

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

Financial Statements
June 30, 2016

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Office of Hawaiian Affairs, State of Hawai‘i

Letter from the Chief Executive Officer - Unaudited
Year Ended June 30, 2016

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, 2016. This report has been prepared by the Resource Management Line of Business. Responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures, rests with OHA. I believe the information, as presented, is fairly stated in all material aspects; that it is presented in a manner designed to fairly set forth the financial position and results of operations of OHA as measured by the financial activity of its various funds; and that all the information necessary to enable the reader to gain the maximum understanding of OHA’s financial affairs has been included.

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

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

THE REPORTING ENTITY

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

GASB Statement No. 14, *The Financial Reporting Entity*, establishes standards for defining and reporting on the financial reporting entity. The financial reporting entity consists of OHA as the primary government, as well as other organizations for which the primary government is financially responsible as component units. Based on the common governance and the financial obligations that OHA has made to fund Ho‘okele Pono LLC and Hi‘ilei Aloha LLC and its subsidiaries, they have been classified as blended component units under proprietary funds. As a result, the financial results of Ho‘okele Pono LLC and

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Hi'ilei Aloha LLC and its subsidiaries through December 31, 2015 have been included as business-type activities in the government-wide financial statements of OHA for the year ended June 30, 2016.

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:

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

PURPOSE OF THE REPORT AND DEFINITIONS

The purpose of the financial audit was to enable the independent auditors to form opinions on to the financial statement of the Office of Hawaiian Affairs as of June 30, 2016, and for the year then ended. The auditors' report represents the conclusion of the independent auditors regarding the fairness of the

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presentations, in conformity with accounting principles generally accepted in the United States of America, set forth in the financial statements and is used to communicate such conclusion to interested parties.

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

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

EMPOWERING HAWAIIANS

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

HO‘OKAHUA WAIWAI

Economic Self-Sufficiency

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

‘ĀINA

Land & Water

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

MAULI OLA

Health

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

EA

Governance

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

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MO‘OMEHEU

Culture

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

HO‘ONA‘AUAO

Education

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

In addition, we continued to fulfill our promise to the State Department of Hawaiian Home Lands, providing \$3 million annually over 30 years to pay the debt service on its infrastructure improvement – an example of how Hawaiian-focused agencies can, and must, work hand-in-hand to leverage assets toward a common goal. This is just part of the approximately \$10.5 million in grants OHA awarded in fiscal year 2016 to improve, among other things, the health, education, housing, and economic conditions of Native Hawaiians.

FACTORS AFFECTING FINANCIAL CONDITION

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

Sources of Funding

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

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

State of the Local Economy

Hawai‘i’s year over year Gross Domestic Product (GDP) increased by 3.9% in 2015 and is forecasted to grow by 2.5% in 2016. GDP for 2015 is at the highest point in Hawaii’s history (\$80 billion) with an estimated \$83 billion in 2016 expanding by 4.1%. Visitor arrivals in 2015 increased by 4.5% in comparison to 2014 (2.4%) and visitor spending declined by 3% in Oahu. The stabilization of the yen and the Japanese economy are causing a stronger than anticipated number of Japanese tourists to visit. Hawai‘i’s unemployment rate fell to 3.6% at the end of 2015, down from the 4.4% figure reported a year earlier and was below the national unemployment rate of 5%. Much of this drop can be attributed to

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increases in construction hiring. Construction will continue to drive the local economy until a majority of the single-family home buildings are completed sometime around 2019. Local price inflation (+1% in 2015) with 2% expected in 2016 is slightly lower than expected due to falling energy prices; however, increasing home prices as well as rentals will remain a headwind. Uncertainty around policies regarding immigration, health care, and government employment could potentially cause disruptions to Hawaii's local economy; however, financial deregulation, changes in tax policy, and increases in infrastructure spending could potentially provide positive benefits. Furthermore, since the election, Hawaii's four largest banks have experienced significant stock price appreciation indicating a healthy appetite for continued business activity.

State of the National Economy

The economy continued to expand into 2016 with the United State Central Banking beginning to raise the overnight interest rate. There have been two rate hikes with an anticipated accelerated pace in 2017. Despite steady gains in employment, housing, and consumer spending, GDP growth has been sluggish relative to previous recoveries, well below 3% annually. Inflation also remained subdued under 2%, aided in part by the collapse in oil prices to \$50/barrel from over \$100 the prior year. The Federal Reserve was in the spotlight for much of the year, as the markets debated the timing of the interest rate "liftoff". With slow domestic economic growth, low inflation, a stronger dollar, and fragile foreign economies the reasons to delay the inevitable tightening were challenging. The counter argument was that the longer the zero-interest rate policy was in effect, the greater the likelihood of an asset bubble with few monetary tools to lessen the impact of the next recession. One of the more certainties from this discussion was that market volatility would increase. Overseas, the European Central Bank initiated efforts to stimulate the economy while Asia showed signs of slower growth and emerging markets remained stagnate. Since the election, equity markets have experienced a sharp rally as a Republican President and Republican controlled congress has signaled to investors that pro-growth fiscal policy will be coming and as well as increases in the interest rates. The White House has plans for financial deregulation, tax reform, and increases in infrastructure spending which is more than welcome as the economy searches for avenues of growth. Furthermore, the repatriation of overseas U.S. Dollars could potentially be a source for the increases in spending. Immigration remains a near-term concern as its effect on various industries such as technology and communications could cause headwinds in research and development.

OHA's Investments

OHA's investment portfolio reported a 0.68% decline in fiscal year 2016, underperforming its strategic benchmark by 1.03%, on a net-of-fees basis. OHA's global equities portfolio had contributed a decline of 5.99%, underperforming its benchmark by 212 basis points. OHA's Alternative investments portfolio posted a 2.04% return outperforming its benchmark by 265 basis points. The disappointing flat

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performance of the Trust Fund during the year follows several years of strong investment performance. For the last 5 years, the annual return on the portfolio has been 4.71% and 7 years is 7.78%.

CLOSING COMMENTS

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

Respectfully submitted,

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



A Hawaii Limited Liability Partnership

Independent Auditor's Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the business-type 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, 2016, and the related notes to the financial statements, which collectively comprise OHA's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of Hi'ilei Aloha LLC, a blended component unit, which statements reflect total assets constituting 3 percent and 99 percent of total government-wide assets and proprietary fund assets, respectively, at June 30, 2016, and total revenues constituting 40 percent and 96 percent of total government-wide program revenues and proprietary fund operating revenues, respectively, for the year then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Hi'ilei Aloha LLC, is based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinions

In our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of OHA, as of June 30, 2016, and the respective changes in financial position, the respective budgetary comparison of the general fund, and, where appropriate, cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 10 through 18 and the schedule of the OHA's proportionate share of the net pension liability and schedule of the OHA's contributions on pages 72 and 73, respectively, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 30, 2017, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the OHA's internal control over financial reporting and compliance.

KMH LLP

KMH LLP

Honolulu, Hawai'i
March 30, 2017

State of Hawai‘i, Office of Hawaiian Affairs

Management’s Discussion and Analysis - Unaudited
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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, 2016, management discussion and analysis will address both this year and the year ended June 30, 2015.

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

FINANCIAL HIGHLIGHTS

Government-wide Financial Statements Highlights

Statement of Net Position – The assets of OHA exceeded its liabilities at fiscal year ended June 30, 2016 by \$574,805,179 (presented as “total net position”). Of this amount, \$322,824,911 is reported as “unrestricted”, while \$26,690,007 is reported as “restricted-federal funds” and \$225,290,261 is reported as “invested in capital assets, net of related debt.”

The assets of OHA exceeded its liabilities at fiscal year ended June 30, 2015 by \$602,805,445 (presented as “total net position”). Of this amount, \$348,589,581 is reported as “unrestricted”, while \$27,494,848 is reported as “restricted-federal funds” and \$226,721,016 is reported as “invested in capital assets, net of related debt.”

Unrestricted net position represents the amount available to be used to meet OHA’s ongoing obligations to beneficiaries and creditors. Restricted assets represent amounts that have legal requirements on their use.

Statement of Activities – OHA’s total net position, decreased by \$28,000,266 (a 4.64% decrease) in fiscal year 2016. This was primarily due to reduced revenue from interest and investment earnings in the amount of approximately \$5.6 million.

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

Governmental Funds Financial Statements Highlights

Governmental Funds – Fund Balances – In fiscal year 2016, OHA’s governmental funds reported an ending fund balance of \$371,729,051. Of this total amount, \$545,845, or 0.15% is classified as nonspendable for prepaid expenses and security deposits. Restricted fund balance totaled \$26,878,339 or 7.23%, broken down as follows: 99.58% for Native Hawaiian Revolving Loan Fund program of which

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\$6,192,859 relates to the long-term portion of outstanding loans, and 0.42% restricted for other federal programs administered by OHA. \$38,596,896 or 10.38% is classified as committed, based on the Board of Trustees’ resolution to commit these funds towards the debt service of DHHL-issued revenue bonds. Assigned fund balance comprises 82.38% or \$306,239,916 of fund balance, broken down as follows: \$10,531,862 or 3.44% has been encumbered, \$495,895 or 0.16% represents the non-current portion of outstanding loans and \$295,212,159 or 96.40% is available for future expenditures. Negative unassigned fund balance amounts included in the General and Federal Funds will be covered by fiscal year 2017 appropriations and grant draws, respectively.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

Government-wide Financial Statements

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

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

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

The government-wide financial statements also include the results of business-type activities, Ho‘okele Pono LLC and Hi‘ilei Aloha LLC and its wholly-owned subsidiaries, through its separate fiscal year end, December 31, 2015. Ho‘okele Pono LLC and Hi‘ilei Aloha LLC have been included as blended component units due to the fact that OHA is the sole corporate member of each entity.

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 included on page 23 and 25 of this report.

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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.

Proprietary Fund Financial Statements

The blended component units, Ho‘okele Pono LLC and Hi‘ilei Aloha LLC and its wholly-owned subsidiaries, have been classified as a proprietary funds. Like the government-wide financial statements, the proprietary fund statements report long-term (noncurrent) and short-term (current) financial information. The Statement of Cash Flows for the proprietary funds presents changes in cash and cash equivalents, resulting from operating, financing and investing activities; excludes depreciation of capital assets. OHA’s proprietary funds are classified as business-type activities in the government-wide financial statements on pages 27 to 30.

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

The governmental funds financial statements are followed by a budgetary comparison statement, which compares the general fund’s original budget, final budget, and actual amounts prepared on a budgetary basis. A reconciliation between the actual general fund revenues and expenditures compared to the general fund revenues and expenditures prepared for budgetary purposes is included in Note 3 to the financial statements. The *Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis), General Fund* can be found on page 26.

Notes to Financial Statements

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

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GOVERNMENT-WIDE FINANCIAL ANALYSIS

Statement of Net Position

Summarized financial information of OHA’s *Statement of Net Position* as of June 30, 2016 and 2015 is as follows:

	<u>2016</u>	<u>2015</u>
Assets:		
Capital assets	\$ 252,871,530	\$ 254,927,397
Other assets	<u>384,924,081</u>	<u>406,694,599</u>
Total assets	<u>\$ 637,795,611</u>	<u>\$ 661,621,996</u>
Deferred outflows of resources:		
Deferred outflows on net pension liability	<u>3,070,777</u>	<u>2,526,642</u>
Total deferred outflows of resources	<u>\$ 3,070,777</u>	<u>\$ 2,526,642</u>
Liabilities:		
Other liabilities	\$ 10,013,205	\$ 7,779,129
Long-term liabilities	<u>54,634,213</u>	<u>51,263,533</u>
Total liabilities	<u>64,647,418</u>	<u>59,042,662</u>
Deferred inflows of resources:		
Deferred outflows on net pension liability	<u>1,413,791</u>	<u>2,300,531</u>
Total deferred outflows of resources	<u>\$ 1,413,791</u>	<u>\$ 2,300,531</u>
Net position:		
Invested in capital assets, net of related debt	225,290,261	226,721,016
Restricted – Federal funds	26,690,007	27,494,848
Unrestricted	<u>322,824,911</u>	<u>348,589,581</u>
Total net position	<u>\$ 574,805,179</u>	<u>\$ 602,805,445</u>

As noted earlier, net position may serve over time as a useful indicator of a government’s financial position. OHA’s net position totaled \$574,805,179 at the end of fiscal year 2016, compared to \$602,805,445 at the end of fiscal year 2015, representing a decrease of 4.64% or \$28,000,266.

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Unrestricted funds represent the largest portion of OHA’s net position (56.16% and 57.83% at June 30, 2016 and 2015, respectively) and are comprised of resources that may be used to meet OHA’s ongoing obligations to beneficiaries and creditors. This also includes internally imposed assignments of resources.

Statement of Activities

Summarized financial information of OHA’s *Statement of Activities* for the fiscal years ended June 30, 2016 and 2015 is as follows:

	<u>2016</u>	<u>2015</u>
Revenues:		
Program revenues:		
Charges for services	\$ 9,899,686	\$ 8,641,794
Operating grants	1,164,361	1,049,602
General revenues:		
Appropriations, net of lapses	3,217,099	2,741,574
Public Land Trust	15,100,000	15,100,000
Donations and other	331,028	709,920
Interest and investment earnings (losses)	(3,759,322)	1,841,431
Non-imposed fringe benefits	213,008	204,692
Total revenues	<u>26,165,860</u>	<u>30,289,013</u>
Expenses:		
Current divisions:		
Board of Trustees	2,721,390	2,480,763
Support Services	18,215,811	17,903,348
Beneficiary Advocacy	25,906,661	22,660,392
Depreciation	2,298,698	2,154,799
Ho‘okele Pono LLC	363,014	364,817
Hi‘ilei Aloha LLC	5,010,868	5,927,162
Total expenses	<u>54,516,442</u>	<u>51,491,281</u>
Net transfers (to)/from other funds	<u>350,316</u>	<u>1,865,935</u>
Changes in net position	<u>\$ (28,000,266)</u>	<u>\$ (19,336,333)</u>

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Management’s Discussion and Analysis - Unaudited
June 30, 2016

OHA’s change in net position decreased by \$8,663,933 during the year. Key elements of this decrease compared to the prior are as follows:

General revenues interest and investment earnings decreased by \$5,600,753 from the prior year primarily due to decline in the bond market, largely during the third quarter of fiscal year 2016.

Decreases in net position were further attributed by increase in expenses in fiscal year 2016 of \$3,025,161. This change was primarily due to increase in Beneficiary advocacy expenses by \$3,246,269, resulting largely from increased grant expense for the year. Increase in personnel fringe benefit rate also contributed to increased expenses in fiscal year 2016.

Increases in expenses were offset by decreases of \$916,294, attributed to the operations of OHA’s proprietary funds Hi‘ilei Aloha LLC and subsidiaries. With assistance from OHA, Hi‘ilei Aloha LLC and subsidiaries continues progress towards self-sustainability.

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

GOVERNMENTAL FUNDS FINANCIAL ANALYSIS

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

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

At the close of fiscal year 2016, OHA’s governmental funds reported an ending fund balance of \$371,729,051. Fund balance was segregated in to the following categories: Nonspendable, Restricted, Committed, Assigned and Unassigned.

Nonspendable fund balance totaled \$545,845 or 0.15% due to amounts related to inventory, prepaid expenses and security deposits.

Restricted fund balance totaled \$26,878,339 or 7.23%, and is comprised of the following: \$26,765,337 or 99.58% for the Native Hawaiian Revolving Loan Fund program of which \$6,192,859 relates to the long-term portion of outstanding loans, and \$113,002 or 0.42% restricted for other federal programs administered by OHA.

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Management’s Discussion and Analysis - Unaudited
June 30, 2016

Committed fund balance totaled \$38,596,896 or 10.38% based on the Board of Trustees’ resolution to commit these funds towards the debt service of DHHL-issued revenue bonds.

Assigned fund balance totaled \$306,239,916 or 82.38% of fund balance and is comprised of the following: \$10,531,862 or 3.44% has been encumbered, \$495,895 or 0.16% represents the non-current portion of outstanding loans and \$295,212,159 or 96.40% is available for future expenditures.

Unassigned fund balance totaled (\$531,945) or (0.14%) of fund balance and will be covered by fiscal year 2017 appropriations.

At the close of fiscal year 2015, OHA’s governmental funds reported an ending fund balance of \$398,210,621. Fund balance was segregated in to the following categories: Nonspendable, Restricted, Committed, Assigned and Unassigned.

Nonspendable fund balance totaled \$503,572 or 0.13% due to amounts related to inventory, prepaid expenses and security deposits.

Restricted fund balance totaled \$27,609,388 or 6.93%, and is comprised of the following: \$27,513,427 or 99.65% for the Native Hawaiian Revolving Loan Fund program of which \$8,541,672 relates to the long-term portion of outstanding loans, and \$95,961 or 0.35% restricted for other federal programs administered by OHA.

Committed fund balance totaled \$39,341,323 or 9.88% based on the Board of Trustees’ resolution to commit these funds towards the debt service of DHHL-issued revenue bonds.

Assigned fund balance totaled \$330,889,834 or 83.09% of fund balance and is comprised of the following: \$13,692,765 or 4.14% has been encumbered, \$836,357 or 0.25% represents the non-current portion of outstanding loans and \$316,360,712 or 95.61% is available for future expenditures.

Unassigned fund balance totaled (\$133,496) or (0.03%) of fund balance and will be covered by fiscal year 2016 appropriations.

OHA’s governmental funds experienced a decrease of \$24,040,085 in fund balance during fiscal year 2016.

PROPRIETARY FUNDS FINANCIAL ANALYSIS

Proprietary funds’ net position increased by \$77,127 in fiscal year 2016, representing an increase of 0.44%. Proprietary funds’ net position totaled \$17,514,770 at the end of fiscal year 2016.

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Management’s Discussion and Analysis - Unaudited
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Invested in capital assets, net of related debt represent the largest portion of proprietary funds’ net position at \$14,932,197 or 85.25% and is primarily comprised of capital assets of Hi‘ilei Aloha LLC and its wholly-owned subsidiaries.

CAPITAL ASSETS AND LONG-TERM LIABILITIES

OHA’s investment in capital assets, net of depreciation, amounted to \$252,871,530 and \$254,927,397, as of June 30, 2016 and 2015, respectively. Capital assets include land, building, leasehold improvements, equipment and software development.

	<u>2016</u>	<u>2015</u>
Land	\$ 226,965,802	\$ 226,965,802
Buildings and improvements	32,431,630	32,304,137
Equipment	6,667,783	6,494,725
Accumulated Depreciation	<u>(13,193,685)</u>	<u>(10,837,267)</u>
Totals	<u>\$ 252,871,530</u>	<u>\$ 254,927,397</u>

The decrease in capital assets is primarily due to combined effect of no significant additions in the current year and an increase in accumulated depreciation from prior year acquisitions. Additional information regarding OHA’s capital assets can be found in Note 9 to the financial statements.

OHA’s long-term liabilities include notes payable, accrued vacation, accrued workers’ compensation, capital lease obligation, and net pension liability. The increase in long-term liabilities is primarily due to recognition of the net pension liability in accordance with current year adoption of GASB Statement No. 68 and 71 and the debt incurred, approximately \$2.7 million, to finance the governance planning related efforts. Additional information about OHA’s long-term liabilities can be found in Note 12 to the financial statements.

REQUEST FOR INFORMATION

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

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

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

Statement of Net Position

June 30, 2016

	Governmental Activities	Business-Type Activities	Total
ASSETS:			
Petty cash	\$ 800	\$ -	\$ 800
Cash:			
Held in State Treasury	8,047,307	-	8,047,307
Held in bank	14,998,208	2,645,391	17,643,599
Held by investment managers	9,380,389	-	9,380,389
Restricted cash	184,230	-	184,230
Accounts receivable, net	4,498,500	273,491	4,771,991
Interest and dividends receivable	41,741	-	41,741
Inventory, prepaid items and other assets	1,145,097	149,997	1,295,094
Notes receivable, net:			
Due within one year	2,524,267	-	2,524,267
Due after one year	6,688,754	-	6,688,754
Investments	334,345,909	-	334,345,909
Capital assets - net	237,939,333	14,932,197	252,871,530
Total assets	619,794,535	18,001,076	637,795,611
DEFERRED OUTFLOWS OF RESOURCES	3,070,777	-	3,070,777
Total assets and deferred outflows of resources	<u>\$ 622,865,312</u>	<u>\$ 18,001,076</u>	<u>\$ 640,866,388</u>
LIABILITIES:			
Accounts payable and accrued liabilities	\$ 6,167,431	\$ 486,306	\$ 6,653,737
Due to State of Hawaii	3,359,468	-	3,359,468
Long-term liabilities:			
Due within one year	2,009,067	-	2,009,067
Due after one year	52,625,146	-	52,625,146
Total liabilities	64,161,112	486,306	64,647,418
DEFERRED INFLOWS OF RESOURCES	1,413,791	-	1,413,791
Total liabilities and deferred inflows of resources	<u>65,574,903</u>	<u>486,306</u>	<u>66,061,209</u>
COMMITMENTS AND CONTINGENCIES			
NET POSITION:			
Invested in capital assets, net of related debt	210,358,064	14,932,197	225,290,261
Restricted	26,690,007	-	26,690,007
Unrestricted	320,242,338	2,582,573	322,824,911
Total net position	<u>557,290,409</u>	<u>17,514,770</u>	<u>574,805,179</u>
Total liabilities, deferred inflows of resources and net position	<u>\$ 622,865,312</u>	<u>\$ 18,001,076</u>	<u>\$ 640,866,388</u>

See accompanying notes to the basic financial statements.

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

Statement of Activities
For the Fiscal Year Ended June 30, 2016

Functions/Programs	Expenses	Program Revenues		Net (Expenses) Revenue and Changes in Net Position		
		Charges for Services	Operating Grants and Contributions	Governmental Activities	Business-Type Activities	Total
Governmental Activities:						
Board of trustees	\$ 2,721,390	\$ -	\$ -	\$ (2,721,390)	\$ -	\$ (2,721,390)
Support services	18,215,811	5,481,274	-	(12,734,537)	-	(12,734,537)
Beneficiary advocacy	25,906,661	-	958,028	(24,948,633)	-	(24,948,633)
Unallocated depreciation	2,298,698	-	-	(2,298,698)	-	(2,298,698)
Total governmental activities	49,142,560	5,481,274	958,028	(42,703,258)	-	(42,703,258)
Business-Type Activities:						
Ho'okele Pono LLC	363,014	-	206,333	-	(156,681)	(156,681)
Hi'ilei Aloha LLC	5,010,868	4,418,412	-	-	(592,456)	(592,456)
Total business-type activities	5,373,882	4,418,412	206,333	-	(749,137)	(749,137)
Total government-wide	\$ 54,516,442	\$ 9,899,686	\$ 1,164,361	\$ (42,703,258)	\$ (749,137)	\$ (43,452,395)
General Revenues:						
State allotments, net of lapsed appropriations				\$ 3,217,099	-	3,217,099
Public land trust revenue				15,100,000	-	15,100,000
Unrestricted contributions				331,028	-	331,028
Interest and investment earnings				(3,759,322)	-	(3,759,322)
Nonimposed employee fringe benefits				213,008	-	213,008
Total general revenues				15,101,813	-	15,101,813
Transfers				(475,948)	826,264	350,316
Total general revenues and transfers				14,625,865	826,264	15,452,129
Change in net position				(28,077,393)	77,127	(28,000,266)
Net Position:						
Beginning of year				602,805,445	-	602,805,445
Fund reclassification (see note 2)				(17,437,643)	17,437,643	-
Net Position at June 30, 2016				\$ 557,290,409	\$ 17,514,770	\$ 574,805,179

See accompanying notes to the basic financial statements.

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

Governmental Funds - Balance Sheet
June 30, 2016

	General Fund	Public Land Trust	Federal Grants	Other	Total
ASSETS:					
Petty cash	\$ -	\$ 800	\$ -	\$ -	\$ 800
Cash:					
Held in State Treasury	636,230	7,411,077	-	-	8,047,307
Held in bank	-	8,558,041	6,144,665	295,502	14,998,208
Held by investment managers	-	1,930,469	7,449,920	-	9,380,389
Restricted cash	-	-	184,230	-	184,230
Accounts receivable	-	4,363,191	126,370	8,939	4,498,500
Interest and dividends receivable	-	1,087	40,654	-	41,741
Inventory, prepaid items and other assets	36,162	506,681	3,002	-	545,845
Notes receivable:					
Due within one year	-	468,894	2,055,373	-	2,524,267
Due after one year	-	495,895	6,192,859	-	6,688,754
Investments	-	329,424,148	4,921,761	-	334,345,909
Total assets	<u>\$ 672,392</u>	<u>\$ 353,160,283</u>	<u>\$ 27,118,834</u>	<u>\$ 304,441</u>	<u>\$ 381,255,950</u>

See accompanying notes to the basic financial statements.

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

Governmental Funds - Balance Sheet (continued)
June 30, 2016

	General Fund	Public Land Trust	Federal Grants	Other	Total
LIABILITIES:					
Accounts payable and accrued liabilities	\$ 976,841	\$ 5,061,660	\$ 128,827	\$ 103	\$ 6,167,431
Due to State of Hawaii	-	3,059,468	300,000	-	3,359,468
Total liabilities	<u>976,841</u>	<u>8,121,128</u>	<u>428,827</u>	<u>103</u>	<u>9,526,899</u>
COMMITMENTS AND CONTINGENCIES					
FUND BALANCES:					
Fund balances:					
Nonspendable -					
Inventory, prepaid items & security deposits	36,162	506,681	3,002	-	545,845
Restricted for:					
Beneficiary advocacy	-	-	113,002	-	113,002
Native Hawaiian loan programs	-	-	20,572,478	-	20,572,478
Long-term portion of notes receivable	-	-	6,192,859	-	6,192,859
Committed to -					
DHHL-issued revenue bonds	-	38,596,896	-	-	38,596,896
Assigned to:					
Support services	-	6,836,321	-	-	6,836,321
Beneficiary advocacy	-	3,692,177	-	304,338	3,996,515
Long-term portion of notes receivable	-	495,895	-	-	495,895
Public Land Trust	-	294,911,185	-	-	294,911,185
Unassigned	(340,611)	-	(191,334)	-	(531,945)
Total fund balances	<u>(304,449)</u>	<u>345,039,155</u>	<u>26,690,007</u>	<u>304,338</u>	<u>371,729,051</u>
Total liabilities and fund balances	<u>\$ 672,392</u>	<u>\$ 353,160,283</u>	<u>\$ 27,118,834</u>	<u>\$ 304,441</u>	<u>\$ 381,255,950</u>

See accompanying notes to the basic financial statements.

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

Reconciliation of the Balance Sheet to the Statement of Net Position
June 30, 2016

Total Fund Balances - Governmental Funds		\$ 371,729,051
Amounts reported for governmental activities in the Statement of Net Position are different because:		
Capital assets used in governmental funds are not financial resources, and therefore, are not reported in the funds		237,939,333
Other assets used in governmental activities are not current financial resources and therefore are not reported in the funds		599,252
Long-term liabilities are not due and payable in the current period and therefore are not reported in the funds:		
Accrued compensated absences	(1,731,440)	
Capital lease obligations	(42,283)	
Notes payable	(20,891,486)	
Line of credit	(10,195,500)	
Net pension liability	<u>(21,773,504)</u>	(54,634,213)
Funds report expenditures for contributions to pensions. The government-wide statements report deferred outflows, deferred inflows and pension expense		<u>1,656,986</u>
Net Position of Governmental Activities		<u><u>\$ 557,290,409</u></u>

See accompanying notes to the basic financial statements.

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

Governmental Funds - Statement of Revenues, Expenditures, and Changes in Fund Balances
Year Ended June 30, 2016

	General Fund	Public Land Trust	Federal Grants	Other	Total
Revenues:					
Public land trust revenue	\$ -	\$ 15,100,000	\$ -	\$ -	\$ 15,100,000
Intergovernmental revenue	-	-	474,947	-	474,947
Appropriations, net of lapses	3,217,099	-	-	-	3,217,099
Charges for services	-	5,887,202	-	68,320	5,955,522
Interest and investment (losses) earnings	-	(3,759,660)	483,081	338	(3,276,241)
Donations and other	-	315,090	15,938	-	331,028
Non-imposed fringe benefits	213,008	-	-	-	213,008
Total revenues	3,430,107	17,542,632	973,966	68,658	22,015,363
Expenditures:					
Board of trustees	39,542	2,681,848	-	-	2,721,390
Support services	1,528,531	17,618,794	-	7,610	19,154,935
Beneficiary advocacy	2,569,088	21,714,766	1,622,807	-	25,906,661
Total expenditures	4,137,161	42,015,408	1,622,807	7,610	47,782,986
Other Financing (Uses) Sources:					
Proceeds from debt	-	2,682,000	-	-	2,682,000
Payments on debt	-	(478,514)	-	-	(478,514)
Net transfers (to) from other funds	(2,898)	157,234	(156,000)	(474,284)	(475,948)
Net change in fund balances	(709,952)	(22,112,056)	(804,841)	(413,236)	(24,040,085)
Fund Balances:					
Beginning of year	405,503	367,151,211	27,494,848	717,574	395,769,136
End of year	\$ (304,449)	\$ 345,039,155	\$ 26,690,007	\$ 304,338	\$ 371,729,051

See accompanying notes to the basic financial statements.

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

Reconciliation of the Statement of Revenues, Expenditures and
Changes in Fund Balances to the Statement of Activities
For the Fiscal Year Ended June 30, 2016

Net Change in Fund Balances - Total Governmental Funds \$ (24,040,085)

Amounts reported for governmental activities in the Statement of
Activities are different because:

Governmental funds report capital outlays as expenditures,
however, in the statement of activities, the cost of those assets
are depreciated over their estimated useful lives as
depreciation expense. This is the amount by which depreciation
exceeded capital outlay in the current period.

Expenditures for capital assets	331,974	
Current year depreciation, amortization and other changes	<u>(2,298,698)</u>	(1,966,724)

The net effect of various miscellaneous transactions involving capital assets is to decrease net assets		(25,184)
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Borrowings provide current financial resources to governmental funds; however, issuing debt increases long-term liabilities in the statement of net position. In the current period this is the amount of the proceeds from borrowings on the line of credit		(2,682,000)
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Repayment of long-term debt is reported as an expenditure in governmental funds, but the repayment reduces long-term liabilities in the statement of net position. In the current year this is the of principal payments on notes payable and capital leases.		625,112
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Some items reported in the Statement of Activities do not involve
current financial resources and therefore are not reported as
revenues or expenditures in governmental funds. These activities
are as follows:

Decreases in other assets	(105,597)	
Increase in deferred outflows of resources	544,135	
Decrease in deferred inflows of resources	886,740	
Decreases in compensated absences	89,775	
Decrease in accrued workers' compensation	47,818	
Increase in net pension liability	<u>(1,451,383)</u>	<u>11,488</u>

Change in Net Position - Governmental Activities \$ (28,077,393)

See accompanying notes to the basic financial statements.

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

Statement of Revenues and Expenditures - Budget and Actual (Budgetary Basis), General Fund
Year Ended June 30, 2016

	Original Budget	Final Budget	Actual (budgetary basis)	Variance
Revenues -				
State appropriations, net of lapses	\$ 3,217,504	\$ 3,217,504	\$ 3,217,099	\$ (405)
Total revenues	3,217,504	3,217,504	3,217,099	(405)
Expenditures:				
Board of Trustees	28,435	28,435	27,386	1,049
Support services	700,159	700,159	1,200,936	(500,777)
Beneficiary advocacy	2,488,910	2,488,910	1,989,182	499,728
Total expenditures	3,217,504	3,217,504	3,217,504	-
DEFICIENCY OF REVENUES UNDER EXPENDITURES	\$ -	\$ -	\$ (405)	\$ (405)

See accompanying notes to the basic financial statements.

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

Proprietary Funds - Statement of Net Position
June 30, 2016

	<u>December 31, 2015</u>		
	<u>Ho'okele Pono LLC</u>	<u>Hi'ilei Aloha LLC</u>	<u>Total</u>
ASSETS:			
Cash and cash equivalents	\$ 34,134	\$ 2,611,257	\$ 2,645,391
Accounts receivable, net	94,536	178,955	273,491
Inventory, prepaid items and other assets	878	149,119	149,997
Capital assets - net	-	14,932,197	14,932,197
	<u>\$ 129,548</u>	<u>\$ 17,871,528</u>	<u>\$ 18,001,076</u>
LIABILITIES --			
Accounts payable and accrued liabilities	<u>\$ 22,691</u>	<u>\$ 463,615</u>	<u>\$ 486,306</u>
COMMITMENTS AND CONTINGENCIES			
NET POSITION:			
Invested in capital assets, net of related debt	-	14,932,197	14,932,197
Unrestricted	<u>106,857</u>	<u>2,475,716</u>	<u>2,582,573</u>
	<u>106,857</u>	<u>17,407,913</u>	<u>17,514,770</u>
	<u>\$ 129,548</u>	<u>\$ 17,871,528</u>	<u>\$ 18,001,076</u>

See accompanying notes to the basic financial statements.

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

Proprietary Funds - Statement of Revenues, Expenses, and Changes in Net Position
Year Ended June 30, 2016

	December 31, 2015		
	Ho'okele Pono LLC	Hi'ilei Aloha LLC	Total
Revenues:			
Sales - gift store and other	\$ -	\$ 2,366,565	\$ 2,366,565
Cost of sales	-	(2,577,318)	(2,577,318)
Gross margin	-	(210,753)	(210,753)
Admissions and tours	-	3,940,404	3,940,404
Other revenue	-	723,264	723,264
Cooperative agreement - Federal government	206,333	-	206,333
Total operating revenue	206,333	4,452,915	4,659,248
Operating Expenses:			
Program services	336,615	3,494,261	3,830,876
Management and general	60,902	1,499,689	1,560,591
Fundraising	-	16,918	16,918
Total operating expenses	397,517	5,010,868	5,408,385
Operating loss	(191,184)	(557,953)	(749,137)
Non-Operating Expenses --			
Net transfers from other funds	170,320	655,944	826,264
Change in net position	(20,864)	97,991	77,127
Net Position:			
Beginning of year	-	-	-
Fund reclassification (see Note 2)	127,721	17,309,922	17,437,643
End of year	\$ 106,857	\$ 17,407,913	\$ 17,514,770

See accompanying notes to the basic financial statements.

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

Proprietary Funds - Statement of Cash Flows
Year Ended June 30, 2016

	<u>December 31, 2015</u>		
	<u>Ho'okele Pono LLC</u>	<u>Hi'ilei Aloha LLC</u>	<u>Total</u>
Cash Flows from Operating Activities:			
Receipts from customers, grantors and funders	\$ 306,938	\$ 7,043,344	\$ 7,350,282
Payments to suppliers, vendors and service providers	(103,302)	(3,652,036)	(3,755,338)
Payments to employees for salaries and benefits	(254,586)	(3,593,471)	(3,848,057)
Net cash used in operating activities	<u>(50,950)</u>	<u>(202,163)</u>	<u>(253,113)</u>
Cash Flows from Capital and Related Financing Activities - acquisitions of property and equipment	<u>-</u>	<u>(276,555)</u>	<u>(276,555)</u>
Cash Flows from Noncapital Financing Activities:			
Repayment of advances from Hi'ilei Aloha LLC	(143,986)	-	(143,986)
Grants from OHA	130,986	689,690	820,676
Net cash (used in) provided by noncapital financing activities	<u>(13,000)</u>	<u>689,690</u>	<u>676,690</u>
Cash Flows from Investing Activities:			
Repayments of advances to Ho'okipaipai LLC	-	143,986	143,986
Grants to Ho'okele Pono LLC and Ho'okipaipai LLC	-	(33,746)	(33,746)
Net cash provided by investing activities	<u>-</u>	<u>110,240</u>	<u>110,240</u>
Net (decrease) increase in cash and cash equivalents	<u>(63,950)</u>	<u>321,212</u>	<u>257,262</u>
Cash and Cash Equivalents - July 1	<u>98,084</u>	<u>2,290,045</u>	<u>2,388,129</u>
Cash and Cash Equivalents - June 30	<u>\$ 34,134</u>	<u>\$ 2,611,257</u>	<u>\$ 2,645,391</u>

See accompanying notes to the basic financial statements.

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

Proprietary Funds - Statement of Cash Flows
Year Ended June 30, 2016

	<u>December 31, 2015</u>		
	<u>Ho'okele Pono LLC</u>	<u>Hi'ilei Aloha LLC</u>	<u>Total</u>
Reconciliation of Operating Loss to Net Cash			
Used in Operating Activities:			
Operating loss	\$ (191,184)	\$ (557,953)	\$ (749,137)
Adjustments to reconcile operating loss to net cash used in operating activities:			
Expenses paid by Hi'ilei Aloha LLC and OHA	40,320	-	40,320
Depreciation of property and equipment	-	338,338	338,338
Loss on disposal of equipment	-	2,178	2,178
Change in:			
Receivables	100,605	39,634	140,239
Inventory, prepaid items and other assets	(287)	4,347	4,060
Accounts payable and accrued liabilities	(404)	(28,707)	(29,111)
Net cash used in operating activities	<u>\$ (50,950)</u>	<u>\$ (202,163)</u>	<u>\$ (253,113)</u>
Schedule of Noncash Financing Activities -			
Grants from Hi'ilei Aloha LLC and OHA - payment of expenses	<u>\$ 40,320</u>	<u>\$ -</u>	<u>\$ 40,320</u>

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i

Notes to Financial Statements
June 30, 2016

1. Financial Reporting Entity

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

As of June 30, 2016, OHA's blended components units are comprised of Hi'ilei Aloha LLC and Ho'okele Pono LLC, Hawai'i limited liability companies (collectively, the Companies) which were formed by OHA in September 2007 and May 2010, respectively. OHA is the sole corporate member of the Companies and the Chief Executive Officer, Chief Financial Officer and Chief Operating Officer of OHA are the managers of the Companies. The results the Companies as of and for the year ended December 31, 2015, their fiscal year ends, have been included in the financial statements. For the period January 1, 2016 through June 30, 2016, the Companies have not entered into any significant or unusual transactions. In 2016, management reclassified these funds from governmental funds to proprietary funds (see Note 2).

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

2. Significant Accounting Policies

a. Basis of Presentation

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

b. Governmental Funds Financial Statements

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

Office of Hawaiian Affairs, State of Hawai'i

Notes to Financial Statements
June 30, 2016

2. Significant Accounting Policies (continued)

b. Governmental Funds Financial Statements (continued)

Expenditures are generally recorded when a liability is incurred as under accrual accounting. Modifications to the accrual basis of accounting include the employees' vested annual leave, workers' compensation, net pension liability and capital lease obligations which are recorded as expenditures when utilized or paid. The amount of accumulated annual leave unpaid, accrued workers' compensation, net pension liability and capital lease obligations at June 30, 2016 have been reported only in the government-wide financial statements.

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

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

OHA reports the following funds as major:

- General Fund – The general fund of OHA is part of the State of Hawai'i General Fund. 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.
- Public Land Trust Fund – Reflects the income and expenditures 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. Expenditures reflect those from the OHA Board of Trustee appropriations of the Public Land Trust Funds.
- Federal Grants Fund – Reflects the interest income earned from the Native Hawaiian Revolving Loan Fund (NHRLF) and the funds earned under other federal grants. Expenditures reflect necessary costs to administer the NHRLF and other federal grants.

Office of Hawaiian Affairs, State of Hawai'i

Notes to Financial Statements
June 30, 2016

2. Significant Accounting Policies (continued)

c. Proprietary Funds Financial Statements

The focus of proprietary fund measurement is upon determination of operating income (loss), changes in net position, and net position. The intent of these funds is to be self-sufficient. The applicable GAAP are those similar to businesses in the private sector.

OHA reports the following funds as major:

- Hi'ilei Aloha LLC – Reflects the revenues and expenditures related to the preservation and perpetuation of cultural and natural resources which are primarily generated from managing admissions to Waimea Valley on Oahu and the activities and events held there. Although this fund does not meet the major fund criteria, management believes this fund is important to financial statement users and has elected to report it as a major fund.
- Ho'okele Pono LLC – Reflects the revenues and expenditures related to community economic development activity in the State of Hawaii which are primarily related to the operation of the Hawaii Procurement Technical Assistance Center. Although this fund does not meet the major fund criteria, management believes this fund is important to financial statement users and has elected to report it as a major fund.

d. Government-Wide Financial Statements

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

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

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

Notes to Financial Statements
June 30, 2016

2. Significant Accounting Policies (continued)

e. Investments

Investments are reported at fair value using a variety of techniques. Mutual funds are actively traded on major stock exchanges, thus fair value is obtained using values from these exchanges, which are based on trades of identical securities available daily on a last trade or official close basis. Certain debt securities, such as U.S. Treasuries and U.S. Agencies, have an active market. These securities can typically be valued using the closing or last traded price on a specific date. Hedge funds, private equity funds, private debt funds and common trust funds are valued using their net asset value (NAV) and are audited annually. The most significant input into the NAV of such entities is the fair value of its investment holdings. These holdings are valued by the general partners on a quarterly basis, in accordance with GAAP. Commingled funds are valued based upon the NAV determined by the investment managers and are audited annually.

Purchases and sales of investments are recorded on the trade date. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

f. Inventory and Prepaid Items

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

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

Notes to Financial Statements
June 30, 2016

2. Significant Accounting Policies (continued)

g. Capital Assets

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

Buildings	30 years
Leasehold improvements	Various
Furniture, fixtures, and equipment	5 years

h. Compensated Absences and Compensatory Pay

OHA accrues all vacation and compensatory pay at current salary rates; including additional amounts for certain salary-related expenses associated with the payment of compensated absences, in accordance with GASB Codification Section C60, Compensated Absences. The balance at June 30, 2016 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 and proprietary fund financial statements, but not reported as an expenditure in the governmental funds financial statements, as current financial resources are not used.

i. 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.

Office of Hawaiian Affairs, State of Hawai'i

Notes to Financial Statements
June 30, 2016

2. Significant Accounting Policies (continued)

j. Governmental Funds – Fund Balance

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

Nonspendable Fund Balance

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

Restricted Fund Balance

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

Committed Fund Balance

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

Assigned Fund Balance

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

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

Notes to Financial Statements
June 30, 2016

2. Significant Accounting Policies (continued)

j. Governmental Funds – Fund Balance (continued)

Unassigned Fund Balance

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

Stabilization Arrangements

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

OHA's Fiscal Reserve is comprised of lapsed fiscal year funding for its Public Land Trust budget. The Public Land Trust fiscal year budget is subject to Trustee approval prior to the start of each fiscal year. Use of Fiscal Reserve funding is subject to Board of Trustee approval and may be used to cover any current year funding shortfalls. As of June 30, 2016, OHA had approximately, \$2.9 million in its Fiscal Reserve and is reported as Assigned Public Land Trust fund balance.

The deficit fund balance in the general fund is caused by the timing of grant reimbursements and will be recovered in the following fiscal year when appropriations become available.

**Office of Hawaiian Affairs,
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Notes to Financial Statements
June 30, 2016

2. Significant Accounting Policies (continued)

k. Encumbrances

Encumbrances against budgeted appropriations are recorded upon the execution of contracts or purchase orders. Such encumbrances have been classified by expenditure division (i.e. Board of Trustees, Support Services, Beneficiary Advocacy) by fund balance classification (i.e. Restricted, Committed, Assigned) in the governmental funds financial statements. The related expenditure is reported in the period in which the liability is incurred. Encumbrances as of June 30, 2016 consist of the following:

General Fund	\$ 156,497
Public Land Trust	10,528,498
Federal Grants	198,396
Other	<u>3,364</u>
	<u>\$ 10,886,755</u>

l. Use of Estimates

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

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

Notes to Financial Statements
June 30, 2016

2. Significant Accounting Policies (continued)

m. Notes Receivables

Notes receivable consist of notes made to Native Hawaiian-owned businesses and individuals. Management provides an allowance for doubtful accounts equal to the estimated amounts deemed uncollectible by management which it considers outstanding for more than 90 days. Management also provides a general allowance for its notes receivable. The composition of notes receivable at June 30, 2016 are as follows:

Native Hawaiian and Hawaiian persons	99.7%
Agencies	<u>0.3%</u>
	<u>100.0%</u>

n. Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Employees' Retirement System (ERS) and additions to/deductions from the ERS's fiduciary net position have been determined on the same basis as they are reported by the ERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with benefit terms. Investments are reported at their fair value.

o. Recent Accounting Pronouncements

In February 2015, GASB issued Statement No. 72, *Fair Value Measurement and Application*. This Statement enhances the comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. The provisions of this Statement are effective for periods beginning after June 15, 2015. OHA implemented the provisions of GASB 72 as of June 30, 2016 and determined that there was no significant impact to the financial statements.

Office of Hawaiian Affairs, State of Hawai'i

Notes to Financial Statements
June 30, 2016

2. Significant Accounting Policies (continued)

o. Recent Accounting Pronouncements (continued)

In June 2015, the GASB issued Statement No. 73 (GASB 73), *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. GASB 73 applies the accounting and financial reporting established in GASB 68 to all defined benefit and defined contribution pensions that are not within the scope of GASB 68. GASB 73 will be effective for OHA's financial statements for the year ending June 30, 2017. Management is currently assessing the impact of GASB 73 on its financial position and results of operations and has not determined if the adoption will have a material effect on its financial statements.

In June 2015, the GASB issued Statement No. 75 (GASB 75), *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. GASB 75 amends the accounting guidance related to employers' accounting for postemployment benefits other than pension (other postemployment benefits or OPEB) administered through trusts that meet specified criteria. GASB 75 establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expenditures related to OPEB. Note disclosures and required supplementary information are addressed by the statement. GASB 75 will be effective for OHA's financial statements for the year ending June 30, 2018. Management is currently assessing the impact of GASB 75 on its financial position and results of operations reported on its financial statements.

In June 2015, the GASB issued Statement No. 76 (GASB 76), *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. GASB 76 reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and non-authoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. OHA implemented the provisions of GASB 76 as of June 30, 2016 and determined that there was no significant impact to the financial statements.

**Office of Hawaiian Affairs,
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Notes to Financial Statements
June 30, 2016

2. Significant Accounting Policies (continued)

o. Recent Accounting Pronouncements (continued)

In March 2016, the GASB issued Statement No. 82 (GASB 82), *Pension Issues – an amendment of GASB Statements No. 67, No. 68, and No. 73*. GASB 82 addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. GASB 82 will be effective for OHA’s financial statements for the year ending June 30, 2017, with earlier adoption permitted. Management is currently assessing the impact of GASB 82 on its financial position and results of operations reported on its financial statements.

p. Fund Reclassification

In 2016, management revisited the purpose of Hi‘ilei Aloha LLC and Ho‘okele Pono LLC, and determined that they should be reported as proprietary funds, as the intent of these funds is to be self-sufficient. As such, management reclassified Hi‘ilei Aloha LLC and Ho‘okele Pono LLC from governmental funds to proprietary funds. The results of the reclassification are as follows:

	Governmental Activities	Business-Type Activities
	<hr/>	<hr/>
Government-Wide Financial Statements		
Net position, as of June 30, 2015, as previously reported	\$ 602,805,445	\$ -
Change in presentation of Hi‘ilei Aloha LLC and Ho‘okele Pono LLC as proprietary funds	<hr/> (17,437,643) <hr/>	<hr/> 17,437,643 <hr/>
Net Position, July 1, 2015 as reclassified	<hr/> <u>\$ 585,367,802</u> <hr/>	<hr/> <u>\$ 17,437,643</u> <hr/>

Office of Hawaiian Affairs, State of Hawai'i

Notes to Financial Statements
June 30, 2016

3. Biennial Budget

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

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

**Office of Hawaiian Affairs,
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Notes to Financial Statements
June 30, 2016

3. Biennial Budget (continued)

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, 2016 from the budgetary basis to GAAP basis are as follows:

Deficiency of revenues under expenditures – actual (budgetary basis)	\$ (405)
Reserve for encumbrances at June 30	156,497
Prior year reserve for encumbrances	411,398
Accrued payables and payroll	(713,841)
Prepaid expenditures not recognized for budgetary purposes – net of prior-year accruals	33,862
Expenditures for liquidation of prior-year encumbrances	<u>(597,463)</u>
Deficiency of revenues under expenditures – actual (GAAP basis)	<u>\$ (709,952)</u>

4. Appropriations

OHA is authorized to transfer appropriation amounts and staffing positions between programs for operating purposes, provided that a report of all transfers are made to the State Legislature prior to convening of the next legislative session. Act 170, Sessions Laws of Hawai'i (SLH) 2015 authorizes a total of \$3,217,504 in general funds.

Office of Hawaiian Affairs, State of Hawai'i

Notes to Financial Statements
June 30, 2016

5. Cash

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

OHA's cash included in State pooled funds is fully collateralized with securities held by third-party agents in the State's name, as required by the HRS, Section 38-8. At June 30, 2016, OHA's cash held in the State Treasury totaled \$8,047,307.

OHA holds cash in banking institutions held outside of the State Treasury to maximize investment returns in accordance with HRS Section 10-5.

At December 31, 2015, Hi'ilei Aloha LLC had a cash balance of \$2,611,257 with a corresponding bank balance of \$2,710,629. Hi'ilei Aloha LLC and its wholly-owned subsidiaries, Hi'ipaka LLC and Hi'ipoi LLC maintain separate legal entity cash accounts with a financial institution in the State of Hawai'i. Balances are insured up to \$250,000 per account holder by the FDIC. Balances may at times, however, exceed the FDIC's insurance limits.

At December 31, 2015, Ho'okele Pono LLC did not have bank balances that exceed FDIC insurance limits. Balances may at times, however, exceed the FDIC's insurance limits.

6. Inventory, Prepaid Items and Other Assets

At June 30, 2016, OHA's governmental funds had prepaid items totaling \$545,845.

At December 31, 2015, Hi'ilei Aloha LLC and Ho'okele Pono LLC, had inventory of \$109,062, and nil, respectively, and prepaid items totaling \$40,057 and \$878, respectively.

Office of Hawaiian Affairs, State of Hawai'i

Notes to Financial Statements
June 30, 2016

7. Notes Receivable

At June 30, 2016, notes receivable bear interest from 4% to 6.25%, mature on various dates through August 2021, and consists of the following:

Loan receivable (of which \$668,845 is guaranteed by Department of Hawaiian Home Lands (DHHL))	\$ 715,198
Native Hawaiian Revolving Loan Fund	9,669,387
Other	<u>1,378,418</u>
Total	11,763,003
Less allowance for doubtful accounts	<u>(2,549,982)</u>
Net	9,213,021
Amounts due within one year	<u>(2,524,267)</u>
Amounts due after one year	<u>\$ 6,688,754</u>

8. Investments

Under the HRS Chapter 10, OHA's Board of Trustees may collect, receive, deposit, withdraw, and invest money and property to further the mission of OHA. On May 29, 2003, OHA's Board of Trustees adopted the Native Hawaiian Trust Fund Investment Policy Statement (NHTF investment policy), as updated September 27, 2012. OHA's Board of Trustees maintain responsibility for setting the investment policy guidelines, asset allocation constraints, and monitoring the advisors to ensure they act prudently and follow the investment policy.

OHA's investment policy allows for investments in U.S. large cap, U.S. small cap equities, international equities, core fixed income, high yield, real estate, absolute return, and private equity securities.

**Office of Hawaiian Affairs,
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Notes to Financial Statements
June 30, 2016

8. Investments (continued)

Investments as of June 30, 2016 and their maturities were as follows:

Investment type	Fund	Fair value	Investment maturities (in years)	
			Less than one	One through five
Mutual funds	NHTF	\$ 110,086,715	\$ 110,086,715	\$ -
Commingled funds	NHTF	99,948,462	99,948,462	-
Hedge funds	NHTF	57,442,185	57,442,185	-
Private equity	NHTF	52,547,943	-	52,547,943
Private debt	NHTF	9,398,843	-	9,398,843
Subtotal - NHTF		329,424,148	267,477,362	61,946,786
U.S. treasuries	NHRLF	3,142,866	229,830	2,913,036
U.S. agencies	NHRLF	1,778,895	259,146	1,519,749
Subtotal - NHRLF		4,921,761	488,976	4,432,785
Total investments		<u>\$ 334,345,909</u>	<u>\$ 267,966,338</u>	<u>\$ 66,379,571</u>

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

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.

**Office of Hawaiian Affairs,
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Notes to Financial Statements
June 30, 2016

8. Investments (continued)

Foreign currency, interest rate, credit and concentration of credit risks for OHA's investments are as follows:

a. Foreign Currency Risk

To diversify the NHTF portfolio against market fluctuations, OHA's investment policy allows for investments in foreign countries. As of June 30, 2016, OHA's foreign currency risks are as follows:

<u>Investment Type</u>	<u>Currency</u>	<u>Value (US Dollar)</u>
Private equity funds	Euro	<u>\$ 5,401,785</u>

b. Interest Rate Risk

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

<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.

c. Credit Risk

Pursuant to 45 C.P.R. 1336.72(a), "any portion of the revolving loan fund that is not required for expenditure must be invested in obligations of the United States or in obligations guaranteed or insured by the United States." At June 30, 2016, credit rates for all securities of government agencies were rated at least Aa (Moody's) or AA (Standard & Poor's).

Office of Hawaiian Affairs, State of Hawai'i

Notes to Financial Statements
June 30, 2016

8. Investments (continued)

d. Concentration of Credit Risk

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

e. Fair Value Measurements

The framework for measuring fair value provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1) and the lowest priority to unobservable inputs (level 3). The three levels of the fair value hierarchy are described as follows:

Level 1 – Investments whose values are based on quoted prices (unadjusted) for identical assets or liabilities in active markets that a government can access at the measurement date. An active market is a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Investments whose values are based on inputs other than quoted prices included within Level 1 that are observable for an asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a level 2 input must be observable for most of the full term of the asset or liability. Level 2 inputs include:

- Quoted prices for similar assets or liabilities in active markets,
- Quoted prices for identical or similar assets or liabilities in markets that are not active,
- Inputs other than quoted prices that are observable for the asset or liability,
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 – Investments classified as Level 3 have unobservable inputs for an asset or liability and may require a degree of professional judgment.

Office of Hawaiian Affairs, State of Hawai'i

Notes to Financial Statements
June 30, 2016

8. Investments (continued)

e. Fair Value Measurements (continued)

The fair value of mutual funds and U.S. government obligations is obtained by using the closing price reported on active markets.

The valuation of commingled funds, hedge funds, private equity, common trust funds, and private debt are obtained by using the NAV, and are excluded from the fair value measurement table below.

The following table sets forth by level, within the fair value hierarchy, assets measured at fair value on a recurring basis as of June 30, 2016

	Fund	Level 1	Level 2	Level 3	Total
2016:					
Mutual funds:					
Blended	NHTF	\$ 45,183,930	\$ -	\$ -	\$ 45,183,930
Bond funds	NHTF	28,015,624	-	-	28,015,624
Real estate	NHTF	17,976,706	-	-	17,976,706
Growth	NHTF	8,605,751	-	-	8,605,751
Value	NHTF	6,085,457	-	-	6,085,457
Diversified emerging markets	NHTF	4,219,247	-	-	4,219,247
Total mutual funds		110,086,715	-	-	110,086,715
U.S. treasuries	NHRLF	-	3,142,866	-	3,142,866
U.S. agencies	NHRLF	-	1,778,895	-	1,778,895
Total investments at fair value		110,086,715	4,921,761	-	115,008,476
Investments held at NAV:					
Commingled funds					99,948,462
Hedge funds					57,442,185
Private equity					52,547,943
Private debt					9,398,843
Total investments					<u>\$ 334,345,909</u>

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Notes to Financial Statements
June 30, 2016

9. Capital Assets

OHA's capital assets activities during the year ended June 30, 2016 was as follows:

	Balance July 1, 2015	Additions	Deductions	Balance June 30, 2016
Capital assets not depreciated --				
Land	\$ 213,961,981	\$ -	\$ -	\$ 213,961,981
Capital assets being depreciated:				
Buildings	23,708,314	635	-	23,708,949
Leasehold improvements	6,140,781	-	-	6,140,781
Furniture, fixtures and equipment	5,622,797	331,339	(244,526)	5,709,610
Total capital assets being depreciated	35,471,892	331,974	(244,526)	35,559,340
Less accumulated depreciation	(9,502,632)	(2,298,698)	219,342	(11,581,988)
Capital assets being depreciated - net	25,969,260	(1,966,724)	(25,184)	23,977,352
Capital assets, net	<u>\$ 239,931,241</u>	<u>\$ (1,966,724)</u>	<u>\$ (25,184)</u>	<u>\$ 237,939,333</u>

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Notes to Financial Statements
June 30, 2016

9. Capital Assets (continued)

Hi'ilei Aloha LLC's capital assets activities during the year ended December 31, 2015 are as follows:

	Balance January 1, 2015	Additions	Deductions	Balance December 31, 2015
Capital assets not depreciated --				
Land	\$ 13,003,821	\$ -	\$ -	\$ 13,003,821
Capital assets being depreciated:				
Buildings	968,388	-	-	968,388
Leasehold improvements	1,486,654	176,124	(49,266)	1,613,512
Furniture, fixtures and equipment	871,928	100,429	(14,184)	958,173
Total capital assets being depreciated	3,326,970	276,553	(63,450)	3,540,073
Less accumulated depreciation	(1,334,635)	(338,338)	61,276	(1,611,697)
Capital assets being depreciated - net	1,992,335	(61,785)	(2,174)	1,928,376
Capital assets, net	<u>\$ 14,996,156</u>	<u>\$ (61,785)</u>	<u>\$ (2,174)</u>	<u>\$ 14,932,197</u>

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10. Capital Leases

OHA leases photocopiers and mail postage meter machines for all offices. Capital leases are recorded as assets and liabilities and amortized over the term of the lease agreement by use of the straight line method. The amortization of assets recorded under capital leases is included with depreciation expenses. As of June 30, 2016, assets recorded under capital lease included in machinery, equipment, furniture and fixtures is \$513,750 and related amortization is \$490,137.

At June 30, 2016, the current portion of minimum lease payments is \$41,595 and the long-term obligation is \$688. Below are minimum lease payments through 2018 and the computation of the current and long-term capital lease obligation:

Fiscal year ending June 30,	
2017	\$ 41,903
2018	<u>691</u>
Total minimum lease payments	42,594
Less interest	<u>(311)</u>
Present value of minimum lease payments	42,283
Less current portion	<u>(41,595)</u>
Long-term capital lease obligation	<u><u>\$ 688</u></u>

11. Operating Leases

OHA leases office space and equipment under various noncancelable operating leases through June 2021. Future minimum payments under all leases as of June 30, 2016 are as follows:

Fiscal year ending June 30,	
2017	\$ 971,000
2018	994,000
2019	1,035,000
2020	70,000
2021	<u>22,000</u>
Total	<u><u>\$ 3,092,000</u></u>

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Notes to Financial Statements
June 30, 2016

11. Operating Leases (continued)

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

Rent expense (including taxes and common area maintenance) under all operating leases totaled approximately \$213,000 for the year ended June 30, 2016.

Hi'ilei Aloha LLC leases office space for its office located in Honolulu, Hawai'i, under a lease that expires October 2019. The lease includes base rent, plus a proportionate share of building operating expenses and general excise tax.

Future minimum payment obligations under all leases as of December 31, 2015 are approximately as follows:

Year ending December 31,	
2016	\$ 60,000
2017	60,000
2018	60,000
2019	50,000
Total	<u>\$ 230,000</u>

Rent expense under operating leases totaled approximately \$73,000 for the year ended December 31, 2015. Hi'ilei Aloha LLC sub-leases certain of its office space to Ho'okele Pono LLC under an agreement that renews annually. Rent revenue and related expenses of approximately \$35,000 for the year ended December 31, 2015, are eliminated in the government-wide adjustments.

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Notes to Financial Statements
June 30, 2016

11. Operating Leases (continued)

Portions of Kaka'ako Makai, land included in capital assets, and Na Lama Kukui, building included in capital assets, are currently leased under operating lease arrangements that expire through 2042 and 2022, respectively. For the year ended June 30, 2016, rental revenue from Kaka'ako Makai and Na Lama Kukui amounted to approximately \$2,622,000 and \$3,265,000, respectively, and are recorded in the PLTF as charges for services.

As of June 30, 2016, approximate minimum future lease rentals under non-cancellable operating leases are as follows:

Fiscal year ending June 30,	
2017	\$ 4,876,000
2018	4,457,000
2019	1,747,000
2020	1,372,000
2021	1,167,000
2022-2026	2,359,000
2027-2031	2,153,000
2032-2036	2,043,000
2037-2041	1,603,000
2042	321,000
Total	<u>\$ 22,098,000</u>

12. Long-Term Liabilities

On August 14, 2012, OHA entered into a \$21,370,000 long term note payable with a bank, to finance the purchase of Na Lama Kukui. The interest rate is fixed at 3.35%. The note is due in full on September 1, 2022 and is collateralized by a mortgage lien on the property, assignment of OHA's right, title and interest as landlord in and to any rents under tenant leases and rental agreements on Na Lama Kukui and security interest in all furniture, fixtures, and equipment. On July 26, 2013 the agreement was modified to increase the interest rate to 3.6% and include certain financial covenants. At June 30, 2016, OHA was in compliance with those covenants.

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Notes to Financial Statements
June 30, 2016

12. Long-Term Liabilities (continued)

The long term note payable future principal and interest payments are as follows:

Year ending June 30,	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ 555,069	\$ 742,524	\$ 1,297,593
2018	575,385	722,208	1,297,593
2019	596,444	701,149	1,297,593
2020	618,274	679,319	1,297,593
2021	640,903	656,690	1,297,593
2022-2023	<u>17,905,411</u>	<u>1,341,610</u>	<u>19,247,021</u>
Total	<u>\$ 20,891,486</u>	<u>\$ 4,843,500</u>	<u>\$ 25,734,986</u>

On June 28, 2013 OHA entered into a \$6,758,000 line of credit to finance the renovation of Na Lama Kukui, which is due in full on June 28, 2023. On January 28, 2015, OHA entered into a \$5,000,000 line of credit to finance OHA's governance planning initiative and other projects, which is due in full on February 3, 2024. OHA had drawn a total of \$10,195,500 between the lines of credit as of June 30, 2016. The interest rates are contingent upon certain elections by OHA. The lines of credit are collateralized by all investment property and financial assets held in certain investment accounts. There were no principal payments made for the year ended June 30, 2016. The lines of credit are also subject to certain financial covenants. At June 30, 2016, OHA was in compliance with those covenants. Future principal and interest payments are as follows:

Year ending June 30,	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ 454,379	\$ 209,911	\$ 664,290
2018	1,699,250	287,493	1,986,743
2019	1,699,250	266,777	1,966,027
2020	1,699,250	239,178	1,938,428
2021	1,699,250	165,826	1,865,076
2022-2024	<u>2,944,121</u>	<u>858,392</u>	<u>3,802,513</u>
Total	<u>\$ 10,195,500</u>	<u>\$ 2,027,577</u>	<u>\$ 12,223,077</u>

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

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Notes to Financial Statements
June 30, 2016

12. Long-Term Liabilities (continued)

Long-term liabilities for the year ended June 30, 2016 are as follows:

	Balance			Balance June 30, 2016	Amount due	
	July 1, 2015	Additions	Reductions		within one year	Amount due after one year
Compensated absences	\$ 1,821,215	\$ 821,585	\$ (911,360)	\$ 1,731,440	\$ 958,024	\$ 773,416
Workers' compensation	47,818	-	(47,818)	-	-	-
Capital lease obligation	188,881	-	(146,598)	42,283	41,595	688
Net pension liability	20,322,122	1,451,382	-	21,773,504	-	21,773,504
Notes payable	21,370,000	-	(478,514)	20,891,486	555,069	20,336,417
Line of credit	<u>7,513,500</u>	<u>2,682,000</u>	<u>-</u>	<u>10,195,500</u>	<u>454,379</u>	<u>9,741,121</u>
Total	<u>\$ 51,263,536</u>	<u>\$ 4,954,967</u>	<u>\$ (1,584,290)</u>	<u>\$ 54,634,213</u>	<u>\$ 2,009,067</u>	<u>\$ 52,625,146</u>

13. Employee Benefits

a. Defined Benefit Pension Plans

All full-time employees of the State 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 employees of Hi'ilei Aloha LLC and Ho'okele Pono LLC are excluded from the ERS plans. Benefit terms, eligibility, and contribution requirements are established by HRS Chapter 88 and can be amended through legislation. The ERS issues a publicly available financial report that can be obtained at ERS's website: <http://ers.ehawaii.gov/>.

The ERS provides retirement, disability, and death benefits that are covered by the provisions of the noncontributory, contributory, and hybrid retirement membership classes. The three classes provide a monthly retirement allowance equal to the benefit multiplier (generally 1.25% or 2%) multiplied by the average final compensation multiplied by years of credited service. The benefit multiplier decreased by 0.25% for new hybrid and contributory class members hired after June 30, 2012. Average final compensation is an average of the highest salaries during any 3 years of credited service, excluding any salary paid in lieu of vacation for employees hired January 1, 1971 or later and the average of the highest salaries during any five years of credited service including any salary paid in lieu of vacation for employees hired prior to January 1, 1971.

Office of Hawaiian Affairs, State of Hawai'i

Notes to Financial Statements
June 30, 2016

13. Employee Benefits (continued)

a. Defined Benefit Pension Plans (continued)

For members hired before July 1, 2012, the original retirement allowance is increased by 2.5% each July 1 following the calendar year of retirement. This cumulative benefit is not compounded and increases each year by 2.5% of the original retirement allowance without a ceiling (2.5% of the original retirement allowance the first year, 5.0% the second year, 7.5% the third year, etc.). For members hired after June 30, 2012 the post-retirement annuity increase was decreased to 1.5% per year.

Retirement benefits for certain groups, such as police officers, firefighters, some investigators, sewer workers, judges, and elected officials, vary from general employees.

Noncontributory Class

Retirement Benefits:

General employees' retirement benefits are determined as 1.25% of average final compensation multiplied by the years of credited service. Employees with 10 years of credited service are eligible to retire at age 62. Employees with 30 years of credited service are eligible to retire at age 55.

Disability Benefits:

Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 35% of their average final compensation. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are determined in the same manner as retirement benefits but are payable immediately, without an actuarial reduction, and at a minimum of 12.5% of average final compensation.

Death Benefits:

For service-connected deaths, the surviving spouse/reciprocal beneficiary receives a monthly benefit of 30% of the average final compensation until remarriage or re-entry into a new reciprocal beneficiary relationship. Additional benefits are payable to surviving dependent children up to age 18. If there is no spouse/reciprocal beneficiary or dependent children, no benefit is payable.

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Notes to Financial Statements
June 30, 2016

13. Employee Benefits (continued)

a. Defined Benefit Pension Plans (continued)

Ten years of credited service is required for ordinary death benefits. For ordinary death benefits, the surviving spouse/reciprocal beneficiary (until remarriage/reentry into a new reciprocal beneficiary relationship) and dependent children (up to age 18) receive a benefit equal to a percentage of member's accrued maximum allowance unreduced for age or, if the member was eligible for retirement at the time of death, the surviving spouse/reciprocal beneficiary receives 100% joint and survivor lifetime pension.

Contributory Class for Employees Hired prior to July 1, 2012

Retirement Benefits:

General employees' retirement benefits are determined as 2% of average final compensation multiplied by the years of credited service. General employees with 5 years of credited service are eligible to retire at age 55.

Police and firefighters' retirement benefits are determined as 2.25% of average final compensation for each year of service up to a maximum of 80%. Police and firefighters with 5 years of credited service are eligible to retire at age 55. Police officers and firefighters with 25 years of credited service are eligible to retire at any age, provided the last five years is service credited in these occupations.

Disability Benefits:

Members are eligible for service-related disability benefits regardless of length of service and receive a one-time payment of the member's contributions and accrued interest plus a lifetime pension of 50% of their average final compensation. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are determined as 1.75% of average final compensation multiplied by the years of credited service but are payable immediately, without an actuarial reduction, and at a minimum of 30% of average final compensation.

Office of Hawaiian Affairs, State of Hawai'i

Notes to Financial Statements
June 30, 2016

13. Employee Benefits (continued)

a. Defined Benefit Pension Plans (continued)

Death Benefits:

For service-connected deaths, the designated beneficiary receives a lump sum payment of the member's contributions and accrued interest plus a monthly benefit of 50% of the average final compensation to the surviving spouse/reciprocal beneficiary until remarriage or re-entry into a new reciprocal beneficiary relationship. If there is no surviving spouse/reciprocal beneficiary, surviving children (up to age 18) or dependent parents are eligible for the monthly benefit. If there is no spouse/reciprocal beneficiary or dependent children/parents, the death benefit is payable to the designated beneficiary.

Ordinary death benefits are available to employees who were active at time of death with at least 1 year of service. Ordinary death benefits consist of a lump sum payment of the member's contributions and accrued interest plus a percentage of the salary earned in the 12 months preceding death, or 50% Joint and Survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least 10 years of service and designated one beneficiary, or 100% Joint and Survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

Contributory Class for Employees Hired After June 30, 2012

Retirement Benefits:

General employees' retirement benefits are determined as 1.75% of average final compensation multiplied by the years of credited service. General employees with ten years of credited service are eligible to retire at age 60.

Police and firefighters' retirement benefits are determined as 2.25% of average final compensation for each year of service up to a maximum of 80%. Police and firefighters with 10 years of credited service are eligible to retire at age 60. Police officers and firefighters with 25 years of credited service are eligible to retire at any age, provided the last five years is service credited in these occupations.

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Notes to Financial Statements
June 30, 2016

13. Employee Benefits (continued)

a. Defined Benefit Pension Plans (continued)

Disability and Death Benefits:

Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 50% of their average final compensation plus refund of contributions and accrued interest. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are 3.0% of average final compensation for each year of service for judges and elected officers and 1.75% of average final compensation for each year of services for police and firefighters and are payable immediately, without an actuarial reduction, at a minimum of 30% of average final compensation.

Death benefits for contributory plan members hired after June 30, 2012 are generally the same as those for contributory plan members hired June 30, 2012 and prior.

Hybrid Class for Employees Hired Prior to July 1, 2012

Retirement Benefits:

General employees' retirement benefits are determined as 2% of average final compensation multiplied by the years of credited service. General employees with 5 years of credited service are eligible to retire at age 62. General employees with 30 years of credited service are eligible to retire at age 55.

Disability Benefits:

Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 35% of their average final compensation plus refund of their contributions and accrued interest. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are determined in the same manner as retirement benefits but are payable immediately, without an actuarial reduction, and at a minimum of 25% of average final compensation.

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Notes to Financial Statements
June 30, 2016

13. Employee Benefits (continued)

a. Defined Benefit Pension Plans (continued)

Death Benefits:

For service-connected deaths, the designated beneficiary receives a lump sum payment of the member's contributions and accrued interest plus a monthly benefit of 50% of the average final compensation to the surviving spouse/reciprocal beneficiary until remarriage or re-entry into a new reciprocal beneficiary relationship. If there is no surviving spouse/reciprocal beneficiary, surviving children (up to age 18) or dependent parents are eligible for the monthly benefit. If there is no spouse/reciprocal beneficiary or dependent children/parents, the death benefit is payable to the designated beneficiary.

Ordinary death benefits are available to employees who were active at time of death with at least 5 years of service. Ordinary death benefits consist of a lump sum payment of the member's contributions and accrued interest plus a percentage multiplied by 150%, or 50% Joint and Survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least 10 years of service and designated one beneficiary, or 100% Joint and Survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

Hybrid Class for Employees Hired After June 30, 2012

Retirement Benefits:

General employees' retirement benefits are determined as 1.75% of average final compensation multiplied by the years of credited service. General employees with 10 years of credited service are eligible to retire at age 65. Employees with 30 years of credited service are eligible to retire at age 60. Sewer workers, water safety officers, and EMTs may retire with 25 years of credited service at age 55.

Disability and Death Benefits:

Provisions for disability and death benefits generally remain the same except for ordinary death benefits. Ordinary death benefits are available to employees who were active at time of death with at least 10 years of service. Ordinary death benefits consist of a lump sum payment of the member's contributions and accrued interest plus a percentage multiplied by 120%, or 50% Joint and Survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least 10 years of service and designated one beneficiary, or 100% Joint and Survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary or if less than 10 years of service, return of member's contributions and accrued interest.

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Notes to Financial Statements
June 30, 2016

13. Employee Benefits (continued)

a. Defined Benefit Pension Plans (continued)

Contributions

Contributions are established by HRS Chapter 88 and may be amended through legislation. The employer rate is set by statute based on the recommendations of the ERS actuary resulting from an experience study conducted every five years. Since July 1, 2005, the employer contribution rate is a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liabilities. The contribution rates for fiscal year 2016 were 25.00% for police and firefighters and 17.00% for all other employees. Contributions to the pension plan from OHA were approximately \$1,706,000 for the fiscal year ended June 30, 2016.

The employer is required to make all contributions for noncontributory members. For contributory class employees hired prior to July 1, 2012, general employees are required to contribute 7.8% of their salary, except for police and firefighters who are required to contribute 12.2% of their salary. For contributory class employees hired after June 30, 2012 are required to contribute 9.8% of their salary, except for police and firefighters who are required to contribute 14.2% of their salary. Hybrid members hired prior July 1, 2012 are required to contribute 6.0% of their salary. Hybrid members hired after June 30, 2012 are required to contribute 8.0% of their salary.

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

At June 30, 2016, OHA reported a liability of \$21,773,504 for its proportionate share of net pension liability. The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. OHA's proportion of the net pension liability was based on a projection of OHA's long-term share of contributions to the pension plan relative to projected contributions of all participants, actuarially determined. At June 30, 2015, OHA's proportion was 0.43% which was an increase of 0.01% from its proportion measured as of June 30, 2014.

There were no changes in other assumptions and inputs that affected the measurement of the total pension liability since the prior measurement date. There were no changes between the measurement date, June 30, 2015, and the reporting date, June 30, 2016, that are expected to have a significant effect on the proportionate share of the net pension liability.

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Notes to Financial Statements
June 30, 2016

13. Employee Benefits (continued)

a. Defined Benefit Pension Plans (continued)

For the year ended June 30, 2016, OHA recognized pension expense of \$2,243,035. At June 30, 2016, OHA reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ 201,254	\$ (599,347)
Changes in assumptions	508,620	-
Net difference between projected and actual earnings on pension plan investments	-	(681,054)
Changes in proportion and differences between OHA contributions and proportionate share of contributions	28,024	(133,390)
OHA contributions subsequent to the measurement date	2,332,879	-
	<u>\$ 3,070,777</u>	<u>\$ (1,413,791)</u>

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Notes to Financial Statements
June 30, 2016

13. Employee Benefits (continued)

a. Defined Benefit Pension Plans (continued)

The \$2,332,879 reported as deferred outflows of resources related to pensions resulting from OHA contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year ending June 30,	
2017	\$ (164,741)
2018	(164,741)
2019	(164,741)
2020	(164,741)
2021	<u>(16,929)</u>
Total	<u>\$ (675,893)</u>

Actuarial Assumptions

The total pension liability in the June 30, 2015 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.00%
Payroll growth rate	3.5%
Investment rate of return	7.65% per year, compounded annual including inflation

The same rates were applied to all periods. There were no changes to ad hoc postemployment benefits including COLA.

Post-retirement mortality rates are based on Client Specific Tables and the 1994 US Group Annuity Mortality Statistic Tables for police and firefighters. Pre-retirement mortality rates are based on the RP-2000 tables.

The actuarial assumptions used in the June 30, 2015 valuation were based on the results of an actuarial experience study for the five-year period ending June 30, 2010. ERS updates their experience studies every five years.

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Notes to Financial Statements
June 30, 2016

13. Employee Benefits (continued)

a. Defined Benefit Pension Plans (continued)

Discount Rate

The discount rate used to measure the net pension liability was 7.65%, a decrease from the 7.75% rate used at the prior measurement date. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that contributions from the State will be made at statutorily required rates, actuarially determined. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all period of projected benefit payments to determine the total pension liability.

Sensitivity of OHA's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

The following presents OHA's proportionate share of the net pension liability calculated using the discount rate of 7.65%, as well as what OHA's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.65%) or 1-percentage point higher (8.65%) than the current rate:

	1 percent decrease (6.65%)	Current discount rate (7.65%)	1 percent increase (8.65%)
OHA's proportionate share of the net pension liability	\$ 27,070,116	\$ 21,773,504	\$ 15,917,483

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Notes to Financial Statements
June 30, 2016

13. Employee Benefits (continued)

a. Defined Benefit Pension Plans (continued)

The long-term expected rate of return on pension plan investments was determined using a “top down approach” of the Bespoke Client-Constrained Simulation-based Optimization Model (a statistical technique known as “re-sampling with replacement” that directly keys in on specific plan-level risk factors as stipulated by the ERS Board) in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Domestic equity	30.0%	8.5%
International equity	26.0%	9.3%
Total fixed-income	20.0%	3.1%
Real estate	7.0% *	9.2%
Private equity	7.0% *	11.9%
Real return	5.0% *	6.7%
Covered calls	5.0%	7.7%
Total investments	100.0%	

*The real estate, private equity, and real return targets will be the percentage actually invested up to 7%, 7%, and 5%, respectively of the total fund. Changes in the real estate, private equity, and real return targets will be offset by an equal percentage change in the large cap domestic equity target.

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Notes to Financial Statements
June 30, 2016

13. Employee Benefits (continued)

a. Defined Benefit Pension Plans (continued)

Pension Plan Fiduciary Net Position

The pension plan's fiduciary net position is determined on the same basis used by the pension plan. The ERS financial statements are prepared using the accrual basis of accounting under which expenses are recorded when the liability is incurred, and revenues are recorded in the accounting period in which they are earned and become measurable. Employer and member contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. Investment purchases and sales are recorded as of their trade date. Administrative expenses are financed exclusively with investment income.

There were no significant changes after the report measurement date. Detailed information about the pension plan's fiduciary net position is available in the separately issued ERS financial report. ERS's complete financial statements are available at www.ers.ehawaii.gov.

Payables to the Pension Plan

At June 30, 2016, the amount payable to the ERS was \$135,592.

b. Post-Retirement Health Care and Life Insurance Benefits

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

OHA's annual other postemployment benefit (OPEB) cost is allocated by the State based on a percentage of OHA's payroll. The State has elected not to allocate an additional share of its annual required contribution to OHA. As such, OHA has not recorded a liability for OPEB as of June 30, 2016. OHA contributed approximately \$967,000 in OPEB expenses for the fiscal year ended June 30, 2016.

Office of Hawaiian Affairs, State of Hawai'i

Notes to Financial Statements
June 30, 2016

13. Employee Benefits (continued)

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

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

c. Trustee Retirement Plan

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

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

Hi'ilei Aloha LLC and Ho'okele Pono LLC offer 401(k) profit sharing plans. Employees become eligible upon six (6) months of employment and may contribute to the plan to the extent allowed by law. Hi'ilei Aloha LLC and Ho'okele Pono match employees' contributions up to a specified percentage of salary. For the year ended December 31, 2015, contribution expense amounted to \$70,721 and \$7,178 for Hi'ilei Aloha LLC and Ho'okele Pono LLC, respectively.

e. Sick Leave

Accumulated sick leave amounted to approximately \$3,245,000 as of June 30, 2016. 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.

14. 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 approximately \$213,000 for the fiscal year ended June 30, 2016, have been reported as revenues and expenditures of OHA's general fund.

Office of Hawaiian Affairs, State of Hawai'i

Notes to Financial Statements
June 30, 2016

15. Risk Management and Contingent Liabilities

a. Workers' Compensation and Other Self-Insurance Liabilities

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

The State is self-insured for workers' compensation. Accordingly, OHA is liable for workers' compensation claims filed by its employees. Liabilities for workers' compensation claims are established if information indicates that it is probable that liabilities have been incurred and the amount of those claims can be reasonably estimated. Beginning in fiscal year 2013 OHA began purchasing a third party workers' compensation policy, but was still liable for outstanding claims related to periods in which OHA was self-insured. The workers' compensation reserve was reduced to nil at June 30, 2016, as all remaining claims were closed.

b. Civil Complaints

In *Akana v. Trustees*, Civil No. 13-1-2485-09, First Circuit Court, on September 13, 2013, the plaintiff has sued OHA trustees claiming that they improperly convened in executive sessions to discuss matters that were not properly discussed in such sessions. OHA believes that the claims have no merit and filed a motion for summary judgment based upon their counterclaim. A hearing on that motion was held on January 29, 2015. On November 13, 2015, the court denied the plaintiff's motion for reconsideration of the order granting summary judgment on the OHA trustees' counterclaim. The original trial date of March 2017 has been continued to November 2017.

Office of Hawaiian Affairs, State of Hawai'i

Notes to Financial Statements
June 30, 2016

15. Risk Management and Contingent Liabilities

c. Quiet Title Litigation

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

As of June 30, 2016, OHA is currently evaluating its potential interest in 18 quiet title actions. OHA continues to monitor this action for any potential escheated interest.

d. 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.

16. Related Party Transactions

OHA receives a portion of ceded land revenues from various state agencies. In June 2006, Act 178 was passed which laid the foundation for a quarterly guaranteed ceded land revenue stream of \$3,775,000, totaling \$15,100,000 per year. The total received during the year ended June 30, 2016 was \$18,159,468, of which \$15,100,000 was included as public land trust revenue in the PLTF. The remaining \$3,059,468 was included as due to the State of Hawai'i in the PLTF.

Office of Hawaiian Affairs, State of Hawai'i

Notes to Financial Statements
June 30, 2016

16. Related Party Transactions (continued)

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

During fiscal year 2016, OHA made payments of \$792,000 to Hi'ilei Aloha LLC and Ho'okele Pono LLC. These payments were reported as transfers in the fund financial statements. The resulting net transfer in of \$350,316 on the statement of activities is due to the difference in reporting period for the proprietary funds noted in Note 1.

In December 2008, OHA and DHHL mutually agreed to a collaborative financing arrangement to provide funds for DHHL's use in the planning, design and construction of infrastructure for homesteads for native Hawaiians on properties owned and controlled by DHHL, in fulfillment of OHA's mission to better the conditions of native Hawaiians. OHA's obligation under the agreement was to pay DHHL an annual fee not to exceed \$3,000,000 for 30 years. For the year ended June 30, 2016, OHA remitted \$3,000,000 to DHHL and amounts have been presented as beneficiary advocacy expenditures in the PLTF; governmental funds – statement of revenues, expenditures, and changes in fund balances. As of June 30, 2016, OHA has committed \$38,596,896 of its fund balances for future payments to DHHL.

17. Subsequent Events

OHA has evaluated subsequent events through March 30, 2017, the date on which the financial statements were available to be issued.

**Office of Hawaiian Affairs,
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Schedule of OHA's Proportionate Share of the Net Pension Liability
Last Ten Fiscal Years

	<u>2016</u>	<u>2015</u>	<u>2014</u>
OHA's proportion of the net pension liability	0.430%	0.420%	0.430%
OHA's proportionate share of the net pension liability	\$21,773,504	\$ 20,322,122	\$ 22,136,982
OHA's covered-employee payroll	\$10,033,406	\$ 9,966,952	\$ 9,270,781
OHA's proportionate share of the net pension liability as a percentage of its covered-employee payroll	217.01%	203.90%	238.78%
Plan fiduciary net position as a percentage of total net pension liability	62.4%	63.9%	58.0%

* Information for 2007 - 2013 is unavailable

See accompanying independent auditor's report

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

Schedule of Contributions
Last Ten Fiscal Years

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Statutorily required contribution	\$ 1,770,495	\$ 1,644,547	\$ 1,483,325
Contributions in relation to the contractually required contribution	<u>1,634,903</u>	<u>1,644,547</u>	<u>1,483,325</u>
Contribution deficiency (excess)	<u>\$ 135,592</u>	<u>\$ -</u>	<u>\$ -</u>
OHA's covered-employee payroll	\$ 10,033,406	\$ 9,966,952	\$ 9,270,781
Contributions as a % of covered-employee payroll	17.00%	16.50%	16.00%

* Information for 2007 - 2013 is unavailable

See accompanying independent auditor's report