocacy	17,953	119,158	104,543	-	-	241,654	(241,654)	-
Native Hawaiian loan programs	-	-	22,490,060	-	-	22,490,060	(22,490,060)	-
Long-term portion of notes receivable	-	-	5,330,127	-	-	5,330,127	(5,330,127)	-
Committed to:								
DHHL	-	81,000,000	-	-	-	81,000,000	(81,000,000)	-
Assigned to:								
Support services	106,802	5,310,548	-	-	-	5,417,350	(5,417,350)	-
Beneficiary advocacy	100,046	9,150,507	-	749,206	-	9,999,759	(9,999,759)	-
Hi'ilei Aloha LLC	-	-	-	-	276,813	276,813	(276,813)	-
Long-term portion of notes receivable	-	2,774,693	-	-	-	2,774,693	(2,774,693)	-
Public Land Trust	-	275,387,710	-	-	-	275,387,710	(275,387,710)	-
Unassigned	(10,614)	-	(50,193)	-	-	(60,807)	60,807	-
Total fund balances	273,773	374,260,714	27,894,651	749,206	326,866	403,505,210	(403,505,210)	-
Total liabilities and fund balances	<u>\$ 459,121</u>	<u>\$ 390,004,507</u>	<u>\$ 28,139,749</u>	<u>\$ 749,206</u>	<u>\$ 603,552</u>	<u>\$ 419,956,135</u>		
Net assets								
Invested in capital assets, net of related debt							26,847,369	26,847,369
Restricted - federal funds							27,894,651	27,894,651
Unrestricted							373,686,411	373,686,411
Total net assets							<u>\$ 428,428,431</u>	<u>\$ 428,428,431</u>

The accompanying notes are an integral part of this statement.

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

Year ended June 30, 2011

	Governmental Funds					Adjustments (Note L)	Government- wide Statement of Activities	
	General Fund	Special Revenue Funds			Total			
	Public Land Trust	Federal Grants	Other	Hi'iilei Aloha LLC				
Expenditures/expenses								
Current divisions:								
Board of Trustees	\$ 35,459	\$ 1,806,777	\$ -	\$ -	\$ -	\$ 1,842,236	\$ (92,208)	\$ 1,750,028
Support services	1,196,772	12,589,362	-	4,852	-	13,790,986	(341,460)	13,449,526
Beneficiary advocacy	1,343,970	19,555,888	1,865,579	228,550	-	22,993,987	87,874	23,081,861
Depreciation	-	-	-	-	-	-	454,734	454,734
Hi'iilei Aloha LLC	-	-	-	-	3,678,421	3,678,421	(84,154)	3,594,267
Total expenditures/expenses	2,576,201	33,952,027	1,865,579	233,402	3,678,421	42,305,630	24,786	42,330,416
Program revenues								
Charges for services	-	-	433,204	-	-	433,204	-	433,204
Operating grants	-	-	922,868	-	-	922,868	-	922,868
Interest and investment earnings	-	-	183,048	5,037	-	188,085	-	188,085
Total program revenues	-	-	1,539,120	5,037	-	1,544,157	-	1,544,157
Net program expenditures/expenses	(2,576,201)	(33,952,027)	(326,459)	(228,365)	(3,678,421)	(40,761,473)	(24,786)	(40,786,259)
General revenues								
Appropriations, net of lapses of \$157,786	2,311,873	-	-	-	-	2,311,873	-	2,311,873
Public land trust	-	15,100,000	-	-	-	15,100,000	-	15,100,000
Interest and investment earnings	-	68,061,561	-	-	115	68,061,676	-	68,061,676
Newspaper advertisements	-	-	-	106,651	-	106,651	-	106,651
Donations and other	-	644,874	-	40,808	-	685,682	-	685,682
Hi'iilei Aloha LLC	-	-	-	-	2,306,531	2,306,531	-	2,306,531
Non-imposed fringe benefits	214,301	-	-	-	-	214,301	-	214,301
Total general revenues	2,526,174	83,806,435	-	147,459	2,306,646	88,786,714	-	88,786,714
EXCESS OF REVENUES (DEFICIENCY) OVER EXPENDITURES/EXPENSES (carried forward)	\$ (50,027)	\$ 49,854,408	\$ (326,459)	\$ (80,906)	\$ (1,371,775)	\$ 48,025,241	\$ (24,786)	\$ 48,000,455

The accompanying notes are an integral part of this statement.

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

Year ended June 30, 2011

	Governmental Funds					Adjustments (Note L)	Government- wide Statement of Activities	
	General Fund	Public Land Trust	Federal Grants	Other	Hi'iilei Aloha LLC			Total
EXCESS OF REVENUES (DEFICIENCY) OVER EXPENDITURES/EXPENSES (brought forward)	\$ (50,027)	\$ 49,854,408	\$ (326,459)	\$ (80,906)	\$(1,371,775)	\$ 48,025,241	\$ (24,786)	\$ 48,000,455
Other financing sources (uses)								
Net transfers (to) from other funds	-	(2,481,986)	-	240,494	1,498,752	(742,740)	-	(742,740)
Net change in fund balance/net assets	(50,027)	47,372,422	(326,459)	159,588	126,977	47,282,501	(24,786)	47,257,715
Fund balance/net assets								
Beginning of year	323,800	326,888,292	28,221,110	589,618	199,889	356,222,709	24,948,007	381,170,716
End of year	<u>\$ 273,773</u>	<u>\$374,260,714</u>	<u>\$27,894,651</u>	<u>\$749,206</u>	<u>\$ 326,866</u>	<u>\$403,505,210</u>	<u>\$24,923,221</u>	<u>\$428,428,431</u>

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs
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STATEMENT OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL
(BUDGETARY BASIS), GENERAL FUND

Year ended June 30, 2011

	Original Budget	Final Budget	Actual (budgetary basis)	Variance
Revenues:				
State appropriations, net of lapses	\$ 2,469,659	\$ 2,469,659	\$ 2,311,873	\$(157,786)
Total revenues	2,469,659	2,469,659	2,311,873	(157,786)
Expenditures:				
Board of Trustees	29,935	29,935	26,077	3,858
Support services	808,657	808,657	1,128,205	(319,548)
Beneficiary advocacy	1,631,067	1,631,067	1,161,238	469,829
Total expenditures	2,469,659	2,469,659	2,315,520	154,139
DEFICIENCY OF REVENUES OVER EXPENDITURES	\$ -	\$ -	\$ (3,647)	\$ (3,647)

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs
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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2011

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 accounting principles generally accepted in the United States of America (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

Reporting Entity

The accompanying basic financial statements present the financial activity of OHA (Primary Government) and its blended component unit, which is a legally separate organization for which the Primary Government is financially accountable.

Hi'ilei Aloha LLC, a Hawai'i limited liability company formed by OHA in September 2007, is presented as a blended component unit due to the common governing body with the primary government. The results of Hi'ilei Aloha LLC as of December 31, 2010, its fiscal year end, have been included in the financial statements. 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.

Audited financial reports for Hi'ilei Aloha LLC and its wholly-owned subsidiaries may be obtained by writing to Hi'ilei Aloha LLC, 711 Kapi'olani Boulevard, Suite 1430, Honolulu, Hawai'i 96813 or by calling (808) 596-8990.

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 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.

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 FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

1. Financial Statement Presentation and Basis of Accounting (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 which is recorded as an expenditure when utilized or paid. The amount of accumulated annual leave unpaid at June 30, 2011 has 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 NHRLF and other grants. 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, OHA's blended component unit, has also been accounted for in a special revenue fund.

2. 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.

3. 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 FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4. 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.

5. 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 Codification Section C60, Compensated Absences. The June 30, 2011 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.

6. 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.

7. Governmental Funds – Fund Balance

During the fiscal year June 30, 2011, OHA adopted GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB 54). 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."

Office of Hawaiian Affairs
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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

7. Governmental Funds – Fund Balance (continued)

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.

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, 2011, OHA had approximately, \$12.1 million in its Fiscal Reserve.

8. 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

Office of Hawaiian Affairs
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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

8. Encumbrances (continued)

governmental funds financial statements. The related expenditure is reported in the period in which the liability is incurred. Encumbrances as of June 30, 2011 consists of the following:

	<u>Encumbrances</u>
General Fund	\$ 206,848
Public Land Trust	14,461,056
Other	13,662
	\$ 14,681,566

9. 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.

10. Concentrations of Credit Risk

The financial instruments that potentially expose OHA to concentrations of credit risk consist principally of its investments and notes receivable. See Note G 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, 2011 are as follows:

Native Hawaiian and Hawaiian persons	91.5%
Agencies	7.8
Other	0.7
	100.0%

11. Notes Receivable

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.

Office of Hawaiian Affairs
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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE B – 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 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.

Office of Hawaiian Affairs
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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE B – BIENNIAL BUDGET (continued)

Adjustments necessary to reconcile the results of operations for the year ended June 30, 2011 from the budgetary basis to GAAP basis are as follows:

Excess of expenditures over revenues – actual (budgetary basis)	\$ (3,647)
Reserve for encumbrances at June 30	224,801
Prior year reserve for encumbrances	(109,732)
Prepaid expenditures not recognized for budgetary purposes – net of prior-year accruals	15,121
Expenditures for liquidation of prior-year encumbrances	<u>(176,570)</u>
Deficiency of revenues over expenditures – actual (GAAP basis)	<u>\$ (50,027)</u>

NOTE C – 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 140, SLH 2009 authorizes a total of \$2,469,659 general funds, and \$5,810,847 trust funds for OHA's programs for fiscal year 2011.

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 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, 2011, OHA's cash held in the State Treasury totaled \$399,535.

OHA holds all other 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, 2011, these deposits totaled \$6,707,814 and had a corresponding bank balance of \$6,929,754. Of this bank balance, \$6,609,941 was insured by either the Federal Deposit Insurance Corporation or National Credit Union administration, or collateralized or invested in U.S. Government securities. The remaining balance, \$319,813 was uninsured as of June 30, 2011 and deposited in one financial institution. While there is no indication that the uninsured cash is at risk,

Office of Hawaiian Affairs
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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE D – CASH (continued)

OHA is in the process of executing a collateralization with this financial institution to ensure future compliance.

At December 31, 2010, Hi'ilei Aloha LLC, OHA's blended component unit, had deposits totaling \$437,784 with a corresponding bank balance of \$441,354. 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 Federal Deposit Insurance Corporation (FDIC). Balances may at times exceed the FDIC's insurance limits.

NOTE E – INVENTORY, PREPAID ITEMS AND OTHER ASSETS

At June 30, 2011, OHA did not maintain inventory. At December 31, 2010, Hi'ilei Aloha LLC, OHA's blended component unit, had inventory totaling \$68,380 which consisted of items held for sale.

At June 30, 2011, OHA had prepaid items totaling \$582,698. At December 31, 2010, Hi'ilei Aloha LLC, OHA's blended component unit, had prepaid items totaling \$49,080.

NOTE F – NOTES RECEIVABLE

Notes receivable at June 30, 2011 consist of the following:

Loans receivable serviced by First Hawaiian Bank (of which, \$2,615,568 is guaranteed by Department of Hawaiian Home Lands (DHHL))	\$ 2,930,961
Native Hawaiian Revolving Loan Fund	8,741,468
Other	<u>1,697,310</u>
Total	13,368,739
Less allowance for doubtful accounts	<u>(2,751,136)</u>
Net	10,618,583
Amounts due within one year	<u>(2,513,763)</u>
Amounts due after one year	<u><u>\$ 8,104,820</u></u>

NOTE G – 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 OHA Board of Trustees adopted the Native Hawaiian Trust Fund Investment Policy Statement (NHTF investment policy), as updated April 15, 2010. 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.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE G – INVESTMENTS (continued)

OHA's investment policy allows for the following investments:

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

Investments as of June 30, 2011 and their maturities were as follows:

Investment type	Fund	Fair value	Investment maturities (in years)	
			Less than one	One thru five
U.S. treasuries	NHRLF	\$ 10,195,990	\$ 207,132	\$ 9,988,858
U.S. agencies	NHRLF	8,172,333	504,910	7,667,423
Mutual & commingled funds	NHTF	217,521,503	217,521,503	-
Hedge funds	NHTF	21,513,720	21,513,720	-
Private equity funds	NHTF	56,458,582	56,458,582	-
Common & preferred stock	NHTF	665,187	665,187	-
Other	NHTF	43,176,912	43,176,912	-
Total investments		357,704,227	340,047,946	17,656,281
Money market funds (not considered investments)	Various	2,919,359	2,919,359	-
Total investments		<u>\$360,623,586</u>	<u>\$342,967,305</u>	<u>\$17,656,281</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 FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE G – 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:

Foreign Currency Risk

To diversify the NHRLF portfolio against market fluctuations, OHA's investment policy allows for investments in foreign countries. As of June 30, 2011, OHA's foreign currency risks are as follows:

Investment Type	Currency	Value (US Dollar)
Mutual & commingled funds	Various	\$25,187,325
Private equity funds	Euro	\$ 7,550,496

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.

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, 2011, credit rates for all securities of government agencies were rated at Aaa (Moody's) or AAA (Standard & Poor's).

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.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE H – CAPITAL ASSETS

OHA's capital assets activities for the year ended June 30, 2011 are as follows:

	July 1, 2010	Additions/ transfer in	Retirements/ transfer out	June 30, 2011
Capital assets not depreciated:				
Land	\$11,354,633	\$ -	\$ -	\$11,354,633
Total capital assets not depreciated	<u>11,354,633</u>	<u>-</u>	<u>-</u>	<u>11,354,633</u>
Capital assets being depreciated:				
Buildings	1,041,665	-	(361)	1,041,304
Leasehold improvements	586,942	2,730	-	615,672
Furniture, Fixtures and Equipment	4,122,802	394,598	(112,870)	4,404,530
Total capital assets being depreciated	5,751,409	423,328	(113,231)	6,061,506
Less accumulated depreciation	(4,580,789)	(319,415)	110,985	(4,789,219)
Capital assets being depreciated – net	<u>1,170,620</u>	<u>103,913</u>	<u>(2,246)</u>	<u>1,272,287</u>
Capital assets – net	<u>\$12,525,253</u>	<u>\$103,913</u>	<u>\$ (2,246)</u>	<u>\$12,626,920</u>

As an overhead item, OHA's depreciation expense of \$110,985 is attributable to support services on the Statement of Activities.

Hi'ilei Aloha LLC's capital assets activities as of December 31, 2010 are as follows:

	January 1, 2010	Additions/ transfer in	Retirements/ transfer out	December 31, 2010
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	968,027	361	-	968,388
Leasehold improvements	282,217	49,953	-	332,170
Furniture, Fixtures and Equipment	385,774	66,140	(51,000)	400,914
Total capital assets being depreciated	1,636,018	116,454	(51,000)	1,701,472
Less accumulated depreciation	(228,487)	(135,319)	18,700	(345,106)
Capital assets being depreciated – net	<u>1,407,531</u>	<u>(18,865)</u>	<u>(32,300)</u>	<u>1,356,366</u>
Capital assets – net	<u>\$14,411,352</u>	<u>\$ (18,865)</u>	<u>\$ (32,300)</u>	<u>\$14,360,187</u>

NOTE I – 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, 2011,

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE I – CAPITAL LEASES (continued)

assets recorded under capital lease included in machinery, equipment, furniture and fixtures is \$323,141 and related amortization is \$205,232.

At June 30, 2011, the present value of minimum lease payments is \$139,738 and the long-term obligation is \$77,471. Below are minimum lease payments through 2015 and the computation of the current and long-term capital lease obligation:

Fiscal year ending June 30,	
2012	\$ 70,451
2013	58,624
2014	11,403
2015	<u>12,312</u>
Total minimum lease payments	152,790
Less stated interest	<u>(13,052)</u>
Present value of minimum lease payments (obligation under capital lease)	139,738
Less current portion	<u>(62,267)</u>
Long-term capital lease obligation	<u><u>\$ 77,471</u></u>

NOTE J – LONG-TERM LIABILITIES

Long-term liabilities for the year ended June 30, 2011 are as follows:

	July 1, 2010	Additions	Reductions	June 30, 2011	Amounts due within one year	Amounts due after one year
Accrued vacation	\$1,286,719	\$745,053	\$(666,458)	\$1,365,314	\$666,588	\$ 698,726
Accrued workers' compensation	389,758	57,015	(37,939)	408,834	-	408,834
Accrued trustee retirement plan	92,208	-	(92,208)	-	-	-
Accrued lease guaranty obligation	62,126	87,874	-	150,000	150,000	-
Capital lease obligation	<u>157,787</u>	<u>38,776</u>	<u>(56,825)</u>	<u>139,738</u>	<u>62,267</u>	<u>77,471</u>
Long-term liabilities	<u><u>\$1,988,598</u></u>	<u><u>\$928,718</u></u>	<u><u>\$(853,430)</u></u>	<u><u>\$2,063,886</u></u>	<u><u>\$878,855</u></u>	<u><u>\$1,185,031</u></u>

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

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE K – 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, 2011 are approximated as follows:

Fiscal year ending June 30,	
2012	\$522,261
2013	312,581
2014	1
Thereafter	<u>19</u>
Total	<u>\$834,862</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 operating leases totaled \$1,127,281 for the year ended June 30, 2011.

Hi'ilei Aloha LLC, OHA's blended component unit, leases office space for its office located in Honolulu, Hawai'i, from OHA, under a lease that expired in February 2011. In February 2011, it renewed the lease directly with the building owner. The new lease expires February 2013, and contains two renewal options of twelve months each. Base rent is approximately \$25,000 per year, plus a proportionate share of building operating expenses and general excise tax. It also leases a poi factory and an adjoining office in Kaua'i, under a lease that expires in February 2013. Future minimum payments under all leases as of December 31, 2010 are approximated as follows:

Year ending December 31,	
2011	\$34,754
2012	36,448
2013	<u>3,984</u>
Total	<u>\$75,186</u>

Rent expense under operating leases totaled approximately \$16,121 for the year ended December 31, 2010.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE L – 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	\$403,505,210
Amounts reported for governmental activities in the statement of net assets are different because:	
Net capital assets used in governmental activities are not current financial resources and therefore are not reported in the funds	26,987,107
Long-term liabilities not due and payable in the current period and therefore not reported in the funds:	
Accrued vacation	(1,365,314)
Accrued workers' compensation	(408,834)
Accrued lease guaranty obligation	(150,000)
Capital lease obligation	<u>(139,738)</u>
Subtotal	<u>(2,063,886)</u>
Total net assets – government-wide	<u><u>\$428,428,431</u></u>

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

Net changes in fund balances – total governmental funds	\$ 47,282,501
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. This is the amount by which depreciation and related debt exceeded capital outlays during the year	50,502
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	(78,595)
Accrued workers' compensation	(19,076)
Accrued trustee retirement plan	(92,208)
Accrued lease guaranty obligation	(87,874)
Capital lease obligation	<u>18,049</u>
Subtotal	<u>(75,288)</u>
Changes in net assets – government-wide	<u><u>\$ 47,257,715</u></u>

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE M – EMPLOYEE BENEFITS

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 average final compensation (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. 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 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, 2011, 2010, and 2009 were approximately \$1,225,230, \$1,156,000, and \$1,257,000, respectively. The contribution rate for the fiscal years ending June 30, 2011, 2010, and 2009 was 15.0%.

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

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE M – EMPLOYEE BENEFITS (continued)

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, 2010. OHA contributed approximately \$584,000 in OPEB expenses for the fiscal year ended June 30, 2011.

The EUTF issues a publicly 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, Hawaii 96813 or by calling (808) 586-7390.

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). During the fiscal year ended June 30, 2011, all open claims made under this Plan were settled as disclosed in Note J.

Hi'ilei Aloha LLC Retirement Plan

Hi'ilei Aloha LLC, OHA's blended component unit, offers a 401(k) profit sharing plan. 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 matches employees' contributions up to 4% of salary. Contribution expense amounted to \$41,728 for the year ended December 31, 2010.

Sick Leave

Accumulated sick leave amounted to \$2,458,484 as of June 30, 2011. Sick leave accumulates at the rate of 14 hours for each month of service, as defined, without limit. Sick pay can be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for sick leave is recorded in the accompanying financial statements.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE N – 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 \$214,301 for the fiscal year ended June 30, 2011, have been reported as revenues and expenditures of OHA's general fund.

NOTE O – RISK MANAGEMENT AND CONTINGENT LIABILITIES

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. The workers' compensation reserve approximated \$409,000 at June 30, 2011. The estimated losses will be paid from the NHTF.

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. At June 30, 2011, the case remains stayed.

This case could have a potential financial impact relative to the valuation of the appraisals. However, at the present time, OHA receives a fixed sum for its pro rata share of the revenues from the Hawai'i State Legislature and so there probably is no financial impact.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE O – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

Civil Complaints

In *C. Kai 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. On September 14, 2011, the plaintiff filed a Second Amended Complaint; hearing is set for February 27, 2012. OHA again expects the Second Amended Complaint 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.

In *Hawaii Civil Rights Commission, Arnold E. Widder v. State of Hawai'i, Office of Hawaiian Affairs*, FEPA No. 16479, EEOC No. 37B-2011-00161 an employment discrimination complaint was filed on May 25, 2011. On November 9, 2011 OHA received a Notice of Dismissal and Right to Sue from the Hawai'i Civil Rights Commission. The plaintiff has not launched any lawsuit against OHA as provided for under the November 9, 2011 notice on this matter.

Threatened Litigation

On September 8, 2011, OHA received a demand for settlement for claims against OHA by an employee. On October 31, 2011 OHA sent a response on this matter. To date, no further communication has been received to pursue any settlement.

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 inthertiable 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, 2011, OHA is currently evaluating its potential interest in 21 quiet title actions. This includes one action where OHA has been named as a cross-claimant for non-kuleana property. OHA continues to monitor this action for any potential escheat interest.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE O – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

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.

Guaranty

On December 27, 2006, OHA entered into an agreement with an unrelated company to act as guarantor of the company's lease agreement in conjunction with OHA's Commercial Business Economic Development grant program. The company's lease agreement was amended on December 21, 2009 and now expires on April 20, 2014. At any time through that date, should the company be over 30 days past due and upon landlord notice to OHA of the company's default, OHA will be obligated to perform pursuant to the guaranty by making payments on all past due obligations of rent, sums, costs and charges of the company up to a maximum amount of \$150,000. On October 21, 2011, OHA received a notice of default from the land lord indicating that the lease had vacated the leased property as of September 16, 2011 and demanded payment for all past due obligations of the lease under the agreement for the period from February 2010 through October 2011. Based on investigation on this claim it was determined that OHA's liability will reach the maximum amount under the guarantee of \$150,000.

Hi'ilei Aloha LLC

Hi'ipaka LLC, which is a wholly owned subsidiary of OHA's blended component unit, Hi'ilei Aloha LLC, is a party to a litigation arising from the normal course of business. Hi'ipaka LLC's insurance carrier is providing legal defense and it is expected that the insurance policy will cover any loss that may be sustained upon settlement, subject to a \$5,000 deductible. 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.

NOTE P – 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. Total received during the year ended June 30, 2011 was \$15,100,000 as reported in the financial statements under general revenue, public land trust. As of June 30, 2011, the related receivable was \$3,720,984 reported in the financial statements under accounts receivable, PLTF.

Besides property leased from DLNR, as discussed in Note K, 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

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2011

NOTE P – RELATED PARTY TRANSACTIONS (continued)

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.

Pursuant to Executive Order 07-05 Act 224, which became effective on July 1, 2006, the State appropriated \$180,000 out of Public Land Trust proceeds to be used for the repair and maintenance of the Royal Mausoleum at Mauna 'Ala. While the Royal Mausoleum was donated to OHA, the site is managed by the State Parks division of the DLNR. No payments made during the fiscal year. The remaining appropriation as of June 30, 2011 was \$101,205 and included in the restricted fund balance of the Public Land Trust Fund.

Payments made to OHA's blended component unit, Hi'ilei Aloha LLC, during fiscal year 2011 totaled \$2,213,868 resulting in a net operating transfer out in the fund financial statements. The blended component unit and each of its subsidiaries are legally separate reporting entity from OHA as discussed in Note A.

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. 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, 2011, OHA remitted \$3,000,000 to DHHL. As of June 30, 2011, OHA has committed \$81,000,000 of its fund balances for future payments to DHHL.

NOTE Q – SUBSEQUENT EVENTS

On November 16, 2011, the State of Hawai'i and OHA reached a tentative agreement subject to final legislative approval and community feedback regarding the settlement of a prior claim by OHA for past due ceded land revenues in the amount of \$200 million stemming from a 2008 settlement. The settlement provides for approximately 25 acres over 10 parcels in the Kaka'ako Makai area. OHA is currently pursuing community feedback and maintains the right to walk away from the settlement prior to legislative approval.

On July 7, 2011, Act 195 of the State of Hawai'i Legislative Session was passed, establishing the Native Hawaiian Roll Commission (NHRC) as an independent Commission funded by OHA. NHRC Commissioners are subject to appointment by the Governor. Funding for the NHRC will be drawn out of the Public Land Trust subject to OHA's internal biennium budget process.