



Financial Statements and Report of Independent
Certified Public Accountants

Office of Hawaiian Affairs
State of Hawai'i

June 30, 2007

Office of Hawaiian Affairs
State of Hawai'i

Contents

	Page
Introduction	1
Report of the Independent Certified Public Accountants	3
Management's discussion and analysis	5
Financial statements	
Governmental funds – balance sheet/government-wide statements of net assets	12
Governmental funds – statements of revenues, expenditures, and changes in fund balances/government-wide statements of activities	14
Statement of revenues and expenditures – budget and actual (budgetary basis), general fund	16
Notes to financial statements	17

Office of Hawaiian Affairs
State of Hawai'i

INTRODUCTION

Year ended June 30, 2007

GENERAL

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

The purposes of OHA include the following:

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

DIVISIONS

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

The title and objective of each division are listed below:

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

PURPOSE OF THE REPORT AND DEFINITIONS

The purpose of the financial audit was to enable the independent auditors to form an opinion as to the financial position of Office of Hawaiian Affairs at June 30, 2007, and the results of its operations for the fiscal 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.



Report of independent certified public accountants

Audit • Tax • Advisory

Grant Thornton LLP
1132 Bishop Street, Suite 1000
Honolulu, HI 96813-2822

T 808.536.0066

F 808.523.8590

www.GrantThornton.com

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

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Office of Hawaiian Affairs (OHA), State of Hawai'i, as of and for the year ended June 30, 2007, which collectively comprise OHA's basic financial statements as listed in the table of contents. These financial statements are the responsibility of OHA's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

As discussed in note A, the financial statements of the Office of Hawaiian Affairs, State of Hawai'i, are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawai'i that is attributable to the transactions of OHA. They do not purport to, and do not, present fairly the financial position of the State of Hawai'i as of June 30, 2007 and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of OHA, as of June 30, 2007, and the respective changes in financial position thereof and the respective budgetary comparison for the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

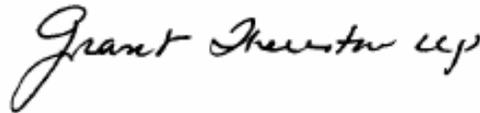
Board of Trustees of the Office of Hawaiian Affairs
State of Hawai'i

As discussed in note N to the basic financial statements, OHA is self-insured for workers' compensation, automobile, and general liabilities. Several claims were filed against OHA during the year ended June 30, 2007. Although OHA has recorded an estimated loss for such claims, as well as from any unasserted claims, the ultimate results may differ from OHA's estimates, due to the subjectivity of the data used by OHA to compute these amounts.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 9, 2008 on our consideration of OHA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 5 through 11 is not a required part of the basic financial statements but is supplementary information required by the accounting principles generally accepted in the United States 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 introduction, as listed in the accompanying contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to auditing procedures applied in the audit of OHA's basic financial statements and, accordingly, we express no opinion on it.



Honolulu, Hawaii
June 9, 2008

Office of Hawaiian Affairs
State of Hawai'i

MANAGEMENT'S DISCUSSION AND ANALYSIS

Year ended June 30, 2007

As management of OHA, we offer the following narrative overview and analysis to readers of our financial statements. While the financial statements present only the financial activities for the fiscal year ended June 30, 2007, management discussion and analysis will address both this year and the year ended June 30, 2006.

Management's discussion and analysis is provided at the beginning of the financial statements 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 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, 2007 by \$505,262,161 (presented as “total net assets”). Of this amount, \$451,395,319 is reported as “unrestricted”, while \$27,301,983 is reported as “restricted-federal funds” and \$26,564,859 is reported as “invested in capital assets, net of related debt.” The assets of OHA exceeded its liabilities at fiscal year ended June 30, 2006 by \$454,159,204 (presented as “total net assets”). Of this amount, \$412,439,886 is reported as “unrestricted”, while \$26,089,587 is reported as “restricted-federal funds” and \$15,629,731 is reported as “invested in capital assets, net of related debt.” 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 \$51,102,957 (a 11.3% increase) in fiscal year 2007. This was primarily due to investment income and gains experienced on the OHA's Native Hawaiian Trust Fund (NHTF). OHA's total net assets, increased by \$49,874,134 (a 12.3% increase) in fiscal year 2006. This was primarily due to investment income, an increase in ceded land revenue and gains experienced in OHA's NHTF.

Governmental Funds Financial Statements Highlights

Governmental Funds – Fund Balances – At the close of fiscal year 2007, OHA's governmental funds reported an ending fund balance of \$481,111,587. Of this total amount, \$465,668,567 represents the unreserved fund balances with 94.3% being in the Public Land Trust Fund (PLTF). Of this \$465,668,567, \$24,465,627 is designated for the Native Hawaiian Revolving Loan Fund (NHRLF), \$39,486 is designated for the Fannie Mae Loan Program; \$29,419 is designated for other grants, \$855,509 is designated for Hawaiian projects; and \$12,851,429 is designated for subsequent year's expenditures, leaving \$427,427,097 as undesignated. This \$427,427,097 is roughly 88.8% of the total fund balance at the end of fiscal year 2007.

At the close of fiscal year 2006, OHA's governmental funds reported an ending fund balance of \$440,162,266. Of this total amount, \$422,987,084 represented the unreserved fund balances with 93.9% being in the PLTF.

Of this \$422,987,084, \$23,257,055 was designated for the NHRLF, \$4,000,000 was designated for the Fannie Mae Loan Program; \$29,419 was designated for other grants, \$693,801 was designated for Hawaiian projects; and \$13,057,000 was designated for subsequent year's expenditures, leaving \$381,949,809 as undesignated. This \$381,949,809 represented roughly 86.7% of the total fund balance at the end of fiscal year 2006.

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 the Financial Statements*. The first three components are intended to present different financial views of OHA. The fourth component is intended to further explain some of the information in the financial statements and provide more detail. These components are described below.

Government-wide Financial Statements

The *Government-wide Financial Statements* provide a broad view of OHA's operations in a manner similar to a private-sector business. These statements provide both short-term and long-term information about OHA's financial position, which assists in assessing OHA's economic condition at the end of the fiscal year. These are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means they follow 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 (federal and other grants that break out charges for services, investment income and net gains/losses on the NHRLF, and operating grants), and general revenues (investment income and net gains/losses on investments, legislative appropriations, non-imposed fringe benefits, newspaper advertisements, donations, PLTF, and other revenues).

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

Governmental Funds Financial Statements

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

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

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, the governmental funds financial statements focus on near-term inflows and outflows of expendable resources. They also focus on the balances of 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 K.

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

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

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

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

Notes to Financial Statements

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

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Statement of Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. OHA's net assets totaled \$505,262,161 at the end of fiscal year 2007, compared to \$454,159,204 at the end of fiscal year 2006.

Unrestricted funds represent the largest portion of OHA's net assets (89.34% and 90.81% at June 30, 2007 and 2006, 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 designations of resources.

Summarized financial information of OHA's *Statement of Net Assets* as of June 30, 2007 and 2006 is as follows:

	2007	2006
Assets:		
Capital assets	\$ 26,662,259	\$ 15,749,470
Other assets	487,429,734	449,266,276
Total assets	<u>\$514,091,993</u>	<u>\$465,015,746</u>
Liabilities:		
Other liabilities	\$ 6,966,147	\$ 9,104,010
Long-term liabilities	1,863,685	1,752,532
Total liabilities	<u>8,829,832</u>	<u>10,856,542</u>
Fund balances:		
Invested in capital assets, net of related debt	26,564,859	15,629,731
Restricted – Federal funds	27,301,983	26,089,587
Unrestricted	<u>451,395,319</u>	<u>412,439,886</u>
Total net assets	<u>505,262,161</u>	<u>454,159,204</u>
Total liabilities and net assets	<u>\$514,091,993</u>	<u>\$465,015,746</u>

At the end of fiscal years 2007 and 2006, OHA is able to report a positive balance in its category of government-wide net assets.

Statement of Activities

OHA's net assets in fiscal year 2007 increased by \$51,102,957 or 11.3% from the prior year. Approximately 16.8% of OHA's total revenue came from the Public Land Trust, while 20.1% came from dividend and interest income, 46.5% came from net investment gains, and 3.2% resulted from Hawai'i State Legislative appropriations. Revenues increased by approximately \$8,202,000 from the prior year. The increase is the net effect of a \$17,492,000 decrease in public land trust revenues due to a one-time special payment in 2006, offset by an \$18,763,000 increase in investment returns as a result of higher investment balances, and receipt of \$3,350,000 and \$7,600,000 from a federal agency and nonprofit corporation, respectively, as discussed in notes G and O. Expenses increased by approximately \$6,946,000, mainly as a result of continual programmatic efforts primarily geared toward education, economic development, social services, governance, and land preservation and conservation.

In 2006, OHA's net assets increased by \$49,874,134 or 12.3% from fiscal year 2005. Approximately 39.9% of OHA's total revenue came from the PLTF, while 15.0% came from dividend and interest income, 28.1% came from net investment gains, and 3.4% resulted from Legislative appropriations. This increase in 2006 over 2005 was due to market fluctuations incurred during the year, and the continuance of further diversifying the investment portfolio to attain long term asset allocation targets.

Summarized financial information of OHA's statement of activities for the fiscal years ended June 30, 2007 and 2006 is as follows:

	<u>2007</u>	<u>2006</u>
Revenues:		
Program revenues:		
Charges for services	\$ 57,821	\$ 53,892
Operating grants	3,723,699	325,945
Contributions	7,600,000	10,105,258
Dividend and interest income	1,093,819	859,118
Net investment gains (losses)	266,204	(350,366)
General revenues:		
Appropriations, net of lapses	2,828,459	2,755,011
Public land trust	15,100,000	32,591,931
Dividend and interest income	16,940,017	11,417,954
Net investment gains (losses)	41,421,318	23,275,048
Newspaper ads	66,860	72,107
Donations and other	403,446	185,323
Non-imposed fringe benefits	220,219	229,089
Total revenues	<u>89,721,862</u>	<u>81,520,310</u>
Expenses:		
Current divisions:		
Board of Trustees	1,736,405	1,779,504
Support Services	8,305,431	10,762,388
Beneficiary Advocacy	28,010,677	18,498,605
Depreciation	566,392	632,679
Total expenses	<u>38,618,905</u>	<u>31,673,176</u>
Changes in net assets	<u>\$51,102,957</u>	<u>\$49,847,134</u>

GOVERNMENTAL FUNDS FINANCIAL ANALYSIS

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

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

At the close of fiscal year 2007, OHA's governmental funds reported an ending fund balance of \$481,111,587. Of this amount, \$465,668,567, or 96.8%, represents unreserved funds, broken down as follows: 5.1% for NHRLF, 0.01% for Fannie Mae Loan Program, 0.01% for other grants, 0.2% for Hawaiian projects, 2.7% for subsequent years' expenditures, and 88.8% undesignated. Reserved fund balances accounted for \$15,443,020, or 3.2% of the total fund balance, broken down as follows: 1.6% for encumbrances, 1.6% for notes receivable, and 0.1% for prepaid expenses and security deposits.

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

CAPITAL ASSETS

A portion of OHA's net assets (5.2% and 3.4% at June 30, 2007 and 2006, respectively) reflects its investment in capital assets such as land, building, leasehold improvements, equipment and software development, less any related debt used to acquire those assets that are still outstanding. OHA uses these capital assets to provide services to beneficiaries; consequently, these assets are not available for future spending. Although OHA's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt, if any, must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

Capital assets at year end (net of depreciation in thousands)

	<u>2007</u>	<u>2006</u>
Land	\$24,358.5	\$13,087.9
Buildings and improvements	1,737.0	1,833.8
Equipment	<u>566.8</u>	<u>827.8</u>
Totals	<u>\$26,662.3</u>	<u>\$15,749.5</u>

This year's major addition is the acquisition of Wao-kele o Puna for approximately \$11.3 million, as discussed in note G.

ECONOMIC FACTORS

In fiscal year 2007, Hawai'i experienced a State-wide slowdown in the real estate sector which directly impacts the residential construction, development planning and consumer spending patterns. Despite higher interest rates in combination with decreased visitor arrivals, Hawai'i's overall unemployment rate, 2.4%, remains one of the lowest in the nation and fairly consistent with 2006's rate of 2.6%. This is predominantly as a result of the scarcity of workers in all classification from entry to professional levels and an increase in the labor force.

Hawai'i experienced an increase in the average monthly labor force of 1.4% or 8,800 people to 650,900 in fiscal year 2007 over 2006. The change in the total workforce is derived by the following: 635,300 average per month employed and 15,600 average per month unemployed in fiscal year 2007 as compared to 625,100 average per month employed and 17,000 average per month unemployed in fiscal year 2006.

A large amount of Hawai'i's workforce are employed in the government, professional and business services, retail trade, food services and drinking places, and health care and social assistance sectors, which comprised of approximately 61.2% of the workforce in Hawai'i.

Hawai'i's tourism industry saw a decrease of approximately 1,070,000 visitors days in fiscal year 2007, down to 67,626,779 from 68,697,142 experienced in fiscal year 2006. Although fiscal year 2007 experienced a decrease in visitor days, according to the Department of Business, Economic Development and Tourism, total annual expenditures rose by \$187,000,000 from about \$11,876,000,000 in fiscal year 2006 to about \$12,063,000,000 in fiscal year 2006, an increase of 1.6%. This improvement is a result of an increase in an average daily spending of \$178.38 in 2007 as compared to \$172.87 in 2006. The report also reflects a change from fiscal year 2006 to fiscal year 2007 in international visitors of 22% to 20% and in domestic visitors of 78% to 80%.

Hawai'i's economy is mainly attributed from construction, real estate, and the tourism industry. It is expected that investments in construction will continue to grow into the latter half of 2007, however still not at peak levels experienced during 2004 and 2005. In fiscal year 2007, building authorizations grew by 5.0% from about \$3,731,000,000 experienced in the fiscal year 2006 to approximately \$3,918,000,000. This percentage increase is a result of an increase in commercial and industrial permits issued for approximately \$289,000,000 and in increase in additions and alterations permits issued for approximately \$259,000,000 while there was a decrease in residential permits issued of approximately \$361,000,000.

It is forecasted that Hawai'i will continue to experience an increase in the number of building permits in 2007 which will surpassed 2006 amounts to an overall increase of approximately 24.0%, from about 1,900 permits to approximately 2,400 by end of 2007.

Although personal income increased to 1.4% in 2007 as compared to 0.04% in 2006, the inflation rate decreased from 4.8% in 2007 from 5.8% in 2006. As the inflation rate decreases, real personal income will continue to grow. It is forecasted that in 2008, Hawai'i will experience a consistent sustainable growth development resulting from a continued growth in the personal income, and visitor spending and arrivals.

OHA's two current investment managers were contracted beginning in March 2003 and provided with a total of approximately \$257,000,000 in trust fund assets. The NHTF has grown to a net value of about \$469,000,000 as of June 30, 2007 (with net accretions in fiscal year 2007 of approximately \$76,700,000 and \$16,400,000 in fiscal year 2006).

OHA will continue to provide grants in support of native Hawaiian projects and initiatives in concert with OHA's mission. Funding is primarily based on the historical performance of OHA's NHTF investments in traditional and non-traditional investment vehicles. The favorable trend of positive returns in recent years contributed to an increase in grant awards between fiscal years 2006 and 2007.

REQUEST FOR INFORMATION

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

Office of Hawaiian Affairs
State of Hawai'i

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

June 30, 2007

ASSETS	Governmental Funds				Total	Adjustments (note K)	Government- wide Statement of Net Assets
	General Fund	Public Land Trust	Federal Grants	Other			
Petty cash	\$ 20,000	\$ -	\$ -	\$ -	\$ 20,000	\$ -	\$ 20,000
Cash in State Treasury	791,787	3,176,733	6,271	800	3,975,591	-	3,975,591
Cash in banks	-	2,791,560	877,998	854,709	4,524,267	-	4,524,267
Cash held by investment manager	-	623,686	141,912	-	765,598	-	765,598
Accounts receivable	-	776,720	-	2,613	779,333	-	779,333
Interest and dividends receivable	-	420,692	253,980	-	674,672	-	674,672
Prepaid and other assets	78,378	227,874	13,888	-	320,140	-	320,140
Notes receivable - due within one year	-	728,565	489,903	-	1,218,468	-	1,218,468
Notes receivable - due after one year	-	5,227,404	1,108,462	-	6,335,866	-	6,335,866
Security deposits	6,030	54,970	1,803	-	62,803	-	62,803
Investments	-	444,287,369	24,465,627	-	468,752,996	-	468,752,996
Capital assets - net	-	-	-	-	-	26,662,259	26,662,259
TOTAL	\$ 896,195	\$ 458,315,573	\$ 27,359,844	\$ 858,122	\$ 487,429,734	\$ 26,662,259	\$ 514,091,993

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, 2007

LIABILITIES AND FUND BALANCES/NET ASSETS	Governmental Funds				Total	Adjustments (note K)	Government- wide Statement of Net Assets
	General Fund	Public Land Trust	Federal Grants	Other			
LIABILITIES:							
Accounts payable and accrued liabilities	\$ 490,017	\$ 5,733,110	\$ 20,180	\$ 17,159	\$ 6,260,466	\$ 648,000	\$ 6,908,466
Due to State of Hawaii	20,000	-	37,681	-	57,681	-	57,681
Long-term liabilities:							
Due within one year	-	-	-	-	-	406,000	406,000
Due after one year	-	-	-	-	-	1,457,685	1,457,685
Total liabilities	510,017	5,733,110	57,861	17,159	6,318,147	2,511,685	8,829,832
FUND BALANCES/NET ASSETS:							
Fund balances:							
Reserved for encumbrances	340,482	7,005,198	160,063	-	7,505,743	(7,505,743)	-
Reserved for notes receivable	-	5,955,969	1,598,365	-	7,554,334	(7,554,334)	-
Reserved for prepaid expenses and security deposits	84,408	282,844	15,691	-	382,943	(382,943)	-
Unreserved:							
Designated for Native Hawaiian revolving loans	-	-	24,465,627	-	24,465,627	(24,465,627)	-
Designated for Fannie Mae Loan Program	-	39,486	-	-	39,486	(39,486)	-
Designated for other grants	-	-	29,419	-	29,419	(29,419)	-
Designated for Hawaiian projects	-	-	-	855,509	855,509	(855,509)	-
Designated for subsequent year's expenditures	-	12,851,429	-	-	12,851,429	(12,851,429)	-
Undesignated	(38,712)	426,447,537	1,032,818	(14,546)	427,427,097	(427,427,097)	-
Total fund balances	386,178	452,582,463	27,301,983	840,963	481,111,587	(481,111,587)	-
Total liabilities and fund balances	\$ 896,195	\$ 458,315,573	\$ 27,359,844	\$ 858,122	\$ 487,429,734		
Net assets:							
Invested in capital assets, net of related debt						26,564,859	26,564,859
Restricted - federal funds						27,301,983	27,301,983
Unrestricted						451,395,319	451,395,319
Total net assets						\$ 505,262,161	\$ 505,262,161

The accompanying notes are an integral part of this statement

Office of Hawaiian Affairs
State of Hawai'i

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

Year ended June 30, 2007

	Governmental Funds				Total	Adjustments (note K)	Government- wide Statement of Activities
	General Fund	Special Revenue Funds		Other			
		Public Land Trust	Federal Grants				
Expenditures/expenses:							
Current divisions:							
Board of Trustees	\$ 49,028	\$ 1,667,292	\$ -	\$ -	\$ 1,716,320	\$ 20,085	\$ 1,736,405
Support services	1,023,208	11,055,644	48,278	964	12,128,094	(3,822,663)	8,305,431
Beneficiary advocacy	1,839,539	21,583,550	3,869,938	35,100	27,328,127	682,550	28,010,677
Depreciation	-	-	-	-	-	566,392	566,392
Total expenditures/expenses	2,911,775	34,306,486	3,918,216	36,064	41,172,541	(2,553,636)	38,618,905
Program revenues:							
Charges for services	-	-	57,821	-	57,821	-	57,821
Operating grants and contributions							
Operating grants	-	-	3,723,699	-	3,723,699	-	3,723,699
Contributions	-	-	-	-	-	7,600,000	7,600,000
Dividend and interest income	-	-	1,082,888	10,931	1,093,819	-	1,093,819
Investment income	-	-	266,204	-	266,204	-	266,204
Total program revenues	-	-	5,130,612	10,931	5,141,543	7,600,000	12,741,543
Net program (expenses) revenue	(2,911,775)	(34,306,486)	1,212,396	(25,133)	(36,030,998)	10,153,636	(25,877,362)
General revenues:							
Appropriations, net of lapses	2,828,459	-	-	-	2,828,459	-	2,828,459
Public land trust	-	15,100,000	-	-	15,100,000	-	15,100,000
Dividend and interest income	-	16,940,017	-	-	16,940,017	-	16,940,017
Investment gains	-	41,421,318	-	-	41,421,318	-	41,421,318
Newspaper advertisements	-	-	-	66,860	66,860	-	66,860
Donations and other	-	311,520	-	91,926	403,446	-	403,446
Non-imposed fringe benefits	220,219	-	-	-	220,219	-	220,219
Total general revenues	3,048,678	73,772,855	-	158,786	76,980,319	-	76,980,319
EXCESS OF REVENUES over EXPENDITURES/CHANGE IN NET ASSETS (carried forward)	\$ 136,903	\$ 39,466,369	\$ 1,212,396	\$ 133,653	\$ 40,949,321	\$ 10,153,636	\$ 51,102,957

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs
State of Hawai'i

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

Year ended June 30, 2007

	Governmental Funds				Total	Adjustments (note K)	Government- wide Statement of Activities
	General Fund	Special Revenue Funds		Other			
		Public Land Trust	Federal Grants				
EXCESS OF REVENUES OVER EXPENDITURES/CHANGE IN NET ASSETS (brought forward)	\$ 136,903	\$ 39,466,369	\$ 1,212,396	\$ 133,653	\$ 40,949,321	\$ 10,153,636	\$ 51,102,957
Fund balance/net assets:							
Beginning of year	249,275	413,116,094	26,089,587	707,310	440,162,266	13,996,938	454,159,204
End of year	<u>\$ 386,178</u>	<u>\$ 452,582,463</u>	<u>\$ 27,301,983</u>	<u>\$ 840,963</u>	<u>\$ 481,111,587</u>	<u>\$ 24,150,574</u>	<u>\$ 505,262,161</u>

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs
State of Hawai'i

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

Year ended June 30, 2007

	Original Budget	Final Budget	Actual (budgetary basis)	Variance
Revenues:				
State appropriations, net of lapses	\$ 2,866,279	\$ 2,866,279	\$ 2,840,336	\$ (25,943)
Total revenues	2,866,279	2,866,279	2,840,336	(25,943)
Expenditures:				
Board of Trustees	34,206	34,206	35,114	(908)
Support services	963,488	971,080	938,069	33,011
Beneficiary advocacy	1,868,585	1,860,993	1,867,153	(6,160)
Total expenditures	2,866,279	2,866,279	2,840,336	25,943
EXCESS OF REVENUES OVER EXPENDITURES	\$ -	\$ -	\$ -	\$ -

The accompanying notes are an integral part of this statement.

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Financial Statement Presentation and Basis of Accounting

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

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

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

Governmental Funds Financial Statements – The governmental funds financial statements are reported using the current financial resources measurement focus and the 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.

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, 2007 has been reported only in the government-wide financial statements.

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

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

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

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2007

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

Special Revenue Funds – These funds include OHA's proceeds and income from the Public Land Trust as defined in Chapter 10, Hawai'i Revised Statutes, as well as the proceeds and income of the Native Hawaiian Rights Fund, the 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.

2. Investments

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

3. Capital Assets

Capital assets acquired for general organization purposes are recorded as expenditures in the governmental funds financial statements. Donated fixed assets are recorded at estimated fair value at the time received on the government-wide financial statements. Depreciation 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.

4. Accrued Vacation

OHA accrues all vacation and compensatory pay at current salary rates; including additional amounts for certain salary-related expenses associated with the payment of compensated absences, in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. The June 30, 2007 balance includes fringe benefits computed at the rate of 7.65% of accrued vacation and compensatory pay. Accrued vacation is reported as an expense when earned in the government-wide financial statements, but not reported as an expenditure in the governmental funds financial statements, as current financial resources are not used.

5. Risk Management

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

6. Governmental Funds – Fund Balance Reserves and Designations

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

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2007

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

governmental funds' designation of fund balance reflects tentative plans for future use of financial resources.

7. Encumbrances

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

8. Use of Estimates

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

9. Concentrations of Credit Risk

The financial instruments that potentially expose OHA to concentrations of credit risk consist principally of notes receivable. OHA extends credit to native Hawaiian and Hawaiian persons and agencies that use OHA's funds for the betterment of Native Hawaiians and Hawaiians. The mix of notes receivable at June 30, 2007 are as follows:

Native Hawaiian and Hawaiian persons	87%
Agencies	12
Other	<u>1</u>
	<u>100%</u>

NOTE B – BIENNIAL BUDGET

Because it is not a part of the executive branch, OHA's budget is considered by the 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 or 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

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2007

NOTE B – BIENNIAL BUDGET (continued)

programmatic objectives, expected outcomes, and financial requirements. The budget also shows the proportion of funding requested from general funds to be appropriated by the Legislature and from trust funds appropriated by OHA's Board of Trustees.

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

The budget is adopted for the general fund and is prepared on a basis other than GAAP. The actual results of operations are presented on the budgetary basis in the 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.

Adjustments necessary to reconcile the results of operations for the year ended June 30, 2007 from the budgetary basis to GAAP basis are as follows:

Excess of revenues over expenditures – actual (budgetary basis)	\$ –
Reserve for encumbrances at June 30	340,482
Prior year reserve for encumbrances	(136,211)
Accrued payables and payroll	350,919
Prepaid expenditures not recognized for budgetary purposes – net of prior-year accruals	63,843
Expenditures for liquidation of prior-year encumbrances	(470,252)
Lapse to State General Fund	<u>(11,878)</u>
Deficiency of revenues over expenditures – actual (GAAP basis)	<u>\$ 136,903</u>

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2007

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 109, SLH 2005 authorizes a total of \$2,866,279 general funds, and \$5,460,424 trust funds for OHA's programs for fiscal year 2007.

NOTE D – CASH

The State maintains a cash pool that is used by all agencies. OHA's portion of this pool is indicated on the *Governmental Funds Balance Sheet* as "cash in State treasury." The Hawai'i Revised Statutes authorize Director of Finance to invest in obligations of or guaranteed by the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally-insured financial institutions. OHA's cash included in State pooled funds is fully collateralized with securities held by third-party agents in the State's name, as required by the Hawai'i Revised Statutes Section 38-3. At June 30, 2007, OHA's cash held in the State treasury totaled \$3,975,591.

On July 1, 2006, Act 107, SLH 2005 authorized OHA to make all necessary deposits and disbursements in any banking institution within or outside the State. With the exception of payroll which OHA will continue to retain services provided by the Department of Accounting and General Services (DAGS), OHA implemented fiscal autonomy and withdrew all non-general fund cash held at the State and established accounts in a banking institution held outside of the State to maximize investment returns in accordance with Hawai'i Revised Statutes Section 10-5. At June 30, 2007, these deposits totaled \$4,524,267, and had a corresponding bank balance of \$6,634,010. Of this bank balance, \$4,921,175 was insured by the Federal Deposit Insurance Corporation, or collateralized or invested in U.S. Government securities.

NOTE E – NOTES RECEIVABLE

Notes receivable at June 30, 2007 consist of the following:

Loans receivable serviced by First Hawaiian Bank (of which, \$3,146,102 is guaranteed by DHHL)	\$ 5,787,569
Native Hawaiian Revolving Loan Fund	3,058,365
Other	<u>1,661,920</u>
Total	10,507,854
Less allowance for doubtful accounts	<u>(2,953,520)</u>
Net	7,554,334
Amounts due within one year	<u>(1,218,468)</u>
Amounts due after one year	<u><u>\$ 6,335,866</u></u>

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2007

NOTE F – INVESTMENTS

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

OHA's investment policy allows for the following investments:

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

Investments as of June 30, 2007 and their maturities were as follows:

Investment type	Fund	Fair market value	Investment maturities (in years)	
			Less than one	One thru five
U.S. treasuries	NHRLF	\$ 3,380,920	\$ 683,045	\$ 2,697,875
U.S. agencies	NHRLF	21,084,707	7,472,946	13,611,761
Pooled investments	NHTF	195,939,368	195,939,368	—
Limited partnerships	NHTF	216,393,013	216,393,013	—
Real estate investments	NHTF	11,177,801	11,177,801	—
Other	NHTF	20,777,187	20,777,187	—
Total securities		468,752,996	452,443,360	16,309,636
Money market funds (not considered securities)	Various	765,598	765,598	—
Total investments		<u>\$469,518,594</u>	<u>\$453,208,958</u>	<u>\$16,309,636</u>

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2007

NOTE F – INVESTMENTS (continued)

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

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. Interest rate, credit and concentration risks for the NHRLF investments are as follows:

Interest Rate Risk

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

<u>Type of investment</u>	<u>Maximum maturity</u>
U.S. Treasuries	5 years
U.S. Agencies	5 years

The duration of the investment portfolio, under normal market conditions, range between 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, 2007, credit rates for all securities of government agencies were rated at Aaa (Moody's) or AAA (Standard & Poor's).

Concentration of Risk

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

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2007

NOTE F – INVESTMENTS (continued)

Foreign Currency Risk

To diversify the NHTF portfolio against market fluctuations, OHA's investment policy allows for investments in foreign countries. As of June 30, 2007, OHA's foreign currency risks are as follows:

Investment type	Currency	Value (US dollar)
Limited partnership	Various	\$30,993,503
Pooled investments	Euro	\$ 1,780,468

NOTE G – CAPITAL ASSETS

Capital Assets activities for the year ended June 30, 2007 are as follows:

	July 1, 2006	Additions	Retirements/ transfer	June 30, 2007
Capital assets not depreciated:				
Land	\$13,087,920	\$11,270,533	\$ –	\$24,358,453
Total capital assets not depreciated	13,087,920	11,270,533	–	24,358,453
Capital assets being depreciated:				
Buildings	2,091,441	–	(3,838)	2,087,603
Leasehold improvements	539,245	21,129	–	560,374
Machinery, equipment, furniture and Fixtures	3,701,862	188,701	(24,344)	3,866,219
Total capital assets being depreciated	6,332,548	209,830	(28,182)	6,514,196
Less accumulated depreciation	(3,670,998)	(566,392)	27,000	(4,210,390)
Capital assets being depreciated – net	2,661,550	(356,562)	(1,182)	2,303,806
Capital assets – net	\$15,749,470	\$10,913,971	\$ (1,182)	\$26,662,259

In fiscal year 2007, OHA acquired 25,856 acres of forest land known as Wao Kele o Puna located in Puna, Hawai'i from The Trust for Public Land. The purchase was made possible through corroboration with the Pele Defense Fund (PDF), the DLNR, the United States Forest Service (USFS) of the United States Department of Agriculture, The Trust for Public Land, the Hawaiian Congressional Delegation, and U.S. Senator Daniel Inouye in a combined effort to protect and properly manage the forest.

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2007

NOTE G – CAPITAL ASSETS (continued)

As part of the above acquisition, OHA received a grant in the amount of \$3,350,000 from the USFS's Forest Legacy Program through a U.S. Congressional appropriation and a non-cash contribution of \$7,600,000 from The Trust for Public Land. These contributions are reflected in the *Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances/Government-wide Statement of Activities*.

NOTE H – CAPITAL LEASES

OHA leases photocopiers and mail postage meter machines for all offices. In accordance with FASB Statement No. 13, 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.

At June 30, 2007, the present value of minimum lease payments is \$97,400 and the long-term obligation is \$49,400. Below are minimum lease payments through 2012 and the computation of the current and long-term capital lease obligation:

Fiscal year ending June 30,	
2008	\$ 54,133
2009	41,929
2010	5,317
2011	3,281
2012	<u>1,951</u>
Total minimum lease payments	106,611
Less implicit interest	<u>(9,211)</u>
Present value of minimum lease payments (obligation under capital lease)	97,400
Less current portion	<u>(48,000)</u>
Long-term capital lease obligation	<u>\$ 49,400</u>

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2007

NOTE I – LONG-TERM LIABILITIES

Long-term liabilities for the year ended June 30, 2007 are as follows:

	July 1, 2006	Additions	Reductions	June 30, 2007	Amounts due within one year	Amounts due after one year
Accrued vacation	\$ 888,056	\$556,968	\$(465,217)	\$ 979,807	\$358,000	\$ 621,807
Accrued workers' compensation	744,737	41,741	-	786,478	-	786,478
Capital lease obligation	119,739	20,166	(42,505)	97,400	48,000	49,400
Long-term liabilities	<u>\$1,752,532</u>	<u>\$618,875</u>	<u>\$(507,722)</u>	<u>\$1,863,685</u>	<u>\$406,000</u>	<u>\$1,457,685</u>

NOTE J – OPERATING LEASES

OHA leases office space and equipment under various noncancelable operating leases through December 2011. Future minimum payments under all leases as of June 30, 2007 are approximated as follows:

Fiscal year ending June 30,	
2008	\$ 699,500
2009	422,300
2010	26,500
2011	27,500
2012	<u>14,100</u>
Total	<u>\$1,189,900</u>

Rent expense (including taxes and common area maintenance) under operating leases totaled \$1,030,659 for the year ended June 30, 2007.

In August 1998, OHA entered into a 35 year lease with the 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. The negotiation of a new lease is anticipated to be completed in 2008.

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2007

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

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

Total fund balance – governmental funds	\$481,111,587
Amounts reported for governmental activities in the statement of net assets are different because:	
Net capital assets used in governmental activities are not financial resources and therefore are not reported in the funds	26,662,259
Other accruals	(648,000)
Long-term liabilities not due and payable in the current period and therefore not reported in the funds:	
Accrued vacation	(979,807)
Accrued workers' compensation	(786,478)
Capital lease	(97,400)
Subtotal	<u>(1,863,685)</u>
Total net assets – government-wide	<u><u>\$505,262,161</u></u>

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

Net changes in fund balances – total governmental funds	\$ 40,949,321
Amounts reported for governmental activities in the statement of activities is different because:	
Governmental funds report capital outlays and capital lease payments as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation and related debt during the year	
	3,335,128
Revenues in the statement of activities that do not provide current financial resources and are not reported as fund revenues	7,600,000
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	(91,751)
Accrued workers' compensation	(41,741)
Other accruals	(648,000)
Subtotal	<u>(781,492)</u>
Changes in net assets – government-wide	<u><u>\$ 51,102,957</u></u>

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2007

NOTE L – 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.

Contribution by OHA for the fiscal year ending June 30, 2007 was approximately \$810,500. The contribution rate for the fiscal year ending June 30, 2007 was 13.75%.

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.

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2007

NOTE L – 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. OHA's contributions for retiree health and group life insurance benefits are subject to the State law governing the EUTF. The EUTF pays for some or all of these benefits for eligible employees, in accordance with the guidelines laid out by State law. The EUTF also reimburses Medicare expenses of retirees and qualified spouses who are at least 62 years of age and have at least 10 years of service. OHA's share of the expense for post-retirement health care and life insurance benefits for the fiscal year ended June 30, 2007 was approximately \$400.

Sick Leave

Accumulated sick leave as of June 30, 2007 was approximately \$1,695,414. Sick leave accumulates at the rate of 14 hours for each month of service, as defined, without limit. Sick pay can be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for sick leave is recorded in the accompanying financial statements.

NOTE M – NON-IMPOSED EMPLOYEE FRINGE BENEFITS

Payroll fringe benefit costs for employees of OHA funded by state appropriations (general fund) are assumed by the State and are not charged to OHA's operating funds. These costs, totaling \$220,219 for the fiscal year ended June 30, 2007, have been reported as revenues and expenditures of OHA's general fund.

NOTE N – RISK MANAGEMENT AND CONTINGENT LIABILITIES

Workers' Compensation and Other Self-Insurance Liabilities

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

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

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2007

NOTE N – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

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

OHA's estimated reserve for losses and loss adjustment costs is based on membership in OHA's workers' compensation plan as of June 30, 2007. OHA believes that, given the subjectivity of data used by OHA to compute these amounts, the reserves are within a reasonable and acceptable range of adequacy. OHA has accrued a liability for workers' compensation at June 30, 2007 that approximated \$786,000.

Department of Education (DOE) Settlement Agreement

On May 4, 2000, OHA entered into a Compromise and Settlement Agreement with the State of Hawai'i DOE, in which the DOE agreed to form a partnership for the support of the DOE's Hawaiian Language Immersion Program (HLIP). Although OHA is not responsible for the education, operation, management, supervision, or any other aspect of the HLIP, OHA has agreed to provide matching funds up to \$500,000 each year for five years beginning July 1, 2000. In 2006, OHA was presented with final invoices from the DOE totaling approximately \$531,000 and final payment was tendered to the DOE in January 2007 thereby fully satisfying all provisions of the settlement agreement and resulting in the formal closure of this matter.

Hina-Mälailena Joint Use Agreement

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

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

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2007

NOTE N – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

During fiscal year 2000, OHA became aware that Hina-Mälailena would not be able to complete the project. As of June 30, 2007, OHA's project team is currently working with the various parties involved in the project to move it towards completion. In May 2008, OHA made a payment of \$648,000 for release of the EDA's interest in the development of the commercial center. The payment has been accrued in the Governmental Funds – Balance Sheet/Government-wide Statement of Net Assets as of June 30, 2007.

Ceded Lands – Public Land Trust

Office of Hawaiian Affairs v. Housing and Community Development Corporation of Hawai'i, f.k.a. Office of Hawaiian Affairs v. Housing Finance and Development Corporation, Hawai'i Supreme Court No. 25570 (Civil No. 94-4207-11) was originally filed in 1994 to enjoin the sale of ceded lands until the claims of the Native Hawaiians were resolved by the government. In December 2002, the lower court issued its opinion and OHA appealed. The Hawai'i Supreme Court issued its opinion on January 31, 2008 and granted OHA and individual Native Hawaiian Plaintiffs request for an injunction on the sale of the ceded lands until the "unrelinquished claims" of the Native Hawaiian people are resolved. The State of Hawaii filed a petition for writ of certiorari with the United States Supreme Court. OHA intends to file an opposition which is due on July 2, 2008. The United States Supreme Court will not decide the state's petition until its next term which begins in October 2008.

On January 11, 2000, all proceedings of the *Office of Hawaiian Affairs v. Hawai'i Housing Authority*, Civil No. 95-2682-07 suit were stayed pending the Hawai'i Supreme Court's decision in *OHA v. State 1*. OHA disagreed that the decision rendered by the Hawai'i Supreme Court on September 12, 2001 in *OHA v. State 1* required the dismissal of the claims in *OHA v. HHA* (which relates to the valuation of five parcels transferred to HHA for affordable public housing units). At June 30, 2007, the case remains stayed.

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

Civil Complaints

In *Arakaki v. Lingle*, Civil No. 02-00139-SOM-KSC, District of Hawai'i, Ninth Circuit No. 04-15306, U.S. Supreme Court No. 988 & 1128, the Plaintiffs challenged the constitutionality of the Office of Hawaiian Affairs relying on the Equal Protection Clause of the United States Constitution and the Civil Rights Act, 28 U.S.C. 1983. The complaint was filed in March 2002 and sought declaratory and injunctive relief and attorneys' fees. All claims have been dismissed and the federal court entered its final order on May 1, 2007.

In *Virgil Day, et. al. v. Haunani Apoliona, et. al.*, Civil No. CV05 00649 ACK BMK, the Plaintiffs, five Native Hawaiians, filed, in 2005 in the United States District Court of the District of Hawai'i, a complaint against two former OHA trustees and the current OHA trustees alleging that OHA is wrongfully expending its trust fund monies on all Hawaiian beneficiaries and not just exclusively on those beneficiaries with 50% or more blood

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2007

NOTE N – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

quantum. Plaintiffs were seeking injunctive relief to enjoin and restrain OHA from certain expenditures of its trust funds as well as a declaratory judgment with regard to certain legal issues. Subsequently, the case was dismissed by a federal judge in August 2006 on jurisdictional grounds. Plaintiffs filed a notice of appeal with the United States Court of Appeals for the Ninth Circuit. The case was heard by a three judge panel of the United States Court of Appeals for the Ninth Circuit on June 5, 2007. They issued a ruling on August 7, 2007 reversing the District Court's dismissal of the case and remanding for further proceedings without expressing any opinion of the merits of the *Day*'s allegations. Since that ruling, the State Attorney General has been given intervener status and has sought en banc review of the panel decision. This request is pending. In November 2007, six non-parties sought to intervene to oppose the Attorney General's en banc rehearing request. Since the Ninth Circuit's remand of the case to the District Court, the OHA defendants ("OHA") on May 27, 2008 filed a Second Motion for Summary Judgment. The plaintiffs opposed the motion, and OHA filed its reply on May 29, 2008. The hearing on the motion is scheduled for Monday, June 9, 2008, before U.S. District Judge Susan Mollway. OHA also filed a motion to strike part of the Plaintiffs' responsive separate and concise statement of facts, which was not in compliance with the page or word-count limit set by the Local Rules. OHA filed an *ex parte* motion to expedite the hearing on this motion, which is also to be heard on June 9, 2008. The State of Hawaii on May 22, 2008 filed a Statement of Position, positing an alternative reason for granting judgment in favor of defendants. The State of Hawaii's motion for summary judgment on this alternative ground was filed on June 4, 2008 and is set for hearing on July 7, 2008. At this time, OHA does not believe that it is legally responsible for any contingent liabilities as the Court has yet to determine whether the Plaintiffs have a claim that can be litigated.

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

In December 2006, OHA entered into an agreement with an unrelated company to act as guarantor of the company's lease agreement. The term of the guarantee is through April 2014. At any time through that date, should the company be over 30 days past landlord notice to OHA of the company default, OHA will be obligated to perform under the guarantee by making payments of rent, sums, costs and charges. The maximum amount of future payments OHA could be required to make under this agreement is \$150,000. As of June 30, 2007, OHA has not accrued a liability for this guarantee because the likelihood of incurring a payment obligation in connection with this guarantee is remote.

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2007

NOTE O – RELATED PARTY TRANSACTIONS

OHA receives a portion of ceded land revenues from various state agencies. In June 2006, Act 178 was passed which 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, 2007 was \$15,100,000 as reported in the financial statements under general revenue, public land trust. As of June 30, 2007, the related receivable was \$638,230 reported in the financial statements under accounts receivable, public land trust.

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

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.

In September 2006, OHA committed \$1,000,000 in joint support (with DAGS and DHHL) towards the Governor's Emergency Proclamation signed on July 6, 2006 to address homelessness on the leeward coast. Funding will be used towards the development of emergency and transitional shelters to approximately 4,000 homeless individuals residing on Oahu's leeward coast. As of June 30, 2007, OHA transferred \$500,000 to DAGS in order to accomplish this objective.

NOTE P – SUBSEQUENT EVENTS

On October 1, 2007, OHA formed a limited liability corporation, Hi'ilei Aloha LLC. The purpose of Hi'ilei Aloha LLC is to assume stewardship of OHA's Waimea Ahupua'a (Waimea Valley purchased in June 2006) from the National Audubon Society effective February 2008, in order to ensure the continued preservation of the valley's cultural and natural resources. In addition, a key task for Hi'ilei Aloha will be to renew the community-based *Waimea Falls (Oahu) Park Proposed Master Plan* created by the City Waimea Falls Park Advisory Committee in 2001.



© Grant Thornton LLP
All rights reserved
U.S. member firm of Grant Thornton International Ltd