



Financial Statements and Report of Independent
Certified Public Accountants

Office of Hawaiian Affairs
State of Hawai'i

June 30, 2008

Office of Hawaiian Affairs
State of Hawai'i

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Office of Hawaiian Affairs
State of Hawai'i

INTRODUCTION

Year ended June 30, 2008

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, 2008. This report has been prepared by the Treasury and Other Services Hale. Responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures, rests with OHA. I believe the information, as presented, is fairly stated in all material aspects; that it is presented in a manner designed to fairly set forth the financial position and results of operations of OHA as measured by the financial activity of its various funds; and that all the information necessary to enable the reader to gain the maximum understanding of OHA's financial affairs has been included.

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

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

THE REPORTING ENTITY AND ITS SERVICES

Organization – 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.

In September 2007, OHA established Hi'ilei Aloha LLC, a nonprofit limited liability company, to serve as the parent company to manage and operate various nonprofit subsidiaries. Hi'ipaka LLC was established as a Hawaii limited liability company in December 2007, to manage and operate the recently acquired Waimea Valley. Hi'ipoi LLC was established as a Hawaii limited liability company in January 2008 to manage and operate the Makaweli Poi Mill on the island of Kaua'i. While Hi'ilei Aloha LLC and its wholly owned subsidiaries, Hi'ipaka LLC and Hi'ipoi LLC are legally separate entities from OHA, they are treated as component units of OHA for financial reporting purposes.

GASB Statement No. 14, *The Financial Reporting Entity*, establishes standards for defining and reporting on the financial reporting entity. The financial reporting entity consists of OHA as the primary government, as well as other organizations for which the primary government is financially responsible as component units. Based on the common governance and the financial obligations that OHA has made to fund 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, 2007 have been included in the financial statements of OHA for the year ended June 30, 2008.

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, 2008, 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.

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 Hawaii 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 current policy limits the withdrawal to five (5) percent of the 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

During fiscal year 2008, there were a series of shocks to the local economy. Among others, the withdrawal of two of three inter-island cruise ships, the closure of Moloka'i Ranch, the shutdown of Aloha Airlines and the shutdown of ATA transpacific passenger service resulted in sudden joblessness for a significant number of beneficiaries. Soon after the closures, the requests for services and referrals increased significantly. With the continued downturn in the local economy and increasing unemployment, OHA anticipates greater demands for services from its beneficiaries.

State of the National Economy

Fiscal year 2008 was a difficult year for the financial markets as volatility increased and the subprime debt crisis spread around the world. Global equity markets experienced double digit declines, and public real estate and

hedge funds lost value. U.S. Treasury rates declined, but credit spreads widened significantly, offsetting some of the gains in the fixed income markets.

OHA's Investments

The bulk of OHA's assets (85%) are comprised of investments held in the NHTF. While the investments are spread between two investment managers to minimize risk, the general slump in the stock market has had a negative effect on the value of the investments in the NHTF.

Traditional equity exposure represented about 48% of the portfolio and experienced a decline of about 13% during the fiscal year, while fixed income exposure, which represented about 30% of the portfolio rose by about 6% during the fiscal year. Performance of both equity and fixed income parts of the portfolio were slightly under their corresponding benchmark returns. Hedge funds, which represented about 12% of the portfolio, experienced an overall return of about -4% during the fiscal year, well below the absolute return benchmark of 8%. The \$25 million loss in market value related to changes in market value, represents an overall 6% negative return for the portfolio and is somewhat below the 4% negative benchmark target. Overall, this translated into an approximately \$25 million loss for the investments held in the NHTF for the fiscal year ended June 30, 2008.

While net investment earnings for fiscal year 2008 represented a loss, the budget for the year is based on a moving average using 12 quarters of historical data, and was therefore derived from investment balances in prior years. The decreasing value of investments will have an effect on future withdrawals for up to three years in the future.

Respectfully submitted,

Clyde W. Nāmuʻo
Administrator, Office of Hawaiian Affairs



Report of Independent Certified Public Accountants

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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, 2008, 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, 2008 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.

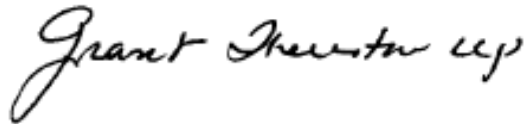
In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of OHA, as of June 30, 2008, and the respective changes in financial position 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

In accordance with *Government Auditing Standards*, we have also issued our report dated January 20, 2009 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 7 through 13 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 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
January 20, 2009

Office of Hawaiian Affairs
State of Hawai'i

MANAGEMENT'S DISCUSSION AND ANALYSIS

Year ended June 30, 2008

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, 2008, management discussion and analysis will address both this year and the year ended June 30, 2007.

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, 2008 by \$446,753,606 (presented as “total net assets”). Of this amount, \$406,367,587 is reported as “unrestricted”, while \$27,911,569 is reported as “restricted-federal funds” and \$12,474,450 is reported as “invested in capital assets, net of related debt.” 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 was reported as “unrestricted”, while \$27,301,983 was reported as “restricted-federal funds” and \$26,564,859 was 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, decreased by \$58,508,555 (a 11.6% decrease) in fiscal year 2008. This was primarily due to investment losses experienced in OHA's Native Hawaiian Trust Fund (NHTF) as well as the transfer out of property. OHA's total net assets, increased by \$51,102,957 (an 11.3% increase) in fiscal year 2007. This was primarily due to investment income and gains experienced in OHA's NHTF.

Governmental Funds Financial Statements Highlights

Governmental Funds – Fund Balances – At the close of fiscal year 2008, OHA's governmental funds reported an ending fund balance of \$436,322,040. Of this total amount, \$397,309,932 represents the unreserved fund balances with 94.6% being in the Public Land Trust Fund (PLTF). Of this \$397,309,932, \$15,495,550 is designated for the Native Hawaiian Revolving Loan Fund (NHRLF), \$37,209 is designated for the Fannie Mae Loan Program; \$29,419 is designated for other grants, \$956,327 is designated for Hawaiian projects; and \$14,346,319 is designated for subsequent year's expenditures, leaving \$366,445,108 as undesignated. This \$366,445,108 represents roughly 84% of the total fund balance at the end of fiscal year 2008.

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 represented the unreserved fund balances with 94.3% being in the PLTF. Of this \$465,668,567, \$24,465,627 was designated for the NHRLF, \$39,486 was designated for the Fannie Mae Loan Program; \$29,419 was designated for other grants, \$855,509 was designated for Hawaiian projects; and \$12,851,429 was designated for subsequent year's expenditures, leaving \$427,427,097 as undesignated. This \$427,427,097 represented roughly 88.8% of the total fund balance at the end of fiscal year 2007.

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 (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 in the NHTF, legislative appropriations, non-imposed fringe benefits, newspaper advertisements, donations, PLTF, and other revenues).

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, 2007. 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 K 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.

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.

The *Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis), General Fund* can be found on page 18.

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, 2008 and 2007 is as follows:

	2008	2007
Assets:		
Capital assets	\$ 12,743,676	\$ 26,662,259
Other assets	449,592,724	487,429,734
	<u>\$462,336,400</u>	<u>\$514,091,993</u>
Liabilities:		
Other liabilities	\$ 13,270,684	\$ 6,966,147
Long-term liabilities	2,312,110	1,863,685
	<u>15,582,794</u>	<u>8,829,832</u>
Net assets:		
Invested in capital assets, net of related debt	12,474,450	26,564,859
Restricted – Federal funds	27,911,569	27,301,983
Unrestricted	406,367,587	451,395,319
	<u>446,753,606</u>	<u>505,262,161</u>
	<u>\$462,336,400</u>	<u>\$514,091,993</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 \$446,753,606 at the end of fiscal year 2008, compared to \$505,262,161 at the end of fiscal year 2007, representing a decrease of 11.6% or \$58,508,555.

Unrestricted funds represent the largest portion of OHA's net assets (90.96% and 89.34% at June 30, 2008 and 2007, 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.

Statement of Activities

Summarized financial information of OHA's statement of activities for the fiscal years ended June 30, 2008 and 2007 is as follows

	2008	2007
Revenues:		
Program revenues:		
Operating grants	\$ 290,787	\$ 3,723,699
Contributions	–	7,600,000
Charges for services	151,187	57,821
	<u>441,974</u>	<u>11,381,520</u>

	<u>2008</u>	<u>2007</u>
Subtotal brought forward	\$ 441,974	\$11,381,520
Interest and investment earnings	1,493,210	1,360,023
General revenues:		
Appropriations, net of lapses	3,043,921	2,828,459
Public land trust	15,100,000	15,100,000
Interest and investment (losses) earnings	(24,586,532)	58,361,335
Newspaper ads	89,974	66,860
Donations and other	2,504,399	403,446
Non-imposed fringe benefits	228,957	220,219
Total revenues	<u>(1,684,097)</u>	<u>89,721,862</u>
Expenses:		
Current divisions:		
Board of Trustees	1,894,176	1,736,405
Support Services	14,270,429	8,305,431
Beneficiary Advocacy	23,865,583	28,010,677
Depreciation	407,226	566,392
Hi'ilei Aloha LLC	47,027	-
Total expenses	<u>40,484,441</u>	<u>38,618,905</u>
Net transfers to other funds	<u>(16,340,017)</u>	<u>-</u>
Changes in net assets	<u><u>\$(58,508,555)</u></u>	<u><u>\$51,102,957</u></u>

OHA's net assets decreased by \$58,508,555 during the year. Key elements of this decrease are as follows:

Operating grants and contributions decreased by \$3,432,912 and \$7,600,000, respectively, from the prior year. The prior year amounts included one-time grants received for the purchase of Wao Kele o Puna rainforest on the island of Hawai'i.

Interest and investment earnings for the NHTF, recorded as general revenues, decreased by \$82,947,867 from the prior year, due primarily to poor market conditions. Dividend and interest income decreased \$9,237,399 while net investment gains decreased by \$73,710,733 from the prior year. In fiscal year 2007, OHA recognized a net investment gain of \$41,421,318 while the deterioration of market conditions resulted in a net investment loss of \$32,289,415 during fiscal year 2008.

During the reporting period, OHA's blended component unit, Hi'ilei Aloha LLC, recognized \$265 of interest income which is also included as interest and investment earnings, recorded as general revenues. Hi'ilei Aloha LLC is a legally separate reporting entity from OHA as discussed in Note A to the financial statements.

Support services expenses increased \$5,964,998 from the prior year primarily as a result of increased operating costs, including an increase in legal fees paid to defend OHA against the many lawsuits filed against it, higher personnel costs as a result of a cost of living raise granted during the year, and increased rents.

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 2008, OHA's governmental funds reported an ending fund balance of \$436,322,040. Of this amount, \$397,309,932, or 91.1%, represented unreserved funds, broken down as follows: 3.55% for NHRLF, 0.01% for Fannie Mae Loan Program, 0.01% for other grants, 0.22% for Hawaiian projects, 3.29% for subsequent years' expenditures, and 83.99% undesignated. Reserved fund balances accounted for \$39,012,108, or 8.9% of the total fund balance, broken down as follows: 2.40% for encumbrances, 2.85% for notes receivable, 0.06% for prepaid expenses and security deposits, and 3.63% for fiscal reserve.

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.

CAPITAL ASSETS

OHA's investment in capital assets amounted to \$12,743,676 and \$26,662,259, net of depreciation, as of June 30, 2008 and 2007, respectively. Capital assets include land, building, leasehold improvements, equipment and software development. The decrease of \$13,918,583 from the prior year is due primarily to the transfer of Waimea Valley, including the building and underlying land, in February 2008 to Hi'ipaka LLC, which is a wholly owned subsidiary of OHA's blended component unit, Hi'ilei Aloha LLC. As the results of Hi'ilei Aloha LLC are presented only through its fiscal year end, December 31, 2007, the transfer of Waimea Valley will be reflected as an addition to capital assets in its financial statements for the year ending December 31, 2008, which will be included in the financial results for OHA for the year ending June 30, 2009.

	2008	2007
Land	\$11,354,632	\$24,358,453
Buildings and improvements	699,671	1,737,016
Equipment	689,373	566,790
Totals	<u>\$12,743,676</u>	<u>\$26,662,259</u>

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

ECONOMIC FACTORS

Locally, the unemployment rate for the state continued to rise during fiscal year 2008 and ended up at 3.8% at June 2008 on a seasonally adjusted basis. One year ago, the rate was at 2.7%. The Honolulu inflation rate was 4.9% in the first half of 2008, up slightly from 4.8% in all of 2007.

Nationally, the volatility of the financial markets was evidenced by changes in the Dow Jones Industrial Average. At June 30, 2007, the index was at 13,408.62 but had dropped to 11,350.01 by June 30, 2008. By October 15, 2008, the index slipped to 8,577.91.

REQUEST FOR INFORMATION

Questions concerning any of the information provided in this report or requests for additional information should be addressed to: info@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, 2008

ASSETS	Governmental Funds					Total	Adjustments (Note K)	Government- wide Statement of Net Assets
	General Fund	Special Revenue Funds						
		Public Land Trust	Federal Grants	Other	Hi'ilei Aloha			
Petty cash	\$ -	\$ 700	\$ -	\$ -	\$ -	\$ 700	\$ -	\$ 700
Cash in State Treasury	662,148	3,051,373	8,734	800	-	3,723,055	-	3,723,055
Cash in banks	-	6,176,058	1,505,896	995,123	66,741	8,743,818	-	8,743,818
Cash held by investment manager	-	302,952	3,758,532	-	-	4,061,484	-	4,061,484
Accounts receivable	-	10,638,615	-	11,663	-	10,650,278	-	10,650,278
Interest and dividends receivable	-	446,588	144,558	-	-	591,146	-	591,146
Prepaid and other assets	58,088	141,393	4,159	-	-	203,640	-	203,640
Interfund balance	-	176,473	(176,473)	-	-	-	-	-
Notes receivable - due within one year	-	671,001	1,383,467	-	-	2,054,468	-	2,054,468
Notes receivable - due after one year	-	4,436,697	5,953,738	-	-	10,390,435	-	10,390,435
Security deposits	6,030	54,843	1,803	-	-	62,676	-	62,676
Investments	-	393,615,474	15,495,550	-	-	409,111,024	-	409,111,024
Capital assets - net	-	-	-	-	-	-	12,743,676	12,743,676
TOTAL	\$ 726,266	\$ 419,712,167	\$ 28,079,964	\$ 1,007,586	\$ 66,741	\$ 449,592,724	\$ 12,743,676	\$ 462,336,400

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, 2008

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	H'i'ilei Aloha			
LIABILITIES								
Accounts payable and accrued liabilities	\$ 295,241	\$ 12,792,247	\$ 108,792	\$ -	\$ 14,801	\$ 13,211,081	\$ -	\$ 13,211,081
Due to State of Hawai'i	-	-	59,603	-	-	59,603	-	59,603
Long-term liabilities:								
Due within one year	-	-	-	-	-	-	456,399	456,399
Due after one year	-	-	-	-	-	-	1,855,711	1,855,711
Total liabilities	295,241	12,792,247	168,395	-	14,801	13,270,684	2,312,110	15,582,794
FUND BALANCES/NET ASSETS								
Fund balances								
Reserved for encumbrances	333,558	9,869,614	226,109	39,596	-	10,468,877	(10,468,877)	-
Reserved for notes receivable	-	5,107,698	7,337,205	-	-	12,444,903	(12,444,903)	-
Reserved for prepaid expenses and security deposits	64,118	196,237	5,962	-	-	266,317	(266,317)	-
Fiscal reserve	-	15,832,011	-	-	-	15,832,011	(15,832,011)	-
Unreserved								
Designated for Native Hawaiian revolving loans	-	-	15,495,550	-	-	15,495,550	(15,495,550)	-
Designated for Fannie Mae Loan Program	-	37,209	-	-	-	37,209	(37,209)	-
Designated for other grants	-	-	29,419	-	-	29,419	(29,419)	-
Designated for Hawaiian projects	-	-	-	956,327	-	956,327	(956,327)	-
Designated for subsequent year's expenditures	-	14,346,319	-	-	-	14,346,319	(14,346,319)	-
Undesignated	33,349	361,530,832	4,817,324	11,663	51,940	366,445,108	(366,445,108)	-
Total fund balances	431,025	406,919,920	27,911,569	1,007,586	51,940	436,322,040	(436,322,040)	-
Total liabilities and fund balances	<u>\$ 726,266</u>	<u>\$ 419,712,167</u>	<u>\$ 28,079,964</u>	<u>\$ 1,007,586</u>	<u>\$ 66,741</u>	<u>\$ 449,592,724</u>		
Net assets								
Invested in capital assets, net of related debt							12,474,450	12,474,450
Restricted - federal funds							27,911,569	27,911,569
Unrestricted							406,367,587	406,367,587
Total net assets							<u>\$ 446,753,606</u>	<u>\$ 446,753,606</u>

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, 2008

	Governmental Funds					Adjustments (Note K)	Government- wide Statement of Activities	
	General Fund	Special Revenue Funds						
	Public Land Trust	Federal Grants	Other	Hi'ilei Aloha	Total			
Expenditures/expenses								
Current divisions:								
Board of Trustees	\$ 41,761	\$ 1,782,763	\$ -	\$ -	\$ -	\$ 1,824,524	\$ 69,652	\$ 1,894,176
Support services	1,103,274	13,333,217	48,089	1,071	-	14,485,651	(215,222)	14,270,429
Beneficiary advocacy	2,082,996	21,056,038	1,213,390	-	-	24,352,424	(486,841)	23,865,583
Depreciation	-	-	-	-	-	-	407,226	407,226
Hi'ilei Aloha LLC	-	-	-	-	48,325	48,325	(1,298)	47,027
Total expenditures/expenses	3,228,031	36,172,018	1,261,479	1,071	48,325	40,710,924	(226,483)	40,484,441
Program revenues								
Charges for services	-	-	151,187	-	-	151,187	-	151,187
Operating grants	-	-	290,787	-	-	290,787	-	290,787
Interest and investment earnings	-	-	1,429,091	64,119	-	1,493,210	-	1,493,210
Total program revenues	-	-	1,871,065	64,119	-	1,935,184	-	1,935,184
Net program (expenses) revenue	(3,228,031)	(36,172,018)	609,586	63,048	(48,325)	(38,775,740)	226,483	(38,549,257)
General revenues								
Appropriations, net of lapses	3,043,921	-	-	-	-	3,043,921	-	3,043,921
Public land trust	-	15,100,000	-	-	-	15,100,000	-	15,100,000
Interest and investment (losses) earnings	-	(24,586,797)	-	-	265	(24,586,532)	-	(24,586,532)
Newspaper advertisements	-	-	-	89,974	-	89,974	-	89,974
Donations and other	-	2,490,798	-	13,601	-	2,504,399	-	2,504,399
Non-imposed fringe benefits	228,957	-	-	-	-	228,957	-	228,957
Total general revenues	3,272,878	(6,995,999)	-	103,575	265	(3,619,281)	-	(3,619,281)
EXCESS OF REVENUES OVER EXPENDITURES (carried forward)	\$ 44,847	\$ (43,168,017)	\$ 609,586	\$ 166,623	\$ (48,060)	\$ (42,395,021)	\$ 226,483	\$ (42,168,538)

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, 2008

	Governmental Funds					Total	Adjustments (Note K)	Government- wide Statement of Activities
	General Fund	Public Land Trust	Federal Grants	Other	Hi'ilei Aloha			
EXCESS OF REVENUES OVER EXPENDITURES (brought forward)	\$ 44,847	\$ (43,168,017)	\$ 609,586	\$ 166,623	\$ (48,060)	\$ (42,395,021)	\$ 226,483	\$ (42,168,538)
Other financing sources (uses)								
Net transfers (to) from other funds	-	(2,494,526)	-	-	100,000	(2,394,526)	(13,945,491)	(16,340,017)
Net change in fund balance/net assets	44,847	(45,662,543)	609,586	166,623	51,940	(44,789,547)	(13,719,008)	(58,508,555)
Fund balance/net assets								
Beginning of year	386,178	452,582,463	27,301,983	840,963	-	481,111,587	24,150,574	505,262,161
End of year	<u>\$ 431,025</u>	<u>\$ 406,919,920</u>	<u>\$ 27,911,569</u>	<u>\$ 1,007,586</u>	<u>\$ 51,940</u>	<u>\$ 436,322,040</u>	<u>\$ 10,431,566</u>	<u>\$ 446,753,606</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, 2008

	Original Budget	Final Budget	Actual (budgetary basis)	Variance
Revenues:				
State appropriations, net of lapses	\$3,053,108	\$3,053,108	\$3,043,921	\$ (9,187)
Total revenues	3,053,108	3,053,108	3,043,921	(9,187)
Expenditures:				
Board of Trustees	31,149	31,149	31,068	81
Support services	936,263	954,566	945,460	9,106
Beneficiary advocacy	2,085,696	2,067,393	2,067,393	-
Total expenditures	3,053,108	3,053,108	3,043,921	9,187
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, 2008

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).

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.

In September 2007, OHA formed a Hawai'i limited liability company, Hi'ilei Aloha LLC. In December 2007, Hi'ilei Aloha LLC created Hi'ipaka LLC as a subsidiary whose primary purpose is to assume stewardship from the National Audubon Society beginning February 2008, in order to ensure the continued preservation of the valley's cultural and natural resources as well as to renew the community-based *Waimea Falls (Oahu) Park Proposed Master Plan* created by the City Waimea Falls Park Advisory Committee in 2001. In January 2008, Hi'ilei Aloha LLC created Hi'ipoi LLC as a subsidiary whose primary purpose of is to foster cultural, educational, and business opportunities related to the production of poi and taro products in Makaweli, Kaua'i. All three entities are exempt from federal income tax under Sections 501(a) and 501(c)3 of the Internal Revenue Code.

Hi'ilei Aloha LLC 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, 2007, its fiscal year end, have been included in the financial statements.

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.

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

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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, 2008 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.

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 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.

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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, 2008 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 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 in the governmental funds financial statements. 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.

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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, 2008 are as follows:

Native Hawaiian and Hawaiian persons	91%
Agencies	8
Other	1
	<hr/>
	100%
	<hr/>

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, 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.

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008

NOTE B – BIENNIAL BUDGET (continued)

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, 2008 from the budgetary basis to GAAP basis are as follows:

Excess of revenues over expenditures – actual (budgetary basis)	\$ –
Reserve for encumbrances at June 30	333,558
Prior year reserve for encumbrances	(233,589)
Accrued payables and payroll	448,416
Prepaid expenditures not recognized for budgetary purposes – net of prior-year accruals	(20,290)
Expenditures for liquidation of prior-year encumbrances	<u>(483,248)</u>
Excess of revenues over expenditures – actual (GAAP basis)	<u>\$ 44,847</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 170, SLH 2007 authorizes a total of \$3,053,108 general funds, and \$6,207,486 trust funds for OHA's programs for fiscal year 2008.

NOTE D – CASH

The State maintains a cash pool that is used by all agencies. OHA's portion of this pool is indicated on the *Governmental Funds Balance Sheet* as "cash in State treasury." The Hawai'i Revised Statutes authorize Director of Finance to invest in obligations of or guaranteed by the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally-insured financial institutions. OHA's cash included in State pooled funds is fully collateralized with securities held by third-party agents in the State's name, as required by the Hawai'i Revised Statutes Section 38-8. At June 30, 2008, OHA's cash held in the State treasury totaled \$3,723,055.

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, 2008, these deposits totaled \$8,743,818, and had a corresponding bank balance of \$10,391,442. Of this bank balance, \$10,150,259 was insured by the Federal Deposit Insurance Corporation, or collateralized or invested in U.S. Government securities.

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008

NOTE E – NOTES RECEIVABLE

Notes receivable at June 30, 2008 consist of the following:

Loans receivable serviced by First Hawaiian Bank (of which, \$2,800,091 is guaranteed by Department of Hawaiian Home Lands (DHHL)	\$ 4,887,589
Native Hawaiian Revolving Loan Fund	8,443,672
Other	<u>1,639,741</u>
Total	14,971,002
Less allowance for doubtful accounts	<u>(2,526,099)</u>
Net	12,444,903
Amounts due within one year	<u>(2,054,468)</u>
Amounts due after one year	<u><u>\$10,390,435</u></u>

NOTE F – INVESTMENTS

Under the Hawai'i Revised Statutes, Chapter 10, the Board of Trustees may collect, receive, deposit, withdraw, and invest money and property on behalf of the office to further the mission of OHA. On May 29, 2003, the OHA Board of Trustees adopted the Native Hawaiian Trust Fund Investment Policy Statement (NHIF 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.

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008

NOTE F – INVESTMENTS (continued)

Investments as of June 30, 2008 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	\$ 3,656,841	\$ –	\$ 3,656,841
U.S. agencies	NHRLF	11,838,709	1,649,159	10,189,550
Pooled investments	NHTF	188,935,964	188,935,964	–
Limited partnerships	NHTF	198,227,035	198,227,035	–
Real estate investments	NHTF	6,452,464	6,452,464	–
Other	NHTF	11	11	–
Total securities		409,111,024	395,264,633	13,846,391
Money market funds (not considered securities)	Various	4,061,484	4,061,484	–
Total investments		<u>\$413,172,508</u>	<u>\$399,326,117</u>	<u>\$13,846,391</u>

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

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, 2008, OHA's foreign currency risks are as follows:

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008

NOTE F – INVESTMENTS (continued)

Foreign Currency Risk (continued)

Investment Type	Currency	Value (US Dollar)
Limited partnership	Various	\$25,127,604
Limited partnership	Euro	\$ 3,131,531

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, 2008, 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.

Office of Hawaiian Affairs
State of Hawai'i

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008

NOTE G – CAPITAL ASSETS

Capital assets activities for the year ended June 30, 2008 are as follows:

	July 1, 2007	Additions	Retirements/ transfer	June 30, 2008
Capital assets not depreciated:				
Land	\$24,358,453	\$ –	\$(13,003,821)	\$11,354,632
Total capital assets not depreciated	<u>24,358,453</u>	<u>–</u>	<u>(13,003,821)</u>	<u>11,354,632</u>
Capital assets being depreciated:				
Buildings	2,087,603	–	(1,046,300)	1,041,303
Leasehold improvements	560,374	10,801	–	571,175
Machinery, equipment, furniture and fixtures	<u>3,866,219</u>	<u>476,461</u>	<u>(150,304)</u>	<u>4,192,376</u>
Total capital assets being depreciated	6,514,196	487,262	(1,196,604)	5,804,854
Less accumulated depreciation	<u>(4,210,390)</u>	<u>(407,226)</u>	<u>201,806</u>	<u>(4,415,810)</u>
Capital assets being depreciated – net	<u>2,303,806</u>	<u>80,036</u>	<u>(994,798)</u>	<u>1,389,044</u>
Capital assets – net	<u>\$26,662,259</u>	<u>\$ 80,036</u>	<u>\$(13,998,619)</u>	<u>\$12,743,676</u>

On February 4, 2008, OHA deeded title of Waimea Ahupua'a (Waimea Valley) to Hi'ipaka, LLC, a Hawai'i limited liability company and wholly-owned subsidiary of Hi'ilei Aloha LLC. OHA originally acquired fee title to Waimea Ahupua'a (Waimea Valley) on the north shore of the island of O'ahu to protect in perpetuity the cultural and natural resources on the property. As the results of Hi'ilei Aloha LLC have only been included through December 31, 2007, the addition of the property will be reflected in their financial statements for the year ending December 31, 2008, which will be included in the financial statements of OHA for the year ending June 30, 2009.

NOTE H – CAPITAL LEASES

OHA leases photocopiers and mail postage meter machines for all offices. In accordance with the Financial Accounting Standards Board Statement No. 13, *Accounting for Leases*, 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, 2008, assets recorded under capital lease included in machinery, equipment, furniture and fixtures is \$324,554 and related amortization is \$63,587.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008

NOTE H – CAPITAL LEASES (continued)

At June 30, 2008, the present value of minimum lease payments is \$269,226 and the long-term obligation is \$210,455. Below are minimum lease payments through 2013 and the computation of the current and long-term capital lease obligation:

Fiscal year ending June 30,	
2009	\$ 77,867
2010	67,883
2011	65,846
2012	61,214
2013	<u>49,388</u>
Total minimum lease payments	322,198
Less stated interest	<u>(52,972)</u>
Present value of minimum lease payments (obligation under capital lease)	269,226
Less current portion	<u>(58,771)</u>
Long-term capital lease obligation	<u><u>\$210,455</u></u>

NOTE I – LONG-TERM LIABILITIES

Long-term liabilities for the year ended June 30, 2008 are as follows:

	July 1, 2007	Additions	Reductions	June 30, 2008	Amounts due within one year	Amounts due after one year
Accrued vacation	\$ 979,807	\$675,979	\$(462,677)	\$1,193,109	\$397,628	\$ 795,481
Accrued workers' compensation	786,478	63,297	–	849,775	–	849,775
Capital lease obligation	<u>97,400</u>	<u>258,849</u>	<u>(87,023)</u>	<u>269,226</u>	<u>58,771</u>	<u>210,455</u>
Long-term liabilities	<u><u>\$1,863,685</u></u>	<u><u>\$998,125</u></u>	<u><u>\$(549,700)</u></u>	<u><u>\$2,312,110</u></u>	<u><u>\$456,399</u></u>	<u><u>\$1,855,711</u></u>

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008

NOTE J – OPERATING LEASES

OHA leases office space and equipment under various noncancelable operating leases through December 2012. Future minimum payments under all leases as of June 30, 2008 are approximated as follows:

Fiscal year ending June 30,	
2009	\$540,573
2010	73,136
2011	57,601
2012	19,799
2013	<u>2,901</u>
Total	<u><u>\$694,010</u></u>

Rent expense (including taxes and common area maintenance) under operating leases totaled \$1,150,505 for the year ended June 30, 2008.

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.

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	\$436,322,040
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	12,743,676
Long-term liabilities not due and payable in the current period and therefore not reported in the funds:	
Accrued vacation	(1,193,109)
Accrued workers' compensation	(849,775)
Capital lease obligation	<u>(269,226)</u>
Subtotal	<u>(2,312,110)</u>
Total net assets – government-wide	<u><u>\$446,753,606</u></u>

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008

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

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

Net changes in fund balances – total governmental funds	\$(44,789,547)
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 depreciation and related debt exceeded capital outlays during the year	(144,918)
The transfer of property to the blended component unit	(13,945,491)
Settlement payment to the Federal Economic Development Administration (as further discussed in Note N to the financial statements) is reported as an expenditure in the governmental funds, but reduces long term liability in the statement of net assets	<u>648,000</u>
Subtotal	(13,442,409)
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	(213,302)
Accrued workers' compensation	<u>(63,297)</u>
Subtotal	<u>(276,599)</u>
Changes in net assets – government-wide	<u><u>\$(58,508,555)</u></u>

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.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008

NOTE L – EMPLOYEE BENEFITS (continued)

Defined Benefit Pension Plans (continued)

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, 2008, 2007, and 2006 were approximately \$1,054,000, \$810,500, and \$721,000, respectively. The contribution rates for the fiscal years ending June 30, 2008, 2007, and 2006 were 13.75%, 13.75%, and 10.82%, respectively.

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, 2008

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 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 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 ten years of service.

Effective July 1, 2007, the State adopted the provisions of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postretirement Benefits Other Than Pensions*. 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, 2008. OHA has contributed approximately \$680,000 in OPEB expenses for the fiscal year ended June 30, 2008.

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.

Sick Leave

Accumulated sick leave as of June 30, 2008 was approximately \$2,039,000. Sick leave accumulates at the rate of 14 hours for each month of service, as defined, without limit. Sick pay can be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for sick leave is recorded in the accompanying financial statements.

NOTE M – NON-IMPOSED EMPLOYEE FRINGE BENEFITS

Payroll fringe benefit costs for employees of OHA funded by state appropriations (general fund) are assumed by the State and are not charged to OHA's operating funds. These costs, totaling \$228,957 for the fiscal year ended June 30, 2008, 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

As a state agency, OHA participates in the state's risk management program. The State maintains certain insurance coverages 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.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008

NOTE N – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

Workers' Compensation and Other Self-Insurance Liabilities (continued)

In addition to the state coverages, 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 \$850,000 at June 30, 2008. The estimated losses will be paid from the NHTF.

Hina-Mālalena Joint Use Agreement

In 1995, OHA entered into a Joint Use Agreement (Agreement) with Hina-Mālalena, a Hawai'i non-profit corporation, for the purpose of developing a commercial/retail complex in Hana, Maui where local businesses would sell their products and services. Financing was provided by OHA through a \$90,000 secured loan, the Federal Economic Development Administration ("EDA") through a \$1.76 million secured grant, the County of Maui, and the State of Hawai'i through its Department of Business, Economic Development and Tourism. Despite completion of initial construction, the project failed due to, among other things, disputes between Hina-Mālalena and the property owners.

Terms of the Agreement state that Hina-Mālalena was 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 were satisfied, and obtaining all necessary permits and approvals. However, in the event of default by Hina-Mālalena, OHA may elect to take control of the project.

During fiscal year 2000, OHA became aware that Hina-Mālalena would not be able to complete the project. OHA worked for several years with the other parties to try to move the project to completion. The EDA made demand on OHA to complete the project or repay the full amount of the EDA grant as an alleged co-grantee. Negotiations ensued, and in early May, 2008, OHA and the EDA settled through payment of \$648,000 by OHA in exchange for a release of claims by the EDA. OHA and the EDA also released their mortgages on the property and OHA terminated its payments to the property owners. In July, 2008, OHA concluded its role in the project and no further action on this matter is expected.

Ceded Lands – Public Land Trust

In *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), a lawsuit was originally filed in 1994 to enjoin the sale of ceded lands until the claims of the Native Hawaiians were resolved by the government. In December 2002, the lower court issued its opinion and OHA appealed. The Hawai'i Supreme Court issued its opinion on January 31, 2008, and granted OHA's and individual Native Hawaiian Plaintiffs' request for an injunction on the sale of the ceded lands until the "unrelinquished claims" of

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008

NOTE N – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

Ceded Lands – Public Land Trust (continued)

the Native Hawaiian people are resolved. The State of Hawai'i filed a petition for writ of certiorari with the United States Supreme Court on October 1, 2008, the Petition for Writ of Certiorari was granted. Oral Argument is set for February 25, 2009.

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). At June 30, 2008, 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. However, at the present time, OHA receives a fixed sum for its pro rata share of the revenues from the Hawai'i State Legislature.

Civil Complaints

In *Day, et al. v. Apoliona, et al.*, Civil No. 05-0649 ACK-BMK, United States District Court of the State of Hawai'i, five native Hawaiians filed a complaint in 2005 (Plaintiffs) against two former OHA trustees and the current OHA trustees alleging that OHA was wrongfully expending its trust fund monies on all Hawaiian beneficiaries and not just exclusively on those beneficiaries with 50% or more blood quantum. Plaintiffs were seeking injunctive relief to enjoin and restrain OHA from certain expenditures of its trust funds as well as a declaratory judgment with regard to certain legal issues. Subsequently, in August, 2006, the case was dismissed by a federal judge on jurisdictional grounds.

Plaintiffs filed a Notice of Appeal with the United States Court of Appeals for the Ninth Circuit. The case was heard by a three judge panel on June 5, 2007 and, without expressing any opinion of the merits of the plaintiff's allegations, issued a ruling on August 7, 2007 reversing the District Court's dismissal of the case on jurisdictional grounds and remanding the case to the United States District Court for further proceedings. The State Attorney General was given intervener status and sought a rehearing en banc of the panel decision. This request was rejected by the Ninth Circuit Court of Appeals.

Since the Ninth Circuit's remand of the case to the District Court, OHA filed a Second Motion for Summary Judgment in May, 2008. The Plaintiffs opposed the Motion and OHA filed its reply on May 29, 2008. 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 was heard on June 9, 2008. On June 20, 2008, the Court granted OHA's Second Motion for Summary Judgment.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008

NOTE N – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

Civil Complaints (continued)

The State of Hawai'i on May 22, 2008 filed a Statement of Position, positing an alternative reason for granting judgment in favor of defendants. The State of Hawai'i's motion for summary judgment on this alternative ground was filed on June 4, 2008 and was set for hearing on July 7, 2008. OHA filed a Statement of No Position on June 17, 2008. Plaintiffs' filed a Memorandum in Opposition on June 19, 2008. The Court dismissed the case on June 20, 2008.

On July 15, 2008, Putative Intervenor, Wendell Marumoto filed a Notice of Appeal. The Opening Brief was due and filed on October 30, 2008 and the Answering Brief was originally due on December 1, 2008, but was extended and filed on December 15, 2008. The optional Reply Brief was filed on December 29, 2008.

On July 21, 2008, plaintiffs filed a Notice of Appeal with the United States Court of Appeals for the Ninth Circuit. The Opening Brief was originally due on November 5, 2008, but was extended and filed on November 19, 2008. The Answering Brief was originally due on December 5, 2008, but was extended until December 19, 2008, and again until January 5, 2009. The Answering Brief was filed on January 5, 2009. There is an optional Reply Brief which is due on February 18, 2009. No date has been set for Oral Argument in this case.

In *Kuroiwa, Jr., et al. v Linda Lingle, et al.*, Civil No. 08-0153 JMS-KSC, United States District Court, Plaintiffs Kuroiwa filed their Complaint and motions for temporary restraining order and preliminary injunction on April 3, 2008. A status conference was held on April 8, 2008 before U.S. District Court Judge Michael Seabright who denied Plaintiffs' motion for temporary restraining order, and set a date of June 30, 2008 (later moved to July 1, 2008) for a hearing on the motion for preliminary injunction and on defendants' anticipated motions to dismiss.

On April 25, 2008, Plaintiffs moved for reconsideration of the order denying the temporary restraining order. Defendants filed opposition memoranda and, on April 25, 2008, the Court denied the motion, reiterated its conclusions that the Ninth Circuit's *Arakaki v. Lingle*, 477 F.3d 1048 (9th Cir. 2007) case controls, and that Plaintiffs had no likelihood of success on the merits.

On May 9, 2008, having filed and served answers to the Complaint (as counsel for Plaintiffs did not agree that the Court implicitly extended the time for answers by setting a deadline for motions to dismiss), OHA and the State filed their motions for judgment on the pleadings and their memoranda in opposition to Plaintiffs' motion for preliminary injunction, pursuant to the Court's order. On June 9, 2008, Plaintiffs' filed their opposition to OHA and the State's motion for judgment on the pleadings.

Since OHA and the State filed their motions for judgment on the pleadings and their memoranda in opposition to Plaintiffs' motion for preliminary injunction, pursuant to the Court's order and the Plaintiffs' filed their opposition to OHA and the State's motion for judgment on the pleadings in June, 2008, on July 1, 2008, the Court granted OHA and the State's motions and dismissed the case. OHA filed a Rule 11 Motion for Sanctions against Kuroiwa's counsel H. William Burgess, Esq. for having filed a frivolous lawsuit. That Motion was granted by Judge Seabright and sanctions in favor of OHA were awarded.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008

NOTE N – RISK MANAGEMENT AND CONTINGENT LIABILITIES (continued)

Civil Complaints (continued)

On October 14, 2008, Kuroiwa, Jr., et al. filed a Notice of Appeal to the United States Court of Appeals for the Ninth Circuit. The Opening Brief was due on November 19, 2008. It was filed on November 19, 2008. The Answering Brief was originally due on December 19, 2008, but was extended until January 2, 2009 and was filed on December 31, 2008. There is an optional Reply Brief which will be due 14 days after the Answering Brief is filed.

On or about October 2008, Burgess, et al. filed a Notice of Appeal regarding the Sanctions Order to the Ninth Circuit Court of Appeals. The Opening Brief is due on January 29, 2009. The Answering Brief is due on March 2, 2009. There is an optional Reply Brief which will be due 14 days after the Answering Brief is filed.

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, 2008, OHA has not accrued a liability for this guarantee because the likelihood of incurring a payment obligation in connection with this guarantee is remote.

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, 2008 was \$15,100,000 as reported in the financial statements under general revenue, public land trust. As of June 30, 2008, the related receivable was \$757,683 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

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008

NOTE O – RELATED PARTY TRANSACTIONS (continued)

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. The agreement between OHA and DLNR regarding this Executive Order was extended through June 30, 2009.

Payments made to OHA's blended component unit, Hi'iilei Aloha LLC, during fiscal year 2009 totaled \$1,904,356. As of June 30, 2008, OHA has accounts payable due to Hi'iilei Aloha LLC of \$590,170. These transactions resulted in a net operating transfer out of \$2,394,526 in the fund financial statements. Hi'iilei Aloha LLC is a legally separate reporting entity from OHA as discussed in Note A to the financial statements.

NOTE P – SUBSEQUENT EVENT

Subsequent to year end, the OHA's investment portfolio has incurred a significant decline in fair value, consistent with the general decline in financial markets. However, because the values of individual investments fluctuate with market conditions, the amount of losses that will be recognized in subsequent periods, if any, cannot be determined.

In October 2008, OHA entered into an agreement with the Defense Logistics Agency of the federal Department of Defense to establish Hawaii's first Procurement Technical Assistance Center (PTAC). OHA's partners include the University Of Hawaii College Of Business and the William S. Richardson School of Law. OHA's PTAC staff will provide procurement technical assistance to help small businesses get contracts to sell their goods and services to the federal, state and county governments.

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 is to pay DHHL an annual fee not to exceed \$3,000,000 for 30 years.



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