
Management and Financial Audits of the Office of Hawaiian Affairs

A Report to the
Governor
and the
Legislature of
the State of
Hawaii

Report No. 93-28
December 1993



THE AUDITOR
STATE OF HAWAII

The Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawaii State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. *Financial audits* attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.
2. *Management audits*, which are also referred to as *performance audits*, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called *program audits*, when they focus on whether programs are attaining the objectives and results expected of them, and *operations audits*, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.
3. *Sunset evaluations* evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.
4. *Sunrise analyses* are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.
5. *Health insurance analyses* examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.
6. *Analyses of proposed special funds* and existing *trust and revolving funds* determine if proposals to establish these funds and existing funds meet legislative criteria.
7. *Procurement compliance audits* and other *procurement-related monitoring* assist the Legislature in overseeing government procurement practices.
8. *Fiscal accountability reports* analyze expenditures by the state Department of Education in various areas.
9. *Special studies* respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

Hawaii's laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.



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OVERVIEW

THE AUDITOR
STATE OF HAWAII

Management and Financial Audits of the Office of Hawaiian Affairs

Summary

The Office of Hawaiian Affairs (OHA) was created in 1978 to be the principal vehicle for the State to meet its trust responsibilities to native Hawaiians and Hawaiians. OHA now commands significant assets—more than \$160 million at June 30, 1993. To use these trust assets judiciously, OHA's Board of Trustees needs to exercise its fiduciary duties and provide for strong management. The board has fundamental fiduciary duties to the beneficiaries of the trust but does not have a full understanding of those responsibilities. Basic fiduciary duties include loyalty, prudence, and the marshaling of trust assets. OHA has vigorously pursued the marshaling of its resources. However, we found instances in which the loyalty or duty of the trustees to act solely in the interest of OHA beneficiaries could be questioned. We also found instances where trustees' actions may lack the prudence expected of fiduciaries. We believe this is due to insufficient training as well as insufficient guidance in OHA's bylaws, manuals, and guides on fiduciary responsibilities.

Some of the board's operations are not conducive to effective management. The operational orientation of some board standing committees has led trustees to advocate specific programs at the expense of the beneficiaries as a whole. The operational orientation also interferes with the board's policy-making functions and promotes unnecessary involvement of trustees with staff.

We found that OHA's revenues from the public land trust are treated inconsistently. Public land trust fund revenues should be classified as "trust funds," but OHA and the Legislature treat the funds as special funds. Special funds are subject to appropriation by the Legislature while trust funds are not.

We found OHA's management controls to be inadequate. The office's master and functional plans have not been updated. Policies and procedures manuals are incomplete and not compiled in a useful way, and internal communications are poor with no method of assuring that staff are kept informed.

A financial audit by Nishihama & Kishida, CPA's, Inc. found no material weaknesses in OHA's internal control structure and operations and that OHA had implemented most of the recommendations in our 1990 audit. However, several improvements in OHA's financial management are still needed. They include following statutory limits on paid leave, better controls over airline coupons, and complying with its own administrative and financial manual.

Recommendations and Response

We recommend that the OHA Board of Trustees develop a formal training program for trustees and staff on the role of a fiduciary. In addition, the board should develop and adopt materials appropriate to the trustees' fiduciary role. We also recommend that the board reorganize its standing committee structure and consider the feasibility of establishing a position within OHA's administration office to handle routine administrative activities of the board.

OHA's administration should update the master and functional plans, complete and organize the manuals into a single coherent working document, assure that OHA's funds are properly classified as trust funds, and take steps to improve internal communications. To assure fiscal control, OHA should complete its Administrative and Financial Manual of Guides, comply with the guide, and implement control procedures on vacation leave and compensatory time off, and interisland airline coupon practices.

We recommend that the Legislature recognize the trust status of OHA's revenue funds, amend Section 10-14.6, HRS to refrain from making appropriations from OHA's trust funds, and assure that these funds are properly identified during the budget appropriation process.

The chair of the Board of Trustees responded that the board respects and agrees with many of our recommendations. The board agrees that it will educate trustees on their fiduciary duties, establish additional bylaws and policies, and treat OHA's revenues as trust funds. It intends to implement our recommendations regarding policies and procedures for program management. The board does not agree that it should change from an operational to a functional committee orientation and says that this would result in even more fragmentation and confusion than the present system. The board says that it has been planning to update the OHA Master Plan but does not agree that the functional plans, developed in 1990, are outdated.

Finally, the board pointed to some inaccuracies in the draft that we have corrected. Based on other information supplied to us and a review of our supporting documentation, we also made additional changes to the draft.

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Conducted by

The Auditor
State of Hawaii
and
Nishihama &
Kishida, CPA's, Inc.

Submitted by

THE AUDITOR
STATE OF HAWAII

Report No. 93-28
December 1993

Foreword

The 1993 Legislature in Act 276 directed the State Auditor to conduct management and financial audits of the Office of Hawaiian Affairs (OHA). OHA was established in 1978 to be the primary vehicle by which the State would meet its trust obligations to the native Hawaiians and Hawaiians.

Our management audit examined OHA's Board of Trustees, its organization, funding sources, and management controls. We contracted with the certified public accounting firm of Nishihama & Kishida, CPA's, Inc. for the financial audit. The financial audit reviewed the office's financial accounting, internal controls, and financial reporting systems.

We wish to express our appreciation for the cooperation and assistance extended to us by the chair and members of the Board of Trustees, and by the administration and staff of the Office of Hawaiian Affairs.

Marion M. Higa
State Auditor

Table of Contents

Chapter 1 Introduction

Background on OHA	1
Objectives of the Audits	2
Scope and Methodology	3

Chapter 2 Findings and Recommendations

Summary of Findings	5
OHA, An Organization in Transition	5
OHA Board of Trustees Needs a Better Understanding of Its Role as a Fiduciary	6
Board Operations Are Not Conducive To Effective Management	11
Trust Funds are Incorrectly Designated as Special Funds	17
OHA Needs to Strengthen its Management	20
Financial Internal Control Practices Need to be Improved	22
Conclusion	25
Recommendations	25

Chapter 3 Financial Audit

Summary of Findings	29
Independent Auditor's Report	29
Independent Auditor's Report on the Internal Control Structure	31
Independent Auditor's Report on Compliance Based on an Audit of the Combined Financial Statements	33
Descriptions and Definitions	34
Notes to the Combined Financial Statements	35

Notes	53
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Response of the Affected Agency.....	55
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List of Exhibits

Exhibit 2.1:	OHA Operating Budget Appropriation Per Fiscal Year	7
Exhibit 2.2:	OHA Growth in Revenue Sources	7
Exhibit 2.3:	Office of Hawaiian Affairs Board of Trustees Committee Structure	12
Exhibit 2.4:	Office of Hawaiian Affairs Organization Chart	14
Exhibit 2.5:	Alignment of OHA Divisions and Office Board of Trustees Standing Committee	15
Exhibit A	State of Hawai'i, Office of Hawaiian Affairs Combined Balance Sheet-All Fund Types and Account Groups, June 30, 1993, with Comparative Amounts for 1992	45
Exhibit B	State of Hawai'i, Office of Hawaiian Affairs Combined Statement of Revenues, Expenditures, and Changes in Fund Balances-All Governmental Fund Types, Fiscal Year Ended June 30, 1993, with Comparative Amounts for 1992	47
Exhibit C	State of Hawai'i, Office of Hawaiian Affairs Combined Statement of Revenues and Expenditures-Budget and Actual (Budgetary Basis)-General Fund Type, Fiscal Year Ended June 30, 1993	48

List of Schedules

Schedule I	State of Hawai'i, Office of Hawaiian Affairs Combining Balance Sheet-General Fund, June 30, 1993	49
Schedule II	State of Hawai'i, Office of Hawaiian Affairs Combining Statement of Revenues, Expenditures, and Changes in Fund Balances-General Fund, Fiscal Year Ended June 30, 1993	50

Schedule III	State of Hawai'i, Office of Hawaiian Affairs Combining Balance Sheet-Special Revenue Fund, June 30, 1993	51
Schedule IV	State of Hawai'i, Office of Hawaiian Affairs Combining Statement of Revenues, Expenditures, and Changes in Fund Balances-Special Revenue Fund, Fiscal Year Ended June 30, 1993	52

Chapter 1

Introduction

The Legislature in Section 7, Act 276, Session Laws of Hawai'i 1993, directed the State Auditor to conduct financial and management audits of the Office of Hawaiian Affairs (OHA). Act 276 stipulates that the audits shall include, but not be limited to:

- 1) The management and use of all general, special, and revolving fund moneys, and all other moneys and assets under the control of the office;
- 2) The internal control structure of the office, including any deficiencies, whether minor or substantial, and any failure to correct, in whole or in part, deficiencies identified in previous financial or management audits of the office;
- 3) The statutory authority for the Office of Hawaiian Affairs' policies and procedures pertaining to use of general, special, or revolving funds.

Background on OHA

OHA is designated as the principal public agency in Hawai'i responsible for the performance, development, and coordination of programs and activities relating to native Hawaiians and Hawaiians.

The 1978 Constitutional Convention proposed the creation of OHA. OHA was to be the primary vehicle by which the State would meet its trust obligations to the Hawaiian people. These obligations had been broadly defined as "...the betterment of the conditions of the native Hawaiians..." in Section 5(f) of the 1959 Admission Act that established statehood for Hawai'i. The 1978 Constitutional Convention also proposed to vest control of the trust with the Hawaiians themselves by placing OHA under an elected board of trustees. The constitutional amendments were ratified in the 1978 general elections and were implemented under Act 196, SLH 1979 (codified as Chapter 10, Hawai'i Revised Statutes).

A broad mandate

Section 5(f) of the Admission Act also provides that the State may use part of the revenues from funds generated by the public land trust to meet its obligations to native Hawaiians. The public land trust consists primarily of lands ceded to the United States when Hawai'i was annexed in 1898 that were returned to the State with statehood. The constitutional amendment created OHA as a trust for two categories of

people of Hawaiian ancestry. The funding mechanism that evolved was two trusts. The first trust is for native Hawaiians (people with at least 50 percent Hawaiian blood). The second trust is for Hawaiians (all people of Hawaiian ancestry).

A formative period

Since 1979, OHA has been in a formative period — shaping and organizing itself, establishing goals and directions, marshaling resources, and identifying and implementing programs to address the concerns of native Hawaiians and Hawaiians. Most recently, OHA established a \$20 million loan program for Department of Hawaiian Home Lands beneficiaries utilizing an innovative public-private “partnership” with a local bank. These accomplishments, however, have tended to be obscured by perceived problems in management, budgeting, image, and direction that were brought to the Legislature's attention. It is in this context of perceived problems that the Legislature requested the management and financial audits of OHA.

Objectives of the Audits

The objectives of the management audit were to:

1. Determine whether the Office of Hawaiian Affairs is meeting its mission, function, and responsibilities as originally defined in Chapter 10, HRS.
2. Identify the impact of current restrictions on the use of OHA's funds.
3. Identify and evaluate OHA's management controls over its programs and activities.

The objectives of the financial audit were to:

1. Assess the adequacy, effectiveness, and efficiency of the systems and procedures for the financial accounting, internal control, and financial reporting of the Office of Hawaiian Affairs to recommend improvements to such systems, procedures, and reports; and to report on the fair presentation of the financial statements of OHA.
2. Ascertain whether expenditures and other disbursements have been made and all revenues and other receipts have been collected and accounted for in accordance with federal and state laws, rules and regulations, and policies and procedures.

3. Ascertain the extent to which recommendations contained in Chapter 6 of the State Auditor's Report No. 90-11, *Management and Financial Audit of the Office of Hawaiian Affairs* have been implemented.

Scope and Methodology

For the management audit, we reviewed the legislative intent, mission, organization, operation, and management of OHA. We focused on activities from 1990 to the present, since we had previously reviewed OHA in 1990.

We observed the operations of the OHA Board of Trustees and attended board, standing committee, and community meetings. We met with each trustee, the administrator, deputy administrator, program and office heads, community affairs officers, and selected staff members of OHA.

We examined selected programs, policies, procedures, and program files as appropriate. We also examined funding sources, the budgetary process, internal correspondence, news articles, and memoranda. In addition we reviewed selected management controls at the program level.

We interviewed selected representatives from organizations that interface with OHA. We also reviewed applicable provisions of trust laws.

For the financial audit, we engaged the services of Nishihama and Kishida, CPA's, Inc. The firm audited the financial records and transactions and the related systems of accounting and internal controls of OHA for the fiscal year July 1, 1992 to June 30, 1993. Included were all fund types and account groups. The firm also reviewed those transactions, systems, and procedures for compliance with applicable laws and regulations.

The audit included a review of the accounting, reporting, and internal control structure to identify deficiencies and weaknesses and to make appropriate recommendations for improvements. The review included an analysis of forms, records, and accounting and operating procedures.

Our work was performed from July 1993 through November 1993 in accordance with generally accepted government auditing standards.

Chapter 2

Findings and Recommendations

The Office of Hawaiian Affairs (OHA) has a broad mandate to meet the State's trust responsibilities to the Hawaiian people. This mandate requires OHA to use its trust assets judiciously to meet the needs of Hawaiian beneficiaries. OHA now commands significant resources. With these increased resources come increased responsibilities. In this chapter we examine matters that are critical to OHA's decision-making process and its effective use of resources.

Summary of Findings

We note that OHA is an organization in the midst of dynamic changes. In the process of transition, OHA needs to correct the following weaknesses:

1. The OHA Board of Trustees needs a better understanding of its role as a fiduciary.
2. The organization of the board is not conducive to effective operations.
3. OHA's trust funds are incorrectly designated as special funds.
4. OHA needs to strengthen administrative and management controls over programs and activities.
5. OHA needs to improve internal controls over its financial practices.

OHA, An Organization in Transition

Some recent changes have significantly altered the nature of OHA. Unlike conditions that prevailed up to 1993, OHA now has substantial funds at its disposal and an opportunity to focus on substantive programs to benefit Hawaiians.

Revenues have jumped

In Act 35, SLH 1993, the Legislature appropriated \$136.5 million to OHA for back payments and interest on OHA's share of previously collected public land trust revenues. OHA received these funds by June 30, 1993. These revenues transform OHA from a relatively minor state agency to a major force that can have a significant impact on Hawai'i. Exhibit 2.1 shows that state general fund appropriations to OHA from FY1980-81 to FY1993-94 have increased from \$225,000 to \$3,580,234

or an increase of 1,491 percent. The special fund appropriations from FY1981-82 to FY1993-94 have grown from \$415,466 to \$3,952,886 or an increase of 851 percent. Exhibit 2.2 shows the leap in total revenues to OHA from \$1,785,043 in FY1981-82 to more than \$145 million in FY1992-93, an increase of 8,078 percent.

Focus is changing

OHA has developed and implemented a number of programs. They include a native Hawaiian claims program, a federally funded native Hawaiian loan fund program, and numerous pilot programs. OHA's past level of funding has limited, however, what it has been able to accomplish. This is no longer the case.

Changes in OHA and its funding make it appropriate for the Board of Trustees and OHA to reconsider their basic responsibilities and duties and to determine how they can better meet the new challenges. In this context, it is particularly important for the board to have an understanding of its fiduciary responsibilities and for OHA to strengthen its management.

OHA Board of Trustees Needs a Better Understanding of Its Role as a Fiduciary

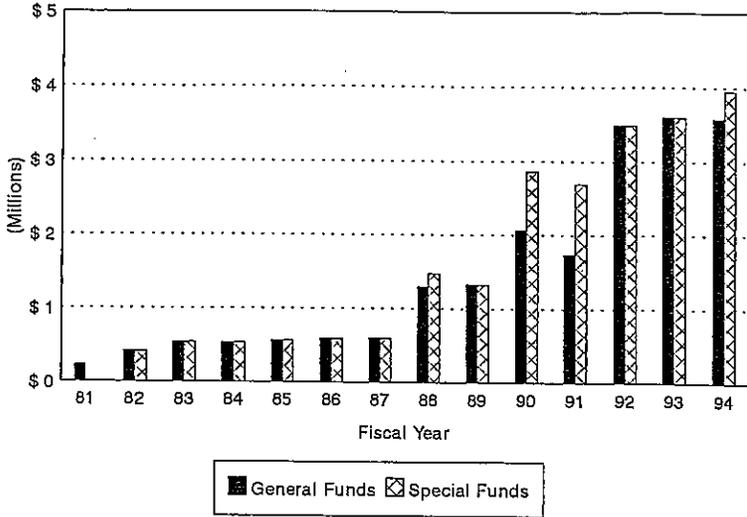
OHA is governed by a Board of Trustees (board) that is the policy and decision making body of OHA. The board consists of nine trustees elected by Hawai'i residents of Hawaiian ancestry who have registered to vote for the OHA board. Trustee terms are staggered so that a portion of the positions are up for election with each general election. Prior to July 1, 1993, the trustees were unpaid, but they were entitled to a per diem compensation and reimbursement for travel expenses incurred on official business. In Act 358, SLH 1993, the Legislature made the OHA trustee positions salaried as of July 1, 1993.

Chapter 10, HRS, affirms the State's trust obligations to the native Hawaiians and the State's delegation of this obligation to OHA. OHA and the trustees are therefore fiduciaries to the native Hawaiians and Hawaiians. OHA's policies and procedures manual further acknowledges this trust relationship by stating that the board shall act according to the highest fiduciary standards of a private trustee.

Trustees have fundamental fiduciary duties

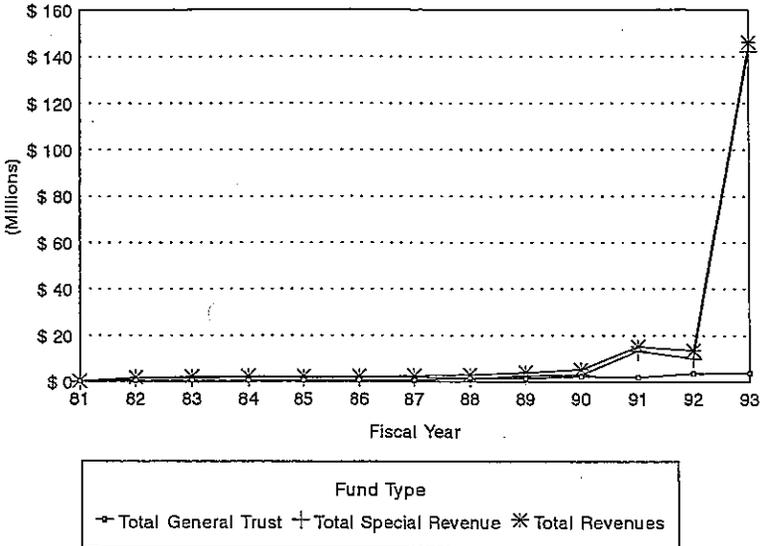
As fiduciaries, trustees have certain fundamental duties. The duties of trustees with respect to their actions on behalf of beneficiaries are based on trust law.¹ Three fundamental fiduciary duties are marshaling resources, loyalty, and prudence.

Exhibit 2.1 OHA Operating Budget Appropriation Per Fiscal Year



Source: OHA Budget Appropriation Acts, 1980-1993, Session Laws of Hawaii (SLH)

Exhibit 2.2 OHA Growth in Revenue Sources



Source: OHA Accounting Section, Administrative Services Office

General Trust Funds include State of Hawaii's general fund appropriations, federal funds, and miscellaneous income
 Special Revenue Fund includes revenues from the public land trust, Native Hawaiian Revolving Loan Fund, Native Hawaiian Rights Fund
 Source: OHA Accounting Section, Administrative Services Office

Marshaling resources

A fundamental duty of a fiduciary is to marshal the resources of the trust. OHA has actively carried out this duty by pursuing entitlements from the State. In 1990, OHA successfully reached an agreement with the State on OHA's past share of the 20 percent pro rata revenues from the public land trust. The 1993 Legislature appropriated \$136.5 million to OHA as settlement for past due revenues from the public land trust.

The settlement has transformed OHA from a trust with few assets to one with significant assets. While continuing to pursue additional entitlements, the trustees must also focus on investing and managing the large assets under their control.

Loyalty

A second fundamental duty of a fiduciary is that of loyalty. Loyalty implies that trustees must administer the trust solely in the interest of the beneficiaries. Trustees must refrain from any activities that would result in a gain by a trustee or a third party at the expense of the trust.

The duty of loyalty also subjects trustees to higher and stricter standards of conduct than those associated with ordinary business relationships. When there are co-trustees, such as at OHA, individual trustees are also responsible for preventing other trustees from committing a breach of trust and for redressing any breach of trust that has been committed.

Prudence

A third fundamental duty of a fiduciary is commonly known as the prudent person rule. Chapter 554A, HRS, Uniform Trustees' Powers Act, defines a prudent person as one who, in exercising trust powers, is reasonable and equitable in the view of the interests of the beneficiaries and acts with the same diligence, discretion, and judgment as would be expected in managing the trustee's own affairs. Key concepts in the rule of prudence include:

- Acting in good faith does not excuse the failure to act in a prudent manner.
- A trustee is not required to have special skills, but if the trustee represents that special skills exist prior to becoming a trustee, those skills must be demonstrated.
- Use of professional services does not relieve the trustees of having to demonstrate that these services are appropriate to the trust.

Trustees have uneven understanding of duties

The trustees generally acknowledge their fiduciary responsibilities. For example, all trustees say that the purpose of OHA is to better the conditions of the native Hawaiians and Hawaiians. However, they do not appear to understand fully their fiduciary duties.

Potential breaches of loyalty

With respect to the duty of loyalty, some trustees cited their responsibilities to the constituents who elected them rather than to the beneficiaries of the trust as a whole. Other trustees equated their role with that of legislators. This is correct to the extent that legislators have an implied fiduciary responsibility. It is insufficient, however, in that OHA is an express trust where trustees have specific duties and obligations to the beneficiaries.

Seeing themselves as equivalent to legislators would permit board members to engage in activities that would not be appropriate for trustees who are held to the higher fiduciary standard dictated by the duty of loyalty. For example, it would appear inappropriate for an elected trustee to advocate terminating OHA while in a fiduciary role. The trustees' understanding of loyalty is also called into question by other actions. Some OHA staff offices have complained that some trustees have used OHA facilities for personal purposes.

Possible breaches of prudence

Trustees have made decisions without considering the impact of these decisions on beneficiaries. Some of these decisions appear imprudent. For example, the board has not carried out its responsibility for making sure that OHA has a basic operating manual. This leaves OHA without clear policies in such important areas as contract administration and program design. The trustees should ensure that OHA receives the necessary policy direction and guidance to function well. In our 1990 audit, we had recommended that OHA complete and adopt its *Administrative and Financial Manual of Guides*. We found that the manual still has not been completed.

Prudence also implies that the board should review and determine whether actions of individual trustees are appropriate. For example, a trustee chairs both a board standing committee and a staff advisory committee to the board standing committee. This situation places the trustee in a potentially conflicting position of being both policymaker and advisor. Allowing this makes it difficult, not impossible, for the trustee to exercise prudence.

For a better understanding of their fiduciary duties, trustees need more guidance and training. The board's bylaws and policies and procedures do not define fiduciary responsibilities, and training about these responsibilities has been non-existent.

Poor written guidance

OHA's bylaws and policies generally acknowledge the board's fiduciary duties and responsibilities. However, they do not define what these fiduciary duties and responsibilities are. We found that the board has no written policies addressing trustee duties or setting forth sanctions and corrective actions for breaches of these duties. To assure that all trustees conduct themselves in an appropriate manner, the board has the duty to identify, define, develop, and implement policies for these responsibilities.

Bylaws are inadequate

The board's policies for trustees are expressed primarily in OHA's bylaws. The bylaws do not adequately address trustee responsibilities. They have no provisions relating to breaches of fiduciary duty or a code of conduct. The bylaws provide only for failure to disclose a conflict of interest or failure to maintain order and decorum. The bylaws provide for written censure, but disciplinary action and the consequences of censure are not identified. We believe that the board should review its bylaws to incorporate fiduciary standards with specific provisions to ensure compliance.

Uniform Trustees' Powers Act gives guidance

When amending its bylaws, the board should look to Chapter 554A, HRS, Uniform Trustees' Powers Act. This act delineates the powers conferred on trustees in Hawai'i by statute. All the powers specified in section 554A-3 apply to the OHA trustees unless specifically limited under Chapter 10, HRS.

By incorporating several provisions of Chapter 554A into its bylaws, the OHA board could clarify and define the duties and obligations of the trustees. Specific sections that the board should consider incorporating include:

- Section 554A-1: definition of "prudent person";
- Section 554A-3(b): the trustee must act in accordance with the trustee's fiduciary obligation to the trust;
- Section 554A-3: specific powers of the trustee;
- Section 554A-5: conflict of interest;
- Section 554A-6: responsibilities of co-trustees, i.e., when three or more trustees are vested with power.

Training on fiduciary duties is needed

Trustees receive no formal training or orientation regarding their fiduciary duties. Since the knowledge and skills that individual trustees bring to the position vary, OHA should train trustees on their fundamental fiduciary duties. Trustees have requested workshops and training but these have related generally to programs and not to fiduciary responsibilities.

Similarly, OHA staff receive no formal orientation or training on fiduciary duties. Since the staff is responsible for executing programs, they should understand the trust and fiduciary foundation for OHA's programs and activities.

Board Operations Are Not Conducive To Effective Management

The board, as a fiduciary, is responsible for assuring that OHA operates in a prudent, diligent, and effective manner on behalf of all the beneficiaries of the trust. The board is required under Section 10-10, HRS, to appoint an administrator who acts as the principal executive of OHA and who serves at the will of the trustees. We found that the current organization and operations of the board encourage interference in OHA's operations and undermine the administrator. The board's activities place demands on the administrator that might better be handled through a new staff position dedicated to the board.

Board standing committees are dysfunctional

The board has six standing committees for the following subject areas:

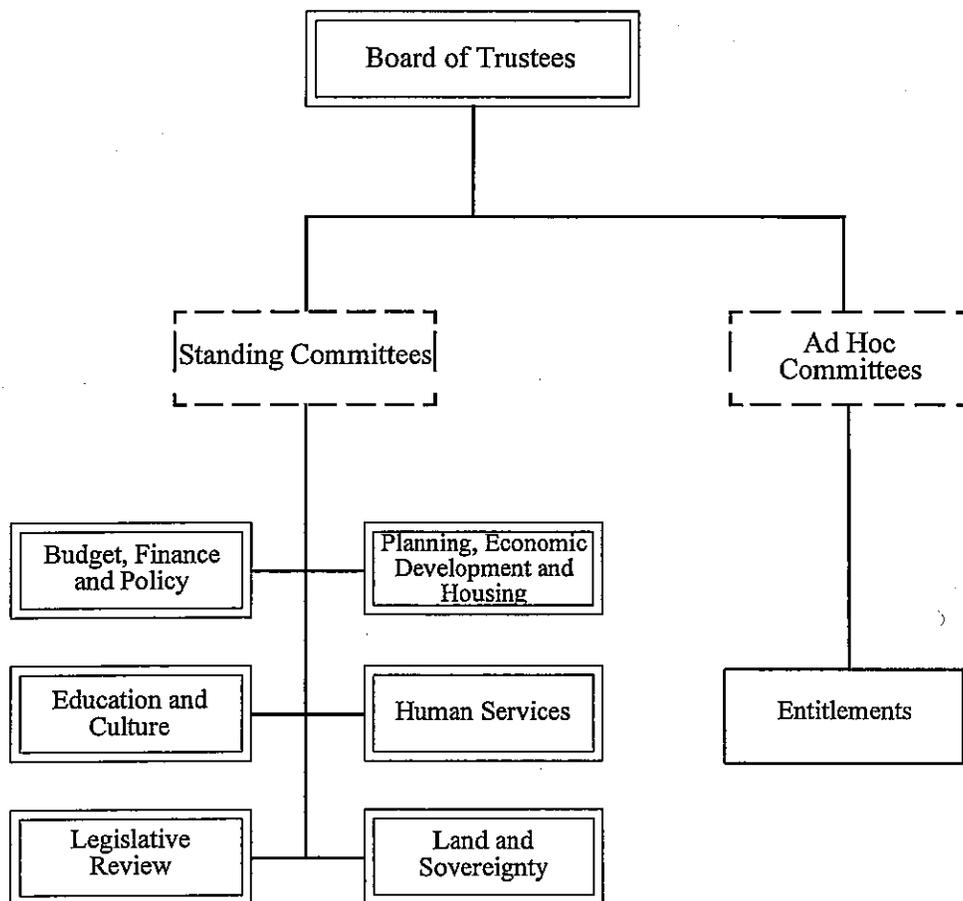
- Budget, Finance and Policy
- Planning, Economic Development and Housing
- Education and Culture
- Human Services
- Legislative Review
- Land and Sovereignty

The board committee structure is depicted in Exhibit 2.3. The standing committees are supposed to consider particular issues and formulate recommendations before the issues are brought before the full board for decision making. The current organization is dysfunctional by encouraging (1) an operational orientation, (2) inappropriate advocacy by trustees, and (3) too many meetings.

Misguided operational orientation

The operational orientation of the board's standing committees detract from its policy function and encourages interference in OHA operations. A 1986 management audit of OHA conducted by Arthur Young and Company noted that several of the board's standing committees had an orientation toward operations rather than policy making. The audit recommended that this orientation be changed and that the board reduce

Exhibit 2.3
Office of Hawaiian Affairs
Board of Trustees Committee Structure



the number of its standing committees. Currently, the board standing committee organization still largely parallels OHA's operations. The standing committees on planning, economic development and housing; education and culture; human services; and land and sovereignty correspond to OHA's operating divisions. In addition, while the board has reduced the number of committees, it still has six standing committees compared to the five that existed during the 1986 audit.

As defined in OHA's bylaws, the standing committees have several operational functions. For example a function of the committee on education and culture is to "... monitor educational programs throughout the State of Hawai'i...."; a function of the committee on human services is to "...monitor health statistics and other information indicating the overall health patterns of native Hawaiians and Hawaiians...." The committees on planning, economic development and housing, and land and sovereignty also have similar monitoring functions.

Several standing committees have the responsibility of coordinating activities with other agencies. These operational functions should not be part of the standing committees' responsibilities. The monitoring and coordinating responsibilities promote unnecessary involvement of the trustees with staff, bypass OHA administrators, and undermine administrative control over staff activities.

Inappropriate advocacy

OHA's program staff is organized into five divisions that cover the following program areas: economic development, education, health and human services, housing, and land and natural resources. These divisions and the trustees are supported by five administrative support offices: administrative services, culture, government affairs, planning and research, and public information. In addition, community affairs offices (formerly liaison offices) operate on the islands of Kaua'i, O'ahu, Moloka'i, Maui, and Hawai'i (offices in Hilo and Kona). The community affairs offices report to the deputy administrator and are the primary contact for beneficiaries on neighbor islands. OHA's organization is shown in Exhibit 2.4.

Board standing committees that are organized along operational lines and program areas encourage individual trustees to advocate interests that coincide with the jurisdictions of the staff program divisions. This relationship is depicted in Exhibit 2.5. This could give the appearance of trustees being biased and not acting in the interests of all beneficiaries. We believe that the entire board is weakened when individual trustees become focused on particular interests instead of overall policies.

**Exhibit 2.4
Office of Hawaiian Affairs
Organization Chart**

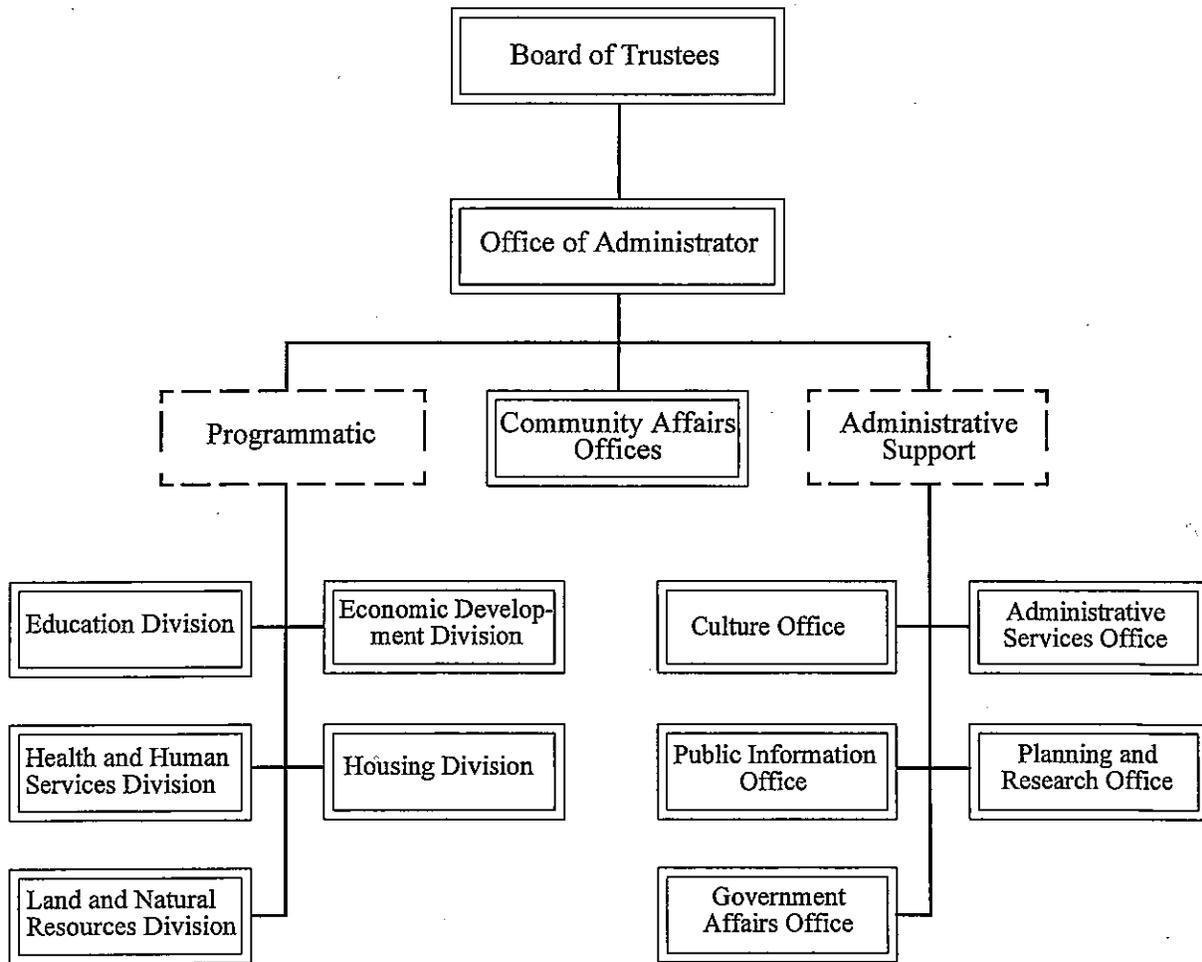
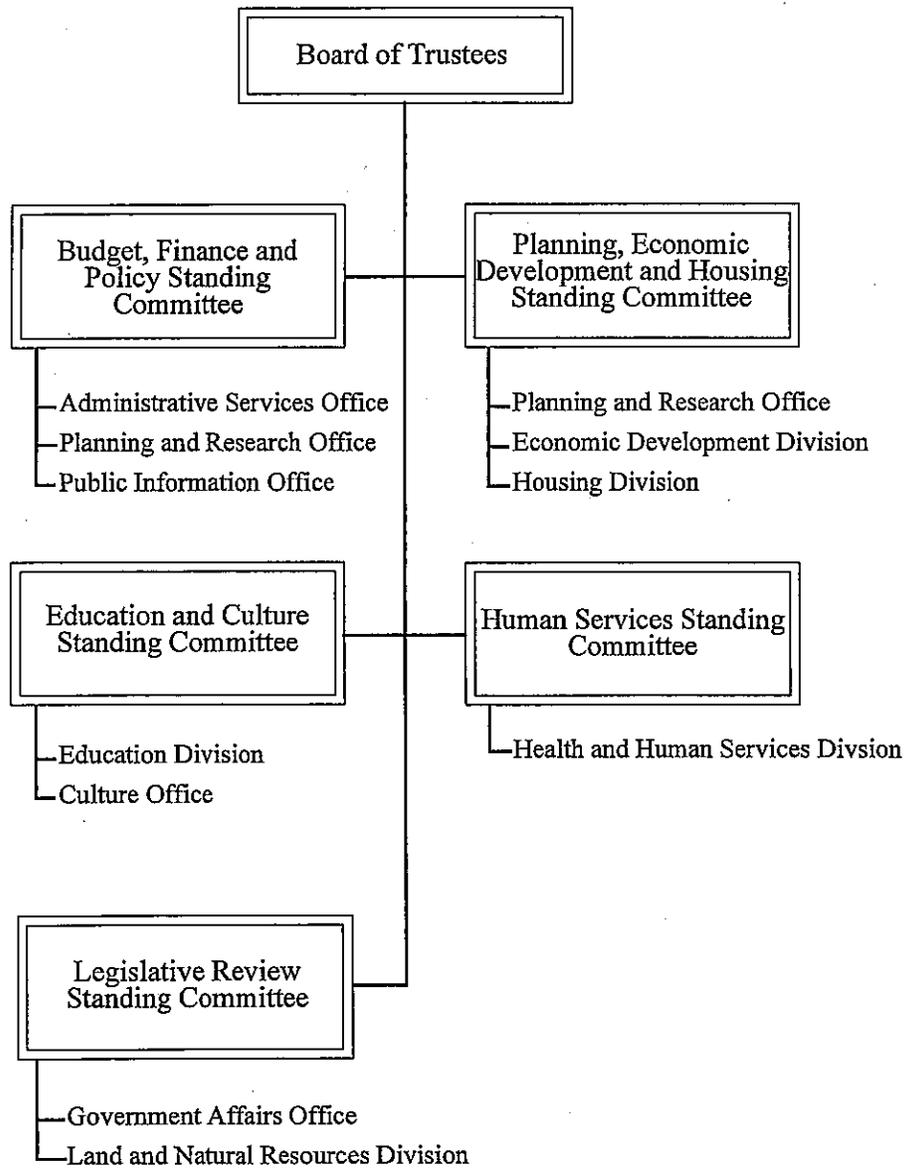


Exhibit 2.5
Alignment of OHA Divisions and Offices With
Board of Trustees Standing Committees



Committee structure undermines administrator

The administrator, as the principal executive, is responsible for the management of OHA. The Office of the Administrator is comprised of the administrator, deputy administrator, and private secretaries. This office is responsible for directing the organization's operations within the parameters set by the trustees and in response to concerns and interests of the beneficiaries. Specific responsibilities include:

- administering the internal operations of OHA;
- developing and overseeing organizational structures, systems, and procedures for effective functioning and accountability;
- providing leadership and coordination for OHA's divisions and offices, and ensuring communication and collaboration for effective utilization of resources;
- guiding implementation of OHA's functional plans;
- evaluating OHA programs to ensure that they are meeting the goals set by the trustees; and determining whether the operational structure needs adjustment to enhance institutional effectiveness.

The administrator is responsible for hiring all staff except for aides to the individual trustees. All staff are exempt employees, but OHA generally follows Department of Personnel Services guidelines in its classification of staff. Staff position descriptions were completed in 1990.

The current board standing committee structure results in some trustees dealing directly with staff members instead of going through administration. This can undermine the authority of the administrator since staff and trustees sometimes do not keep the administrator informed of their activities.

The current structure also gives staff members the opportunity to align themselves with trustees to advocate particular programs. The orientation of individual trustees may distort and pit programmatic areas against each other. These forces detract from the board's policy-making responsibility of rationally evaluating alternatives.

Too many meetings

Some trustees and staff members have complained of too many standing committee meetings. Currently, some committees share jurisdiction. For example, policy for use of OHA's land is under the land and sovereignty committee as well the committee on planning, economic

development, and housing. This fragmentation often factionalizes trustees and splits them into special interest camps. Subjects are often heard repeatedly by different committees. Confusion occurs about referrals and the status of issues pending action by different committees. In addition, staff time and effort to prepare for frequent meetings detract from ongoing administrative work.

Board needs greater administrative support

Board operations require substantial support from OHA's administrative staff. Services to the board place demands upon the present administrative staff that interfere with their regular responsibilities. With salaried trustee positions and the large increase in assets, staff will face even greater demands. Currently, the administrator, or his deputy, attends all board and standing committee meetings. The administrator also serves as the interface between trustees and staff and processes board expenditures.

One example of a service to the board is the processing of reimbursement for travel expenses. The chairperson approves all trustees' travel expenses, but the administrator reviews and recommends whether to approve the travel requests. Three trustees have objected to this practice, stating that the administrator is in effect dictating the actions of the trustees. Disputes over the administrator's recommendations can result in time consuming justifications that detract from staff related duties.

The board should consider creating a staff position dedicated to supporting board operations. This position would be under the OHA administrator to ensure management control. This assistance would permit the administrator to focus more attention on directing OHA and implementing the policies established by the Board.

Organization of board can be improved

The board should review its organization to determine how it can best carry out its fiduciary and policy making responsibilities. In doing so, the board should consider reducing the number of standing committees. Each standing committee should have clear jurisdiction over a functional area, such as budgeting, planning, or program management instead of a subject area such as health. This would reduce any alignment between board committees and OHA's program divisions.

Trust Funds are Incorrectly Designated as Special Funds

There has been confusion about whether OHA's revenues from the public land trust should be treated as trust funds or special funds. Sometimes they are treated as trust funds and sometimes as special funds.

OHA has two sources of funding

OHA has two trusts from two major sources of funding—one for native Hawaiians and one for Hawaiians. The trust for native Hawaiians is funded by the 20 percent pro rata portion of the revenues from the public land trust received by OHA. The Admission Act restricts the use of these funds to programs that benefit native Hawaiians. The trust for Hawaiians is supported by the State’s general fund.

The Legislature in 1979 gave OHA an initial general fund appropriation of \$125,000 for the operation of the office. The Legislature has continued to appropriate general funds to OHA. Until FY1986-87, the general fund appropriations were to be matched one-for-one with OHA’s revenues from the public land trust. Since then, the Legislature has treated OHA’s income from the public land trust as a special fund and has made specific appropriations of both general and special funds. The Legislature requires OHA to submit its budget requests in a manner similar to other state agencies to assure consistency in the budget process.

Recent legal decisions have expanded the interpretation of “betterment of the condition of native Hawaiians.” This expanded interpretation gives OHA more flexibility in the use of native Hawaiian trust funds, but OHA still needs general fund appropriations from the Legislature to fund programs for Hawaiians. The Legislature and OHA have generally followed a practice of matching general funds and trust revenues for OHA’s operating budget.

The basis for dual funding is the continued classification of Hawaiians into two groups by blood quantum. The Constitutional Convention hoped to remove this distinction — OHA has conducted two referenda on the blood quantum distinction; both referenda supported removal of the distinction. Resolution of this issue remains one of OHA’s objectives.

Revenues come from the public land trust

Section 5(f) of the Admission Act created the “public land trust.” The public land trust consists of approximately 1.8 million acres of “ceded lands” transferred to the State by the federal government at statehood. “Ceded lands” refers to the Hawaiian Government and Crown Lands that were ceded to the United States when Hawai’i was annexed in 1898. Government Lands were lands set aside by Kamehameha III for the benefit of Hawaiian chiefs and the people under the Great Mahele of 1848. Crown Lands were lands set aside for the sovereign as a source of income for the crown.

In 1962, a “Public Land Trust Fund” was established under the Department of Land and Natural Resources (DLNR). All revenues

derived from the sale of ceded public lands and rents received from leases, licenses, and permits of ceded lands (less 30 percent of sugar cane lease revenues which are transferred to the Department of Hawaiian Home Lands) are deposited into this fund. It is this trust fund that pays OHA its 20 percent pro rata portion on a quarterly basis.

Trust funds differ from special funds in several important ways as discussed below.

Trust funds need not be appropriated

Section 37-62, HRS, defines a “trust fund” as a fund in which designated persons or classes of persons have a vested beneficial interest or equitable ownership; or which was created or established by a gift, grant, contribution, devise, or bequest that limits the use of the fund to designated objects or purposes.

Section 37-40, HRS, states further that trust fund expenditures may be made by any department without appropriation or allotment as long as the expenditures do not exceed the amount in the fund or violate any lawful purpose. In addition, a trust fund established pursuant to law does not have to be reappropriated annually.

Special funds are subject to greater control

Section 37-62, HRS, defines a “special fund” as a fund dedicated or set aside by law for a specified object or purpose, but excluding revolving or trust funds. Sections 37-51 to 37-54, HRS, define the budgetary control of special funds and provide that:

- 1) all special funds are under legislative and executive budgetary control in the same manner as the general fund; except those funds applicable to federal laws and regulations and payments on principal and interest on revenue bonds;
- 2) expenditures from any special fund cannot exceed the moneys available in the special fund;
- 3) departments may, with the approval of the governor, transfer moneys from any of their special funds to the general revenues of the State; and
- 4) all state funds shall be deposited in the state treasury except funds that belong to patients and wards for whom the State is responsible and as otherwise provided by law.

The primary differences between trust funds and special funds are that:

- trust funds need not be reappropriated annually; and
- trust fund expenditures may be made without appropriation or allotment.

OHA revenues should be designated as trust fund

Statutes support the treatment of revenues from the public land trust as trust funds. The Admission Act provides that lands granted to the State together with the proceeds from the sale or other disposition of any such lands and the income therefrom should be held by the State as a public trust.

The Hawai'i State Constitution recognizes OHA's trust entitlement from the "public land trust" to include "all income and proceeds from that pro rata portion of the trust." Furthermore, the State Constitution establishes OHA as a fiduciary to hold all real and personal property transferred to it in trust for native Hawaiians and Hawaiians. Article XII, Section 5 of the State Constitution states:

There is hereby established an Office of Hawaiian Affairs. The Office of Hawaiian Affairs shall hold title to all the real and personal property now or hereafter set aside or conveyed to it which shall be held in trust for native Hawaiians and Hawaiians.

We conclude that all of OHA's income and proceeds, including the revenues received from the public land trust, are trust assets. We also conclude that the designated purpose of OHA's funds fits that of a "trust fund." This source of funding for OHA's programs and activities should properly be classified as trust funds rather than special funds.

Since these are trust funds, the responsibility for managing them rests with the OHA Board of Trustees. The Legislature should not subject the trust funds to appropriation and allotment control. The Legislature could, however, require complete disclosure of activities related to the management, investment, and use of these funds.

OHA Needs to Strengthen its Management

OHA does not have adequate management controls to direct its operations. It lacks current plans and policies and procedures to guide its staff. Staff efforts are disjointed and work at cross purposes.

Master and functional plans are outdated

OHA has master and functional plans that are intended to guide its operations. The master plan, originally developed in 1982 and updated in 1988, established a ten-year plan setting the mission and goals of OHA. The functional plans, first completed in 1990, established detailed plans on how to achieve the goals. Both types of plans were intended to be updated periodically to reflect changing conditions.

OHA's Planning and Research Office is supposed to provide the primary planning services. The office is responsible for coordinating the update of the master plan. It also assists OHA's other offices and divisions in developing and regularly updating their functional plans.

The Planning and Research Officer reports that the office has been unable to update the plans because it has been given other responsibilities such as the grants approval process. Without current plans, OHA is unable to assure that its various activities operate in concert with each other and are relevant to meeting its goals. OHA should update its master and functional plans so that they will remain dynamic and give direction to the agency's operations.

Policies and procedures are not completed

Since our 1990 audit, OHA has made progress in documenting policies relating to program management. Many of the policies on program management, such as the functional plans and the grants and evaluation policies, are well written and well organized. However, OHA's administration has not brought the policies together into an overall system of program management. As a result, staff do not fully utilize the policies on hand.

OHA has numerous policies and manuals but has not compiled them in a way that would be useful to staff. For example, information on program management is contained in ten separate policy manuals and documents. These scattered materials do not give staff an integrated picture of the process for developing and managing programs. The number of manuals involved makes it difficult for staff to locate applicable policies.

OHA has two processes for program development: a referral process from the board and a development process initiated by staff. Under the board's referral process, external requests or trustee proposals may be referred to staff committees for further consideration. Under the staff's development process, the staff develops proposals that are then channeled through OHA's budget process. The board's referral process is identified in the Trustees' Operations Guide, but the guide does not fully explain how staff is involved in the process. Some staff members were unaware of this process since it is not described in any of the staff manuals.

OHA also has a policy that all programs are subject to evaluation. Evaluations, however, are not integrated into the program development process. Further, evaluations are not used to decide whether to continue, modify, or terminate programs. OHA should develop a policy that would require evaluation of its programs to ensure that the programs actually have a positive impact on beneficiaries.

Internal communications are poor

Many OHA staff members we interviewed felt that they were not adequately apprised of OHA activities. One staff member attributed this to their workload. Staff focus on their own activities and are not aware of other program areas. Another staff member stated that the administration has made little effort to keep members informed.

The administrator holds weekly staff meetings, but several staff commented that there was not sufficient time for substantive discussions during the hour-long staff meetings. Attendance is also limited to program officers and administrative staff. Minutes are not recorded and participants are not required to brief their subordinates about the meetings. One staff noted that some officers keep their staff informed while other officers "never" relay any information to their staff. Another staff member noted that the lack of communication forces staff to act hastily because they receive inadequate notice about production, deadlines, or other demands.

Financial Internal Control Practices Need to be Improved

Internal controls are steps instituted by management to assure that objectives are met and resources are safeguarded. We were pleased to note that OHA had implemented most of our prior recommendations. Cash receipt functions have been segregated, compensation request forms are being signed and submitted in a timely manner, and travel expenditures are properly documented. However, improvements in OHA's financial management are still needed.

Lapsing of general fund appropriations was circumvented

Fiscal year 1991-92 funds were improperly encumbered at year end and subsequently used for fiscal year 1992-93 expenses of the Native Hawaiian Historic Preservation Council. A total of \$29,615 was encumbered on June 30, 1992 for travel, equipment and other contract services costs to be incurred during fiscal 1992-93. The costs were shared equally by the special revenue fund and general fund. The funds were encumbered using consecutively numbered purchase orders, all dated June 30, 1992, to make up for a perceived shortfall in fiscal year 1992-93 appropriations for this program. General fund appropriations for fiscal 1991-92 are to be used for operations in the same year. Funds not used or obligated for that year's operations should have reverted to the state's general fund at year end. The general fund portion (\$14,583) of these encumbrances should have lapsed to the State's general fund.

Statutory limits for paid leave are not followed

OHA has not yet developed the sections of its policies and procedures manual that deal with employee practices. The three missing sections have been tentatively called "Employee Compensation," "Employee Policies," and "Employee Handbook." Lacking any internal guidance, OHA has allowed some employees to accrue vacation leave of up to 1,000 hours and compensatory time off exceeding 1,000 hours.

OHA employees are entitled to all state benefits and are allowed to transfer accrued vacation and sick leave if they transfer to or from another state agency. They also participate in the state employees health fund and retirement system. They should follow the same vacation leave and compensatory time off practices of other state agencies. The statutes allow the carryover of more than 720 hours of vacation in certain extreme circumstances, but we found no evidence of those circumstances at OHA. Further, we found no support for the practice of giving employees compensatory time off.

Employees of OHA are exempt from Chapters 76 and 77 of the Hawai'i Revised Statutes, but they may not be exempt from Chapter 79 which establishes leave policies for employees of state agencies. Chapter 79 limits the amount of accrued vacation that employees can carry forward to the following year to 90 days (720 hours). The State has no statutory or administrative authority for compensatory time off.

Trustee medical premiums were paid by OHA

In our 1990 report we found that trustees had a health benefit plan separate from that provided to OHA employees. We recommended that OHA clarify its criteria for having a separate health benefit plan for its trustees. Subsequently, OHA trustees enrolled in the same public employee's health fund as OHA's employees.

All other health fund participants, which include members of elected boards and OHA employees, make personal payments for a portion of the medical premiums. During the fiscal year ended June 30, 1993, OHA paid the entire premium for participating OHA trustees.

OHA trustees should be treated no differently from members of other elected boards as well as OHA employees. We understand that, effective July 1, 1993, OHA trustees are paying a portion of the health benefit plan as do OHA employees. The Board of Trustees should continue to align its benefits with those of its employees and not provide itself with additional benefits.

Controls are needed over interisland airline ticket coupons

During the year, airline ticket coupons costing about \$4,000 expired. OHA does not have an adequate system of monitoring the use and purchase of interisland airline coupons. It has inadequate controls over the inventory of unused coupons. In addition, OHA continues to purchase airline coupons without regard to the number of unused coupons on hand.

OHA's practice is to purchase coupons for each program and place them in folders in one filing cabinet. Coupons are taken from the folders as needed. On October 1, 1993, we counted 1,629 coupons in the various folders. Of these, 98 had expired. We were informed that OHA

generally does not use more than 100 coupons per month. OHA also purchases monthly airline passes for frequent travelers. Based on this usage, the inventory of unused coupons on hand exceeds one year's worth of travel. More coupons may expire before they can be used.

Effective control over the usage and inventory of interisland airline coupons is needed to ensure proper use of OHA's resources. OHA should establish a log for unused coupons. This log should be used to document the cost and expiration dates of coupons, the date of issuance, and the person to whom the coupons were issued. The cost of these coupons should be recorded as prepaid expenses until they are used. In addition, regular physical inventory counts of unused coupons should be performed and reconciled to the control log.

Existing policies and procedures are not being followed

OHA's procedures over purchasing are governed by its *Administrative and Financial Manual of Guides*. We found instances of non-compliance with procedures in the manual. Specifically we found that:

- Purchase orders for payments of printing, personal services and refreshment costs were issued after the related invoice date. Title III, Section 1.6 of the manual states that, "No purchase shall be made unless the purchase has first been approved by the Administrator or Administrative Services Officer." The manual does allow for emergency purchases after which a "confirming purchase order" is to be prepared, approved, and issued. We found no evidence that an emergency existed for these purchases.
- Documentation of competitive bid procedures or sole source authorizations were not maintained. As a result, we were unable to determine if OHA adhered to its purchasing procedures. Title III, Section 2.4 of the manual states in part, "... purchases costing \$4,000 or more but less than \$8,000 may be made only after a call for informal bids has been published at least once in a newspaper of general circulation," and "...purchases costing \$8,000 or more may be made only after a call for sealed bids has been published not less than five times in a newspaper of general circulation...." Purchases of goods or services that do not allow for competition and purchases from governmental agencies are excluded from these requirements. However, we could find no documentation that these purchases were exempt from competitive bid procedures.
- Manual check disbursements were made without purchase orders or contracts. We also noted two instances when disbursements were processed through normal channels without purchase orders. In addition, approvals for payments on

executed contracts were not documented. Title III, Section 1.7 of the manual states, "Authorization to purchase any goods or services shall be evidenced by either purchase order or a contract. No payment for goods or services shall be made by the accountant without such a purchase order or contract." In addition, since approvals for payments on executed contracts were not documented, we were unable to determine the extent to which management monitored the contract as part of its overall responsibility to ensure that the contracted work is being properly performed.

Conclusion

OHA is entering a new phase as a trust with major assets. This change in status emphasizes the importance of having the board and individual trustees understand and behave in a manner appropriate to their fiduciary duties and responsibilities. OHA has initiated several significant programs and has demonstrated its ability to implement programs that are progressive and beneficial to the native Hawaiians and Hawaiians. The board must now seek to implement standards of behavior for the trustees that will complement and enhance these achievements. This would strengthen OHA and support its increasing independence.

Recommendations

1. We recommend that the Board of Trustees of the Office of Hawaiian Affairs should make the following improvements:
 - a. Develop a formal training and orientation program for trustees and staff that includes educational materials relating to trusts and the role of a fiduciary. The training and orientation program should be flexible so that it can be updated as needed to stay current with applicable trust laws.
 - b. Incorporate relevant provisions of Chapter 554A, HRS, Uniform Trustees' Powers Act, and other appropriate trust related materials into OHA's bylaws, policies and procedures, and manual of guides.
 - c. Develop and adopt a code of conduct based upon the obligations imposed on trustees of fiduciaries, the duties given to OHA trustees, and Chapter 10, HRS.
 - d. Reorganize its standing committees to focus on important policy issues instead of operational issues. Each standing committee should have clear jurisdiction over a functional area.

- e. Evaluate the feasibility of establishing a position within OHA's administration office to handle the routine administrative activities of the board.
2. We recommend that the administration of the Office of Hawaiian Affairs should:
 - a. Update the master and functional plans.
 - b. Consolidate and integrate its manuals into a single coherent working document that would be useful to staff. The document should provide guidelines for developing and managing programs.
 - c. Take steps to have OHA's funds properly classified as trust funds.
 - d. Improve communications among staff and record and circulate minutes of staff meetings.
3. To strengthen its fiscal controls, we recommend that OHA:
 - a. Take steps necessary to ensure that proper encumbrance practices are followed;
 - b. Complete its *Administrative And Financial Manual of Guides* and establish a policy on vacation leave and compensatory time off that conforms to state statutes;
 - c. Implement procedures to ensure that the inventory of interisland airline coupons are properly controlled and utilized.
 - d. Take steps to ensure that fiscal policies stated in its *Administrative and Financial Manual of Guides* are being followed;
4. The Board of Trustees should continue to align its benefit plans with those for its employees.
5. The Legislature should recognize that OHA's funds are trust funds by:
 - a) Changing the designation of the "Means of Financing" of OHA's trust funds from "special funds" to "trust funds" in all budget and fiscal related matters.

- b) Amending Section 10-14.6, HRS, to delete the provision stating that the Legislature shall appropriate any matching special funds.
- c) Refrain from making appropriations from OHA's trust funds.

Chapter 3

Financial Audit

This chapter presents the results of the financial audit of the Office of Hawaiian Affairs (OHA) for the fiscal year ended June 30, 1993. It displays financial statements of all fund types and account groups administered by OHA, together with explanatory notes. It also includes reports on the internal control structure and compliance with laws and regulations.

Summary of Findings

In the opinion of Nishihama & Kishida, CPA's, Inc., the financial statements present fairly, in all material respects, the combined financial position of OHA as of June 30, 1993, and the combined results of its operations for the fiscal year then ended in conformity with generally accepted accounting principles.

Nishihama & Kishida, CPA's, Inc. noted no matters involving the internal control structure and its operation that they considered to be material weaknesses as defined in the report on the internal control structure. They also noted, that with respect to items tested, that OHA has complied, in all material respects, with laws and regulations applicable to OHA.

Independent Auditors' Report

To the Auditor
State of Hawai'i

We have audited the following financial statements of the State of Hawai'i Office of Hawaiian Affairs:

Combined balance sheet—all fund types and account groups—June 30, 1993 (Exhibit A);

Combined statement of revenues, expenditures, and changes in fund balances—all governmental fund types—fiscal year ended June 30, 1993 (Exhibit B); and

Combined statement of revenues and expenditures—budget and actual (budgetary basis)—general fund type—fiscal year ended June 30, 1993 (Exhibit C).

These combined financial statements are the responsibility of the management of the State of Hawai'i Office of Hawaiian Affairs. Our responsibility is to express an opinion on these combined financial statements based on our audit. Information as of June 30, 1992 and for the fiscal year then ended, is presented for comparative purposes only and was extracted from the financial statements which were audited by other auditors whose report dated October 9, 1992, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with generally accepted auditing standards and *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 combined financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of OHA at June 30, 1993, and the results of its operations for the fiscal year then ended in conformity with generally accepted accounting principles.

Our audit was made for the purpose of forming an opinion on the combined financial statements of OHA taken as a whole. The combining financial statements listed below, which are also the responsibility of OHA's management, are presented for purposes of additional analysis and are not a required part of the combined financial statements.

Combining balance sheet—general fund—June 30, 1993 (Schedule I);

Combining statement of revenues, expenditures, and changes in fund balances—general fund—fiscal year ended June 30, 1993 (Schedule II);

Combining balance sheet—special revenue fund—June 30, 1993 (Schedule III); and

Combining statement of revenues, expenditures, and changes in fund balances—special revenue fund—fiscal year ended June 30, 1993 (Schedule IV).

Such additional information in the above schedules have been subjected to the auditing procedures applied in our audit of the combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the combined financial statements taken as a whole.

/s/ Nishihama & Kishida, CPA's, Inc.

Honolulu, Hawai'i
October 28, 1993

**Independent
Auditors' Report
on the Internal
Control Structure**

To the Auditor
State of Hawai'i

We have audited the combined financial statements of the State of Hawai'i Office of Hawaiian Affairs (OHA), as of and for the fiscal year ended June 30, 1993, and have issued our report thereon dated October 28, 1993.

We conducted our audit in accordance with generally accepted auditing standards and *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 combined financial statements are free of material misstatement.

In planning and performing our audit of the combined financial statements of OHA for the fiscal year ended June 30, 1993, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the combined financial statements and not to provide assurance on the internal control structure.

The management of OHA is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of combined financial statements in accordance with generally accepted

accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories:

- Revenues and receipts
- Purchases and disbursements
- Payroll

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the combined financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control structure and its operation that we consider to be material weaknesses as defined above.

However, we noted certain matters involving the internal control structure and its operation that we have reported to the Auditor, State of Hawai'i in Chapter 2.

This report is intended for the information of the Auditor, State of Hawai'i and the management of OHA. However, this report is a matter of public record and its distribution is not limited.

/s/ Nishihama & Kishida, CPA's, Inc.

Honolulu, Hawai'i
October 28, 1993

**Independent
Auditors' Report
on Compliance
Based on an Audit
of the Combined
Financial
Statements**

To the Auditor
State of Hawai'i

We have audited the combined financial statements of the State of Hawai'i Office of Hawaiian Affairs (OHA) as of and for the fiscal year ended June 30, 1993, and have issued our report thereon dated October 28, 1993.

We conducted our audit in accordance with generally accepted auditing standards and *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 combined financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to OHA is the responsibility of OHA's management. As part of obtaining reasonable assurance about whether the combined financial statements are free of material misstatement, we performed tests of OHA's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the combined financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests indicate that, with respect to the items tested, OHA complied, in all material respects, with the provisions referred to in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that OHA had not complied, in all material respects, with those provisions.

This report is intended for the information of the Auditor, State of Hawai'i and the management of OHA. However, this report is a matter of public record and its distribution is not limited.

/s/ Nishihama & Kishida, CPA,s, Inc.

Honolulu, Hawai'i
October 28, 1993

Descriptions and Definitions

This section provides descriptions of the financial statements audited and definitions of technical terms used in this chapter.

Descriptions of financial statements

The following is a brief description of the financial statements audited by Nishihama & Kishida, CPA's, Inc. The financial statements are attached at the end of this chapter.

Combined balance sheet—all fund types and account groups (Exhibit A). This statement presents assets, liabilities, and fund balances of all fund types and account groups used by OHA on an aggregate basis.

Combined statement of revenues, expenditures, and changes in fund balances—all governmental fund types (Exhibit B). This statement presents revenues, expenditures, other financing sources (uses) and changes in fund balances for all governmental fund types of OHA on an aggregate basis. Revenues include state appropriations mandated by the Office of Hawaiian Affairs Budget Act of 1991 (Act 301, Session Laws of Hawai'i 1991), as amended by the Office of Hawaiian Affairs Budget Act of 1992 (Act 302, Session Laws of Hawai'i 1992), and other specific appropriations acts.

Combined statement of revenues and expenditures - budget and actual - general fund type (Exhibit C). This statement presents a comparison of budgeted and actual revenues, expenditures, and other financing sources for the general fund accounts used by OHA.

Definition of terms

Technical terms are used in the financial statements and in the related notes to the financial statements. The more common terms and their definitions are as follows:

Appropriation. An authorization granted by the State Legislature permitting a state agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures.

Encumbrance. An obligation in the form of a purchase order or contract which is chargeable to an appropriation, the incurring of which sets aside the appropriation for the amount of the obligation.

Expenditure. The actual disbursement of funds for the payment of goods delivered or services rendered, the obligation to pay for such goods or services having been incurred against authorized funds.

Reserve. An account used to earmark a portion of the fund balance to indicate that it is not available for expenditure.

Transfers. The transaction between funds, departments, and/or programs which is approved by the appropriate authority.

Notes to the Combined Financial Statements

Financial statement presentation

Explanatory notes which are pertinent to an understanding of the combined financial statements and financial condition of the funds administered by OHA are discussed in this section.

General. The accompanying combined financial statements of OHA present the financial position of the various fund types and account groups, and the results of operations of the various fund types for the fiscal year ended June 30, 1993.

Reporting entity. OHA was established in 1978 by an amendment to the Constitution of the State of Hawai'i.

Fund accounting. The financial activities of OHA are recorded in individual funds classified by type and described in the following sections, each of which is deemed to be a separate accounting entity. The financial position and operations of each fund are accounted for in separate self-balancing accounts which represent the fund's assets, liabilities, equity, revenues and expenditures or expenses. The funds are intended to conform with the State of Hawai'i general accounting system and are structured to comply with the requirements of appropriations authorized by State law.

Account groups are used to establish accounting control and accountability for OHA's general fixed assets and general long-term obligations. Account groups are not funds as they do not reflect available financial resources and related liabilities.

Governmental fund types. Financial resources which are not accounted for in other funds are accounted for in the general fund. The measurement focus of governmental funds is on determination of financial position and changes in financial position rather than upon net income determination. The budget adopted by the State Legislature provides the basic framework within which the resources and obligations of the general fund are accounted. The general fund of OHA is a part of the State's general fund and the accompanying general fund financial statements are limited to and reflect only the appropriations, expenditures, and obligations of the general fund accounts used by OHA, and the general fund appropriations received by OHA.

Included in this fund are small amounts of federal grants which are restricted to carrying out certain programs which benefit Hawaiians. Since management believes that the legal restrictions and sound financial management can be met without segregating this activity into a separate fund, such grants have been included in the General Fund.

Financial resources obtained from specific revenue sources and used for restricted purposes are accounted for in the special revenue fund. This fund includes OHA's proceeds and income from the public land trust as defined in Chapter 10, Hawai'i Revised Statutes, as well as the proceeds and income of the Native Hawaiian Revolving Loan Demonstration Project grant.

Account groups. The general fixed assets account group is used to account for all fixed assets of OHA. The general long-term debt account group is used primarily to account for the accrued vacation payable for governmental fund types.

Total columns on combined financial statements. Total columns on the accompanying combined financial statements are captioned "memorandum only" to indicate that they are presented only to facilitate financial analysis. Data in these columns do not purport to present financial position, results of operations, or changes in financial position or fund equity of OHA in conformity with generally accepted accounting principles. Such data is not comparable to a consolidation.

Summary of significant accounting policies

Basis of accounting. The accounts of the governmental fund types are reported using the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when they become measurable and available to finance operations of the current fiscal year. Measurable means that the amount of the transaction can be determined. Available means that the amount is collected in the current fiscal year or soon enough after fiscal year-end to liquidate liabilities existing at the end of the fiscal year. Expenditures are generally recognized when the related liability is incurred, except for accumulated unpaid vacation and accrued workers' compensation claims which are recognized as expenditures when payable from expendable available financial resources. Encumbrances are recorded obligations in the form of purchase orders or contracts. OHA records encumbrances at the time purchase orders or contracts are awarded and executed. Encumbrances outstanding at fiscal year-end are reported as reservations of fund equity since they do not constitute expenditures or liabilities.

Accumulated vacation and sick leave. Employees' vested annual vacation and sick leave are recorded as expenditures when actually taken. The employees of OHA are entitled to receive cash payment for

accumulated vacation leave upon termination. The liability for such accumulated vacation leave pay is not reflected in the governmental funds but is reflected in the general long-term debt account group.

Intrafund and interfund transactions. Significant transfers of financial resources between activities included within the same fund are offset within that fund. Transfers of revenues from funds authorized to receive them to funds authorized to expend them have been recorded as operating transfers in the combined financial statements.

Investments. Investments are generally stated at cost except for marketable equity securities which are carried at the lower of cost or market. OHA uses the first-in, first-out method in computing gain or loss on sales of marketable equity securities.

Public land trust revenue. Public land trust revenue is recognized when received from various departments of the State of Hawai'i.

Operating leases. Operating leases with scheduled rent increases are measured on a straight-line basis over the lease term. The unpaid portion is accrued as a liability of the General Long-Term Debt Account Group.

Budgeting and budgetary control

The budget of OHA is a detailed operating plan identifying estimated costs and results in relation to estimated revenues. At the present time, OHA's budget encompasses the general fund appropriations and the corresponding special revenue fund's share of general operating expenditures. The budget includes (1) the program, services and activities to be provided during the fiscal year, (2) the estimated revenues available to finance the operating plan and (3) the estimated spending requirements of the operating plan. The budget represents a process through which policy decisions are made, implemented, and controlled. Amounts reflected as budgeted revenues and budgeted expenditures in Exhibit C are derived primarily from the Office of Hawaiian Affairs Budget Act of 1991 (Act 301, Session Laws of Hawai'i 1991), as amended by the Office of Hawaiian Affairs Budget Act of 1992 (Act 302, Session Laws of Hawai'i 1992), and other specific appropriations acts.

All expenditures of these appropriated funds are made pursuant to the appropriation in the 1991-1993 biennial budget. The final legally adopted budget in Exhibit C represents the original appropriations, transfers, and other legally authorized legislative and executive changes.

Budgetary control is maintained at the appropriation line item as established in the appropriations acts. Records and reports reflecting the

detailed level of control are maintained by and are available at OHA. During the fiscal year ended June 30, 1993, there were no expenditures in excess of appropriations at the legal level of budgetary control.

To the extent not expended or encumbered, general fund appropriations generally lapse at the end of the fiscal year in which the appropriations were made. The Legislature specifies the lapse date and any other particular conditions relating to terminating the authorization for other appropriations.

The budget adopted by the Legislature for the general fund is presented in Exhibit C. OHA's annual budget is prepared on the modified accrual basis of accounting with several differences, principally related to the encumbrances of purchase orders and contract obligations. These differences represent departures from generally accepted accounting principles (GAAP). A reconciliation between non-GAAP budgetary actual and GAAP actual for OHA's general fund is as follows:

Excess of revenues and other sources over expenditures and other uses - actual on a budgetary basis	\$ 100,470
Reserved for encumbrances at fiscal year-end	1,052,070
Prepaid expenditures at fiscal year-end	(1,344)
Expenditures for liquidation of prior fiscal year encumbrances	(1,147,663)
Lapsed appropriations	(131,884)
State assessments	(5,100)
Nonbudgeted revenues and expenditures	<u>135,180</u>
Excess of revenues and other sources over expenditures, other uses and other changes in fund balance - GAAP basis	<u>\$ 1,729</u>

The cash held in State treasury is fully collateralized with securities held by third-party agents under the State of Hawai'i as required by the Hawai'i Revised Statutes Section 38-3.

Cash

In addition, OHA maintains its cash accounts in two commercial banks located in Hawai'i. Cash balances in accounts at each bank are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000 per account holder. At June 30, 1993, OHA had cash balances which surpassed the FDIC insurance limit as follows:

Cash balances per banks	\$2,242,069
Less portions insured by the FDIC	<u>(108,195)</u>
Uninsured cash balances	<u>\$2,133,874</u>

At June 30, 1993, OHA also had \$2,493,566 in cash held by an investment broker. The cash balance is insured by the Federal Home Loan Insurance Corporation (FHLIC) up to \$100,000 per account holder. A summary of the insured and uninsured portions at June 30, 1993 is as follows:

Cash balance	\$2,493,566
Less portions insured by the FHLIC	<u>(100,000)</u>
Uninsured cash balance	<u>\$2,393,566</u>

Loans receivable

At June 30, 1993, the Special Revenue Fund loans receivable consisted of approximately \$2,012,000 in loans issued under the Native Hawaiian Revolving Loan Fund, which is net of an allowance for doubtful accounts of approximately \$778,000.

Investments

OHA's investments consist of repurchase agreements, and various equity and debt securities. At June 30, 1993, \$400,000 in repurchase agreements were held by the State Department of Budget and Finance for OHA. The following table presents OHA's investments at June 30, 1993, and provides information about the credit and market risks associated with OHA's investments. The three categories of credit risk are:

Category 1: investments which are insured or registered, or securities held by OHA or its agent in OHA's name.

Category 2: investments which are uninsured and unregistered, with securities held by the counterparty's trust department or agent in OHA's name.

Category 3: investments which are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in OHA's name.

Type of Security	Category			Cost	Market Value
	1	2	3		
Repurchase agreements	\$129,689,473	\$400,000	\$ -	\$130,089,473	\$130,089,473
Marketable equity securities	10,632,496	-	-	10,632,496	11,190,523
U.S. government obligations	6,001,406	-	-	6,001,406	6,259,031
Corporate bonds	3,238,268	-	-	3,238,268	3,340,780
Foreign bonds, notes & debentures	712,507	-	-	712,507	742,700
Municipal obligations	<u>525,000</u>	<u>-</u>	<u>-</u>	<u>525,000</u>	<u>544,320</u>
	<u>\$150,799,150</u>	<u>\$400,000</u>	<u>\$ -</u>	<u>\$151,199,150</u>	<u>\$152,166,827</u>

General fixed assets

The changes in the general fixed assets were as follows:

	Land	Leasehold Improvements	Furniture and	Total
			Equipment	
Balance at July 1, 1992	\$84,100	\$263,148	\$1,440,754	\$1,788,002
Additions	-	116,362	267,004	383,366
Deductions	<u>-</u>	<u>-</u>	<u>70,870</u>	<u>70,870</u>
Balance at June 30, 1993	<u>\$84,100</u>	<u>\$379,510</u>	<u>\$1,636,888</u>	<u>\$2,100,498</u>

General long-term debt

The changes in the general long-term debt were as follows:

	Accrued Employee	Operating	Total
	Benefits Payable	Lease Rents	
Balance at July 1, 1992	\$344,371	\$158,413	\$502,784
Net additions and payments	-	12,111	12,111
Net vacation earned but not taken	<u>127,681</u>	<u>-</u>	<u>127,681</u>
Balance at June 30, 1993	<u>\$472,052</u>	<u>\$170,524</u>	<u>\$642,576</u>

Retirement plan

All eligible employees of OHA are required by Chapter 88 of the Hawai'i Revised Statutes to become members of the Employees' Retirement System of the State of Hawai'i (ERS), a cost-sharing multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. Prior to June 30, 1984, the plan consisted of only a contributory option. In 1984, legislation was enacted to add a new noncontributory option for

members of the ERS who are also covered under social security. Persons employed in positions not covered by social security are excluded from the noncontributory option. The noncontributory option provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory option or to elect the new noncontributory option and receive a refund of employee contributions. All benefits vest after five and ten years of credited service for the contributory and noncontributory options, respectively.

The ERS's funding policy provides for employer contributions at actuarially determined rates that should provide sufficient resources to pay member pension benefits when due. The funding method used to calculate the total employer contribution required is the frozen initial liability method.

Under this method, the total employer contribution is comprised of the "normal cost" plus the level annual payment required to amortize the frozen unfunded accrued liability. The employer normal cost is the level percentage of payroll contribution to pay all future benefits, after subtracting expected future member contributions, the unfunded accrued liability, and the assets accumulated as of the valuation date. Actuarial gains and losses resulting from differences between actual and assumed experience are reflected in the employer normal cost rates.

Actuarial valuations are prepared for the entire ERS and are not separately computed for each department or agency. Information on vested and nonvested benefits and other aspects of the ERS is also not available on a departmental or agency basis.

The amount shown as "pension benefit obligation" is a standardized disclosure measure of the present value of credited projected pension benefits, adjusted for effects of projected salary increases, estimated to be payable in the future as a result of member service to date. The measure is the actuarial present value of credited projected benefits and is intended to help users assess the funding status of the ERS on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among public employee retirement systems. The measure is independent of the actuarial funding method used to determine contributions to the ERS described previously.

The pension benefit obligation was determined as of June 30, 1992. Significant assumptions underlying the actuarial computations include:

- In accordance with the provisions of Act 184 of the 1989 Regular Session of the State Legislature, the long-term rate of investment yield on the assets of the ERS is assumed to be 8 percent per year.
- An assumed annual salary increase of 6-1/2 percent per year for all members. Of this assumed salary increase, 5 percent is attributable to inflation and 1-1/2 percent is attributable to seniority and merit.
- The assumed rates of retirement, turnover and disability were based upon the ERS's experience.
- The assumed mortality rates were based on published statistical data as determined by the ERS's experience.
- The unused sick leave credit accumulated by members is assumed at 12 days per year.

At June 30, 1992, the total and unfunded pension benefit obligation for all members of the ERS was as follows:

Pension benefit obligation:

Pensioners and beneficiaries currently receiving benefits and terminated members not yet receiving benefits	\$2,308,411,700
Current members:	
Accumulated member contributions	824,646,800
Employer-financed vested	1,694,171,000
Employer-financed nonvested	1,265,252,900
Total pension benefit obligation	6,092,482,400
Net assets available for pension benefits, at cost	4,502,354,880
Unfunded pension benefit obligation	\$1,590,127,520

Ten-year historical trend information designed to provide information about the ERS's progress in accumulating sufficient assets to pay benefits when due is included in the separately issued audited financial statements of the ERS.

In addition to providing pension benefits, the State provides certain health care and life insurance benefits to retired State employees. Contributions are based upon negotiated collective bargaining agreements, and are funded by the State as accrued. OHA's share of the post-retirement health care and life insurance benefits expense for the fiscal year ended June 30, 1993, was approximately \$82,000 and is included in OHA's financial statements.

Operating leases

OHA leases various office facilities on a long-term basis as provided for in the lease agreements. The following is a schedule of minimum future rentals on noncancellable operating leases at June 30, 1993:

Fiscal Year Ending <u>June 30</u>	<u>Amount</u>
1994	\$ 521,000
1995	519,000
1996	520,000
1997	516,000
1998	487,000
Thereafter	<u>1,003,000</u>
	<u><u>\$3,566,000</u></u>

Rent expense incurred for noncancellable operating leases during the year ended June 30, 1993 amounted to approximately \$578,000.

Commitments and contingencies

Insurance coverage. Insurance coverage is maintained at the State level. The State is substantially self-insured for all perils including workers' compensation. Expenditures for workers' compensation and other insurance claims are appropriated annually from the State General Fund.

Accumulated sick pay. Employees earn sick leave credits at the rate of one and three-quarters working days for each month of service without limit. Sick leave can be taken only in the event of illness and is not convertible to pay upon termination of employment. However, an employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the Employees' Retirement System. Accumulated sick leave at June 30, 1993 was approximately \$648,000.

Deferred compensation plan. In 1983, the State established a deferred compensation plan which enables State employees to defer a portion of their compensation. The State Department of Personnel Services has the

fiduciary responsibility of administering the plan. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or gifts are (until paid or made available to the employee or other beneficiary) solely the property and rights of the State (without being restricted to the provisions of benefits under the plan), subject to the claims of the State's general creditors. Participants' rights under the plan are equal to those of the general creditors of the State in an amount equal to the fair market value of the deferred account for each participant.

State of Hawaii
Office of Hawaiian Affairs
COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUPS
June 30, 1993, with Comparative Amounts for 1992

	Governmental Fund Types		Account Groups		Total (Memorandum Only)
	General Fund	Special Revenue	General Fixed Assets	General Long-Term Debt	
ASSETS					
Cash held in State Treasury	\$ 901,186	\$ 2,074,687	\$ -	\$ -	\$ 2,975,873
Cash in banks	-	4,635,784	-	-	4,635,784
Petty cash	10,000	-	-	-	10,000
Notes receivable, net of allowance for doubtful accounts of \$778,000	-	2,011,558	-	-	2,011,558
Interest receivable	-	385,884	-	-	385,884
Due from Special Revenue Fund	82,730	-	-	-	82,730
Prepaid expenses	25,900	74,004	-	-	99,904
Security deposits	-	39,253	-	-	39,253
Investments	-	151,199,150	-	-	151,199,150
Land	-	-	84,100	-	84,100
Leasehold improvements	-	-	379,510	-	379,510
Machinery, equipment, furniture and fixtures, artwork	-	-	1,636,888	-	1,636,888
Amount to be provided for payment of general long-term debt	-	-	-	642,576	642,576
TOTAL ASSETS	\$1,019,816	\$160,420,320	\$2,100,498	\$642,576	\$26,985,765

EXHIBIT A (Continued)

State of Hawaii
Office of Hawaiian Affairs
COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUPS (Continued)
June 30, 1993, with Comparative Amounts for 1992

	Governmental Fund Types			Account Groups			Total	
	General Fund	Special Revenue	General Fixed Assets	General Long-Term Debt	(Memorandum Only)		1992	
					1993			
LIABILITIES AND FUND EQUITY								
LIABILITIES								
Accounts payable	\$ 162,271	\$ 38,460	\$ -	\$ -	\$ 200,731	\$	154,383	
Due to State General Fund	10,000	-	-	-	10,000		10,000	
Due to General Fund	-	82,730	-	-	82,730		65,233	
Deferred revenue	-	200,000	-	-	200,000		200,000	
Vacation benefits and compensatory time off	-	-	-	472,052	472,052		344,371	
Operating lease rents	-	-	-	170,524	170,524		158,413	
Total liabilities	<u>172,271</u>	<u>321,190</u>	<u>-</u>	<u>642,576</u>	<u>1,136,037</u>		<u>932,400</u>	
FUND EQUITY								
Investment in general fixed assets	-	-	2,100,498	-	2,100,498		1,788,002	
Fund balances:								
Reserved for encumbrances	567,640	816,344	-	-	1,383,984		1,546,537	
Reserved for notes receivable	-	2,011,558	-	-	2,011,558		1,908,422	
Reserved for prepaid expenses and security deposits	25,901	113,257	-	-	139,158		100,204	
Reserved for Native Hawaiian Revolving Loans	-	732,519	-	-	732,519		245,000	
Unreserved:								
Designated for Native Hawaiian Revolving Loans	-	1,946,255	-	-	1,946,255		638,415	
Designated for investments	-	-	-	-	-		1,500,000	
Designated for Hawaiian projects	254,004	363,260	-	-	617,264		273,738	
Designated for subsequent year's expenditures	-	16,806,912	-	-	16,806,912		16,547,810	
Designated for land entitlements	-	-	-	-	-		417,948	
Undesignated	-	137,309,025	-	-	137,309,025		1,087,289	
Total fund equity	<u>847,545</u>	<u>160,099,130</u>	<u>2,100,498</u>	<u>-</u>	<u>163,047,173</u>		<u>26,053,365</u>	
TOTAL LIABILITIES AND FUND EQUITY	\$1,019,816	\$160,420,320	\$2,100,498	\$ 642,576	\$164,183,210		\$26,985,765	

See accompanying notes to the financial statements.

State of Hawaii
Office of Hawaiian Affairs
COMBINED STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES -
ALL GOVERNMENTAL FUND TYPES
Fiscal Year Ended June 30, 1993, with Comparative Amounts for 1992

	Governmental Fund Types		Total (Memorandum Only)	
	General	Special Revenue	1993	1992
REVENUES				
State allotted appropriations	\$ 3,854,524	\$ -	\$ 3,854,524	\$ 3,590,887
Public land trust proceeds	-	70,700,130	70,700,130	8,993,725
Dividend and interest income	463	70,437,982	70,438,445	842,856
'Onipa'a centennial revenues	272,779	-	272,779	-
Federal grants	-	1,000,000	1,000,000	727
Hawaiian Projects Fund revenues	33,587	-	33,587	36,520
Native Hawaiian Rights Fund revenues	-	38,153	38,153	99,644
Non-imposed fringe benefits	255,536	-	255,536	200,629
Other	-	47,903	47,903	10,772
	<u>4,416,889</u>	<u>142,224,168</u>	<u>146,641,057</u>	<u>13,775,760</u>
EXPENDITURES				
Policy and Administration	1,317,203	538,321	1,855,524	1,721,961
Administrative Services	1,270,540	132,800	1,403,340	1,308,711
Public Information	514,816	147,286	662,102	416,667
Health and Human Services	1,001,678	79,269	1,080,947	879,541
Planning and Research	430,371	-	430,371	258,775
Culture	189,130	122,898	312,028	39,559
Government Affairs	643,908	-	643,908	104,796
Land and Natural Resources	1,219,924	43,967	1,263,891	1,081,909
Economic Development	778,518	229,654	1,008,172	942,574
Education	829,665	178,685	1,008,350	424,263
Housing	160,229	32,900	193,129	17,933
Capital Outlays	276,788	95,780	372,568	540,516
	<u>8,632,770</u>	<u>1,601,560</u>	<u>10,234,330</u>	<u>7,737,205</u>
EXCESS OF REVENUES OVER (UNDER) EXPENDITURES	(4,215,881)	140,622,608	136,406,727	6,038,555
OTHER FINANCING SOURCES (USES)				
Unrealized gain on investments	-	292,663	292,663	-
Unrealized loss on investments	-	-	-	(292,663)
Realized gain on sales of investments	-	118,906	118,906	819,763
State assessment	(5,100)	-	(5,100)	-
Operating transfers in	4,354,594	-	4,354,594	3,403,410
Operating transfers out	-	(4,354,594)	(4,354,594)	(3,403,410)
	<u>4,349,494</u>	<u>(3,943,025)</u>	<u>406,469</u>	<u>527,100</u>
EXCESS OF REVENUES AND OTHER SOURCES OVER EXPENDITURES AND OTHER USES	133,613	136,679,583	136,813,196	6,565,655
OTHER CHANGES IN FUND BALANCE				
Lapsed appropriations	(131,884)	-	(131,884)	(54,625)
EXCESS OF REVENUES AND OTHER SOURCES OVER EXPENDITURES, OTHER USES AND OTHER CHANGES IN FUND BALANCES	1,729	136,679,583	136,681,312	6,511,030
FUND BALANCES AT JULY 1, 1992	<u>845,816</u>	<u>23,419,547</u>	<u>24,265,363</u>	<u>17,754,333</u>
FUND BALANCES AT JUNE 30, 1993	<u>\$ 847,545</u>	<u>\$160,099,130</u>	<u>\$160,946,675</u>	<u>\$24,265,363</u>

See accompanying notes to the financial statements.

State of Hawaii
Office of Hawaiian Affairs
COMBINED STATEMENT OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL
(BUDGETARY BASIS) - GENERAL FUND TYPE
Fiscal Year Ended June 30, 1993

	Actual (Budgetary Basis)	Budget	Variance Favorable (Unfavorable)
REVENUES			
State appropriations	\$3,854,524	\$3,854,524	\$ -
Special revenue fund matching share	<u>3,760,980</u>	<u>3,764,524</u>	<u>(3,544)</u>
Total revenues	<u>7,615,504</u>	<u>7,619,048</u>	<u>(3,544)</u>
EXPENDITURES			
Policy and Administration	984,635	991,995	7,360
Administrative Services	1,158,767	1,224,423	65,656
Public Information	449,919	455,670	5,751
Health and Human Services	1,040,298	1,041,863	1,565
Planning and Research	332,133	337,708	5,575
Culture	177,339	177,339	-
Government Affairs	352,159	357,923	5,764
Land and Natural Resources	1,226,975	1,231,594	4,619
Economic Development	767,338	770,936	3,598
Education	882,483	885,260	2,777
Housing	<u>142,988</u>	<u>144,337</u>	<u>1,349</u>
Total expenditures	<u>7,515,034</u>	<u>7,619,048</u>	<u>104,014</u>
EXCESS OF REVENUES OVER EXPENDITURES	<u>\$ 100,470</u>	<u>\$ -</u>	<u>\$100,470</u>

See accompanying notes to the financial statements.

State of Hawaii
Office of Hawaiian Affairs
COMBINING BALANCE SHEET - GENERAL FUND
June 30, 1993

	Hawaiian Projects Fund				Total
	State Appropriations	Ka Wai Ola O OHA	'Onipa'a Centennial	Donations and Other	
ASSETS					
Cash held in State Treasury	\$632,988	\$99,212	\$106,573	\$62,413	\$ 901,186
Petty cash	10,000	-	-	-	10,000
Prepaid expenses	25,900	-	-	-	25,900
Due from Special Revenue Fund	<u>82,730</u>	-	-	-	<u>82,730</u>
TOTAL ASSETS	<u>\$751,618</u>	<u>\$99,212</u>	<u>\$106,573</u>	<u>\$62,413</u>	<u>\$1,019,816</u>
LIABILITIES AND FUND EQUITY					
LIABILITIES					
Due to State General Fund	\$ 10,000	\$ -	\$ -	\$ -	\$ 10,000
Accounts payable	<u>160,900</u>	<u>1,371</u>	-	-	<u>162,271</u>
Total liabilities	<u>170,900</u>	<u>1,371</u>	-	-	<u>172,271</u>
FUND EQUITY					
Fund balances:					
Reserved for encumbrances	554,817	12,378	-	445	567,640
Reserved for prepaid expenses and security deposits	25,901	-	-	-	25,901
Unreserved					
Designated for Hawaiian projects	-	<u>85,463</u>	<u>106,573</u>	<u>61,968</u>	<u>254,004</u>
Total fund equity	<u>580,718</u>	<u>97,841</u>	<u>106,573</u>	<u>62,413</u>	<u>847,545</u>
TOTAL LIABILITIES AND EQUITY	<u>\$751,618</u>	<u>\$99,212</u>	<u>\$106,573</u>	<u>\$62,413</u>	<u>\$1,019,816</u>

State of Hawaii
Office of Hawaiian Affairs
COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN
FUND BALANCES - GENERAL FUND
Fiscal Year Ended June 30, 1993

	State Appropriations	Hawaiian Projects Fund			Total
		Ka Wai Ola O OHA	'Onipa'a Centennial	Donations and Other	
REVENUES					
Appropriations	\$ 3,854,524	\$ -	\$ -	\$ -	\$ 3,854,524
Dividend and interest income	-	463	-	-	463
'Onipa'a Centennial	-	-	272,779	-	272,779
Hawaiian Projects Fund	-	22,897	-	10,690	33,587
Non-imposed fringe benefits	255,536	-	-	-	255,536
	<u>4,110,060</u>	<u>23,360</u>	<u>272,779</u>	<u>10,690</u>	<u>4,416,889</u>
EXPENDITURES					
Policy and Administration	1,317,203	-	-	-	1,317,203
Administrative Services	1,270,540	-	-	-	1,270,540
Public Information	509,373	5,443	-	-	514,816
Health and Human Services	1,001,678	-	-	-	1,001,678
Planning and Research	430,371	-	-	-	430,371
Culture	189,130	-	-	-	189,130
Government Affairs	345,288	-	298,620	-	643,908
Land and Natural Resources	1,219,924	-	-	-	1,219,924
Economic Development	778,518	-	-	-	778,518
Education	829,665	-	-	-	829,665
Housing	160,229	-	-	-	160,229
Capital Outlay	276,788	-	-	-	276,788
	<u>8,328,707</u>	<u>5,443</u>	<u>298,620</u>	<u>-</u>	<u>8,632,770</u>
EXCESS OF REVENUES OVER (UNDER) EXPENDITURES	(4,218,647)	17,917	(25,841)	10,690	(4,215,881)
OTHER FINANCING SOURCES (USES)					
State assessment	(5,100)	-	-	-	(5,100)
Operating transfers in (out)	4,222,180	(11,144)	132,414	11,144	4,354,594
	<u>4,217,080</u>	<u>(11,144)</u>	<u>132,414</u>	<u>11,144</u>	<u>4,349,494</u>
EXCESS OF REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURES AND OTHER USES	(1,567)	6,773	106,573	21,834	133,613
OTHER CHANGES IN FUND BALANCE					
Lapsed appropriations	(131,884)	-	-	-	(131,884)
EXCESS OF REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURES, OTHER USES AND OTHER CHANGES IN FUND BALANCES	(133,451)	6,773	106,573	21,834	1,729
Fund Balances at July 1, 1992	714,168	91,068	-	40,580	845,816
Fund Balances at June 30, 1993	<u>\$ 580,717</u>	<u>\$ 97,841</u>	<u>\$106,573</u>	<u>\$62,414</u>	<u>\$ 847,545</u>

State of Hawaii
Office of Hawaiian Affairs
COMBINING BALANCE SHEET - SPECIAL REVENUE FUND
June 30, 1993

	Public Land Trust	Native Hawaiian Revolving Loan Fund	Native Hawaiian Rights Fund		Total
			Land Title Project	Other	
ASSETS					
Cash in State Treasury	\$ 1,506,943	\$ 404,484	\$88,106	\$ 75,154	\$ 2,074,687
Cash in banks	2,407,877	2,227,907	-	-	4,635,784
Notes receivable, net of allowance for doubtful accounts of \$778,000	277	2,011,281	-	-	2,011,558
Interest receivables	339,501	46,383	-	-	385,884
Prepaid expenses	74,004	-	-	-	74,004
Security deposits	39,253	-	-	-	39,253
Investments	150,799,150	-	-	400,000	151,199,150
TOTAL ASSETS	\$155,167,005	\$4,690,055	\$88,106	\$475,154	\$160,420,320
LIABILITIES AND FUND EQUITY					
LIABILITIES					
Accounts payable	\$ 38,460	\$ -	\$ -	\$ -	\$ 38,460
Due to general fund	82,730	-	-	-	82,730
Deferred revenue	-	-	-	200,000	200,000
Total liabilities	121,190	-	-	200,000	321,190
FUND EQUITY					
Fund Balances:					
Reserved for encumbrances	816,344	-	-	-	816,344
Reserved for notes receivable	277	2,011,281	-	-	2,011,558
Reserved for prepaid expenses and security deposits	113,257	-	-	-	113,257
Reserved for Native Hawaiian Revolving Loans	-	732,519	-	-	732,519
Unreserved:					
Designated for Native Hawaiian Revolving Loans	-	1,946,255	-	-	1,946,255
Designated for Hawaiian projects Designated for subsequent year's expenditures	16,806,912	-	88,106	275,154	363,260
Undesignated	137,309,025	-	-	-	137,309,025
Total fund equity	155,045,815	4,690,055	88,106	275,154	160,099,130
TOTAL LIABILITIES AND FUND EQUITY	\$155,167,005	\$4,690,055	\$88,106	\$475,154	\$160,420,320

State of Hawaii
Office of Hawaiian Affairs
COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN
FUND BALANCES - SPECIAL REVENUE FUND
Fiscal Year Ended June 30, 1993

	Public Land Trust	Native Hawaiian Revolving Loan Fund	Native Hawaiian Rights Fund		Total
			Land Title Project	Other	
REVENUES					
Public land trust proceeds	\$ 70,700,130	\$ -	\$ -	\$ -	\$ 70,700,130
Dividend and interest income	70,309,097	128,678	53	154	70,437,982
Native Hawaiian Revolving Loan Fund	-	1,000,000	-	-	1,000,000
Native Hawaiian Rights Fund	-	-	38,153	-	38,153
Other	47,903	-	-	-	47,903
	<u>141,057,130</u>	<u>1,128,678</u>	<u>38,206</u>	<u>154</u>	<u>142,224,168</u>
EXPENDITURES					
Policy and Administration	538,321	-	-	-	538,321
Administrative Services	132,800	-	-	-	132,800
Public Information	147,286	-	-	-	147,286
Health and Human Services	79,269	-	-	-	79,269
Culture	122,898	-	-	-	122,898
Land and Natural Resources	26,777	-	17,190	-	43,967
Economic Development	-	229,654	-	-	229,654
Education	178,685	-	-	-	178,685
Housing	32,900	-	-	-	32,900
Capital Outlays	95,780	-	-	-	95,780
	<u>1,354,716</u>	<u>229,654</u>	<u>17,190</u>	<u>-</u>	<u>1,601,560</u>
EXCESS OF REVENUES OVER EXPENDITURES	<u>139,702,414</u>	<u>899,024</u>	<u>21,016</u>	<u>154</u>	<u>140,622,608</u>
OTHER FINANCING SOURCES (USES):					
Unrealized gain on investments	292,663	-	-	-	292,663
Realized gain on sale of investments and marketable equity securities	118,906	-	-	-	118,906
Operating transfers in (out)	(5,554,594)	1,000,000	-	200,000	(4,354,594)
	<u>(5,143,025)</u>	<u>1,000,000</u>	<u>-</u>	<u>200,000</u>	<u>(3,943,025)</u>
EXCESS OF REVENUES AND OTHER SOURCES OVER EXPENDITURES AND OTHER USES	<u>134,559,389</u>	<u>1,899,024</u>	<u>21,016</u>	<u>200,154</u>	<u>136,679,583</u>
Fund Balances at July 1, 1992	<u>20,486,426</u>	<u>2,791,031</u>	<u>67,090</u>	<u>75,000</u>	<u>23,419,547</u>
Fund Balances at June 30, 1993	<u>\$155,045,815</u>	<u>\$4,690,055</u>	<u>\$88,106</u>	<u>\$275,154</u>	<u>\$160,099,130</u>

Notes

Chapter 2

1. George T. Bogert, *Trusts, Sixth Edition*, Hornbook Series Student Edition, West Publishing Co., St. Paul, MN, 1987, 793 pgs.

Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Chair of the Board of Trustees of the Office on Hawaiian Affairs on December 13, 1993. A copy of the transmittal letter to the chair is included as Attachment 1. The response from the chair is included as Attachment 2.

The chair of the Board of Trustees responded that the board respects and agrees with many of our recommendations. The board agrees that it needs a better understanding of its role as a fiduciary and has begun the process of obtaining experts to conduct workshops to educate trustees on their duties. It agrees to establish additional bylaws and policies. It also agrees that OHA's revenues are trust funds. Finally, OHA intends to implement our recommendations regarding policies and procedures for program management.

The board does not agree that it should change from an operational to a functional committee orientation. It believes that this would result in even more fragmentation and confusion than the present system. The board says that it does recognize our concerns about committee operations and will eliminate their monitoring and coordinating responsibilities. The board says that it has been planning to update the OHA Master Plan but does not agree that the functional plans, developed in 1990, are outdated.

Finally, the board pointed to some inaccuracies in the draft that we have corrected. Based on other information supplied to us and a review of our supporting documentation, we have made additional changes in the draft.

ATTACHMENT 1

STATE OF HAWAII
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917



MARION M. HIGA
State Auditor

(808) 587-0800
FAX: (808) 587-0830

December 13, 1993

C O P Y

The Honorable Clayton H.W. Hee, Chair
Board of Trustees
Office of Hawaiian Affairs
711 Kapi'olani Boulevard, Suite 500
Honolulu, Hawaii 96813

Dear Mr. Hee:

Enclosed for your information are 10 copies, numbered 6 to 15 of our draft report, *Management and Financial Audits of the Office of Hawaiian Affairs*. Please distribute the copies to the members of the Board and the Administrator. We ask that you telephone us by Thursday, December 16, 1993, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Tuesday, December 28, 1993.

The Governor, and presiding officers of the two houses of the Legislature have also been provided copies of this draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

A handwritten signature in cursive script that reads 'marion m. higa'.

Marion M. Higa
State Auditor

Enclosures



STATE OF HAWAII
OFFICE OF HAWAIIAN AFFAIRS

711 KAPIOLANI BOULEVARD, SUITE 500
HONOLULU, HAWAII 96813-5249
PHONE (808) 586-3777
FAX (808) 586-3799

RECEIVED

DEC 28 3 14 PM '93

OFC. OF THE AUDITOR
STATE OF HAWAII

December 28, 1993

Ms. Marion Higa
Legislative Auditor
Office of the Legislative Auditor
465 S. King Street
Honolulu, Hawaii 96813

Dear Ms. Higa:

The Office of Hawaiian Affairs is generally pleased with the results of your management and financial audits which concluded "OHA has initiated several significant programs and has demonstrated its ability to implement programs that are progressive and beneficial to the native Hawaiians and Hawaiians", both the financial statements and the internal control structure had no material weaknesses, and that OHA complied, in all material respects, with laws and regulations applicable to OHA. The Board of Trustees (BOT) feels vindicated that the perceived problems which caused the Legislature to request the audits were illusory. More importantly, the Legislature should be reassured that OHA has taken the steps necessary to manage its resources for the betterment of our people.

In our response, where appropriate, the BOT indicates the action we anticipate taking. In other instances, where we do not concur we provide the basis for our position. At the outset, it should be noted that the BOT views its role as going beyond that of merely being policy makers striving to achieve the most efficient organization possible. Instead, we firmly believe our role is to better the conditions of our beneficiaries including maintaining and perpetuating our culture. As such we need to be constant advocates for our beneficiaries. At times these goals and our cultural values may conflict with management doctrine but we will not sacrifice them at the altar of management efficiency. On the other hand, as will be seen, we respect and agree with many of your recommendations.

Ms. Marion Higa
December 28, 1993
Page 2

1. The Board of Trustees agrees it needs a better understanding of its role as a fiduciary. We have begun the process of obtaining experts to assist us in ensuring every Trustee understands his/her fiduciary duty and will conduct workshops to educate trustees on their duties.
2. The Board of Trustees agrees to establish additional bylaws and policies. We, however, take strong exception to your concluding that not defining "ho'oponopono" in the bylaws is an example that they lack clarity. Why define it? All the trustees understand "ho'oponopono". More importantly, we believe it is our duty to promote Hawaiian language and culture whenever feasible. Thus, Hawaiian terms and practices will continue to have a place in OHA bylaws and practices. If not here, where?
3. The Board of Trustees will review our organization to determine how we can best carry out our fiduciary and policy making responsibilities.
4. The Board of Trustees does not agree that changing from an operational to a functional committee orientation is the panacea for the problems you list on page 12. The problems could just as easily occur under a functional rather than operational committee orientation. In fact, the solution to the problems you list lies more with individual trustees than any committee structure.

While you recommend a functional approach exemplified by separate committees for planning, budgeting, or program management, we anticipate that it would be unwieldy. First, such a horizontally integrated structure would result in even more shared jurisdiction, fragmentation, and confusion than you ascribe to the present system. Second, each functionally oriented committee would have to conduct an in depth review on every subject and program at OHA. Thus, a planning committee while conceptually dealing with only the planning aspect of each program would necessarily have to overlap with the budgeting, program management committees and at the same time develop subject matter expertise.

We might add that the Legislature retains a subject matter committee orientation. We do recognize your concerns about the problems you noted and the BOT has agreed to take steps to alleviate them. As you suggest, we will eliminate the monitoring and coordinating responsibilities of the committees. The remaining problems have been thoroughly discussed and each trustee realizes his/her individual responsibility to alleviate the identified problems. Please be advised, however, we believe it would be unwise to altogether stop advocating or dealing directly with staff as circumstances may often dictate otherwise.

5. The Board of Trustees fully agrees that OHA's revenues from the public land trust should be treated as trust funds.

6. The Board of Trustees agrees that the OHA Master Plan should be updated but that update has been long planned. In fact, Objective 1.2 of the Planning and Research Functional Plan states that OHA intends to "systematically review and revise the OHA Master Plan so that every six years, beginning July 1, 1994, a revised OHA Master Plan is published. We note that during 1993 we requested funding to update the master plan but were unsuccessful in obtaining Legislative approval.

The audit report does not mention OHA's efforts (begun on June 30, 1992 and scheduled for completion by June 30, 1994) to create a comprehensive master plan for Hawaiians which is broader in scope than the OHA Master Plan as it includes other agencies dealing with Hawaiians.

7. The Board of Trustees does not agree that the Functional Plans, developed in 1990 for the period 1991-97, are outdated. Nor are they ineffective in providing direction. Only two years have passed. We do not believe updating the functional plans every two years is judicious given the relatively short 6 year span of the Functional plans.

8. The Board of Trustees intends to implement your recommendation regarding policies and procedures for program management. We will retain independent outside consultants to complete the tasks you outlined. We will also seek outside advice on improving internal communications.

While the management audit report is generally factually accurate we note the need for several minor corrections, which we offer for your consideration, to the following pages of the draft Report:

Page 1 Section 5(f) of the Admission Act does not mandate the State use "**part**" of the revenues from funds generated by the public land trust to meet its obligations to native Hawaiians. Rather, the Act states "...for one or more of the five enumerated purposes".

Page 2 a) The Legislature did not establish "two trusts" under Chapter 10. Instead the Constitutional amendment (XII section 5) created a trust for native Hawaiians and Hawaiians. b) The definition of Hawaiian as excluding those with 50 percent or more Hawaiian blood is inconsistent with Chapter 10 section 2. Under HRS § 10-2 the definition of Hawaiian does not exclude a native Hawaiian. c) OHA did not

Ms. Marion Higa
December 28, 1993
Page 4

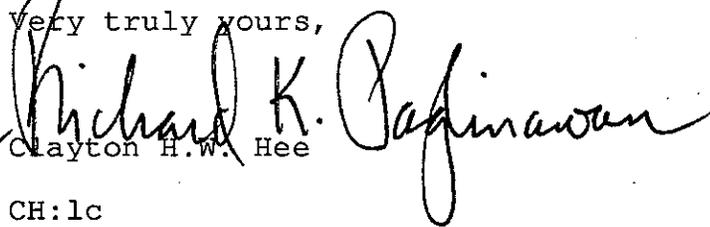
actually exist in 1979 except by way of statutory authority.
The office began to function in December 1980.

Page 24 Although the report states \$4,000 of airline ticket coupons expired no mention is made that the coupons are still honored. Thus, the "expired" coupons do not in fact expire.

Page 25 Checks were not issued from petty cash on two occasions. Both payments were by the enclosed state warrants (ZA3093 and ZA3395).

Thank you for the opportunity to comment on your draft report. Please be advised that this is the official response by the Board of Trustees. Any other response by an individual trustee should not be viewed as representing the official position of the Office of Hawaiian Affairs.

Very truly yours,

for 
Clayton H.W. Hee

CH:lc

