Accuity LLP

CERTIFIED PUBLIC ACCOUNTANTS

State of Hawaii
Department of Hawaiian Home Lands

Financial and Compliance Audit

June 30, 2008

Submitted by
The Auditor
State of Hawaii

Quality *Integrity* *Insight*

State of Hawaii
Department of Hawaiian Home Lands
Index
June 30, 2008

PART I

Financial Section

Accuity LLP
CERTIFIED PUBLIC ACCOUNTANTS

Report of Independent Auditors

The Auditor and Hawaiian Homes Commission
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii, Department of Hawaiian Home Lands (the "Department"), as of and for the year ended June 30, 2008, which collectively comprise the Department's basic financial statements, as listed in the index. These financial statements are the responsibility of the management of the Department. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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 opinions.

As discussed in Note 1 to the financial statements, the financial statements of the Department are intended to present the financial position, and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2008, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 17 to the basic financial statements, an error resulting in the overstatement of the previously reported department-wide net assets as of June 30, 2007, were discovered by management of the Department during the current year. Accordingly, the fiscal year 2007 financial statements have been restated and an adjustment has been made to the department-wide net assets as of July 1, 2007 to correct the error.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Department, as of June 30, 2008, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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In accordance with *Government Auditing Standards*, we have also issued our report dated June 10, 2009 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis on pages 3 through 10 is not a required part of the basic financial statements but is supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Department's basic financial statements. The information on the combining balance sheet – nonmajor governmental funds and combining statement of revenues, expenditures and changes in fund balances – nonmajor governmental funds, are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining balance sheet – nonmajor governmental funds and combining statement of revenues, expenditures and changes in fund balances – nonmajor governmental funds have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. As described in Note 1 to the schedule of expenditures of federal awards, the accompanying schedule of expenditures of federal awards was prepared on the cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects on the basis of accounting described in Note 1, in relation to the basic financial statements taken as a whole.

Accuity LLP

Honolulu, Hawaii
June 10, 2009

The following Management's Discussion and Analysis ("MD&A") is designed to provide an overview of the financial performance of the State of Hawaii, Department of Hawaiian Home Lands (the "Department") for the fiscal year ended June 30, 2008. Please read it in conjunction with the Department's financial statements, which follow this section.

Financial Highlights for Fiscal Year 2008

- The Department's total net assets, the amount of assets exceeding liabilities, totaled $671.5 million. Of this amount, $90.2 million is unrestricted, $137.0 million is restricted, and $444.3 million is invested in capital assets, net of related debt.
- The Department's total net assets increased $62.8 million over the course of this year's operation.
- In fiscal year 2008, the Department's revenues exceeded expenditures (before transfers) by $12.8 million. In fiscal year 2007, expenditures exceeded revenues (before transfers) by $6.0 million.
- The total expenditures of the Department increased by $32.0 million, or 51.5%.
- The General Fund appropriation was $169,635 more than fiscal year 2007. This represented a 15% increase in General Fund appropriations.
- The total fund balance of the Department's governmental funds decreased by $2.6 million.
- The Department entered into a 25-year facility lease agreement with a financial institution for the use of an office facility, which serves as the Department's administrative headquarters.
- The Department's Hawaiian Home Land Trust Fund received a $20 million appropriation for the design and construction of the east-west collector road in Kapolei, Hawaii.

Overview of the Financial Statements

This MD&A serves as an introduction to the Department's basic financial statements. The basic financial statements are comprised of three components: (1) department-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report also contains other supplementary information (combining financial statements – nonmajor governmental funds) in addition to the basic financial statements.

The first two statements are department-wide financial statements that provide both long-term and short-term information about the Department's overall financial status and operations.

The fund financial statements focus on individual parts of the Department, reporting the Department's status and operations in more detail than the department-wide financial statements. These statements tell how general departmental services were financed in the short-term as well as what remains for future spending.

The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

Department-Wide Financial Statements
The department-wide financial statements provide a broad view of the Department's operations. The statements provide both short-term and long-term information about the Department's financial position and activities, which assists in assessing the Department's economic condition at the end of the fiscal year and operations for the year then ended. These statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. The department-wide financial statements include two statements:

The statement of net assets presents all of the Department's assets and liabilities. The difference between the assets and liabilities are reported as "net assets."

The statement of activities presents information showing how the Department's net assets changed during the fiscal year. This statement presents a comparison between direct expenses and program revenues for each division of the Department.

The activities of the Department are mostly supported by state appropriation, rental income from commercial land leases and intergovernmental revenues. The Department's basic services fall under this type of activity.

Fund Financial Statements
A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Department uses fund accounting to ensure and demonstrate compliance with legal requirements.

The fund financial statements provide more detailed information about the Department's status and operations. Certain of the Department's funds were established under State Law or by bond covenants. Other funds of the Department are established by the Hawaiian Homes Commission. These funds manage money for particular purposes.

The Department only has governmental funds which finance the Department's basic services. Governmental funds are used to account for essentially the same functions reported as governmental activities in the department-wide financial statements. However, unlike the department-wide financial statements, the fund financial statements focus on near-term inflows and outflows of spendable resources as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the Department's short-term financing requirements.

Because the focus of fund financial statements is narrower than that of the department-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the department-wide financial statements. By doing so, readers may better understand the long-term impact of the Department's short-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The Department has fourteen governmental funds, seven of which are separately disclosed as major funds for presentation purposes. Each major fund is presented in a separate column in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures and changes in fund balance. These funds are briefly described as follows:

General Fund – The general fund is authorized and appropriated by the State Legislature each year for planning, development, management and general support for Hawaiian Homestead Program.

Hawaiian Home General Loan Fund – This revolving loan fund was established from a consolidation of all loan funds other than the Hawaiian Home Loan Fund in 1986. The major source of receipts for this fund is through principal repayment. The Department can make loans from the revolving funds for the construction of homes, home repairs or additions, or for the development and operation of a farm, ranch or agriculture operation.

Hawaiian Home Land Trust Fund – This fund was established by Act 14, Special Session 1995 which settles all claims made on behalf of the Hawaiian Home Land Trust against the State between August 21, 1959 and July 1988. It requires that the State make twenty annual deposits of $30 million or their discounted equivalent into the Hawaiian Home Land Trust Fund. Proceeds of the fund may be used by the Department for capital improvements and other purposes undertaken in furtherance of the Hawaiian Homes Commission Act of 1920, as amended.

Hawaiian Home Operating Fund – This fund was established through a merger of the Hawaiian Home Development Fund and Hawaiian Home Operating Fund in 1986. Any interest or earnings arising out of investments from the Hawaiian Home Loan Fund are to be credited to and deposited into the Hawaiian Home Operating Fund. All monies received by the Department from any other source, other than those prescribed in other funds of the Hawaiian Homes Commission Act, are deposited into this fund. The Department uses the fund for construction operation and maintenance of revenue-producing activities that are intended to serve principally occupants on Hawaiian Home Lands. The fund is used to finance improvements and developments necessary to serve present and future occupants of Hawaiian Home Lands.

Hawaiian Home Receipts Fund – All interest monies from loans or investments received by the Department from any fund, except the Hawaiian Home Loan Fund, Hawaiian Home Administration Account, Native Hawaiian Rehabilitation Fund, Hawaiian Home Lands Revenue Bond Special Fund and Hawaiian Home Land Trust Fund, are deposited into this fund. This fund serves as a clearing account at the end of each quarter. All monies in this fund are transferred to other funds as authorized by the Hawaiian Homes Commission Act.

Hawaiian Home Administration Account – The revenue sources of this fund are the entire receipts from any leasing or other dispositions of "available lands" and any interest or other earnings arising out of investments from this fund. The Department expends the monies for salaries and all other administrative expenses of the Department, excluding capital improvements, in the absence of general funds appropriated for operating and administrative costs.

Federal Grants – The Department is the recipient of an annual block grant under the Native American Housing Assistance and Self-Determination Act of 1996 ("NAHASDA"). The U.S. Department of Housing and Urban Development is the cognizant entity of the NAHASDA grant in carrying out affordable housing activities for Native Hawaiian families qualified for this program.

The accompanying notes to the financial statements are part of the financial statements. The notes provide additional information that is essential to gain a full understanding of the information provided in the department-wide and fund financial statements.

In addition to the basic financial statements and accompanying notes this report also presents other supplementary information consisting of the combining balance sheet and combining statement of revenues, expenditures and changes in fund balances in connection with nonmajor governmental funds and schedule of expenditures of federal awards.

Financial Analysis of the Department as a Whole

Net Assets

The Department's total net assets increased by $62.8 million to approximately $671.5 million between fiscal year 2008 and 2007, primarily due to the $30 million annual settlement payment from the State of Hawaii in accordance with Act 14, SP SLH 1995 and the $20 million allocation from the General Appropriations Act of 2007 for the design and construction of the east-west collector road in Kapolei. A large portion of the Department's net assets (66%) reflects its investment in capital assets such as land, buildings, infrastructure, furniture and equipment, and construction-in-progress. The Department uses these capital assets to provide public lands, which are leased to Native Hawaiians; consequently, these assets are not available for future spending. Although the Department's investment in its capital assets are reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets cannot be used to liquidate these liabilities.

The following is a comparative statement of net assets:

Summary of Statement of Net Assets
(in millions)

	2008	2007 (restated)	Increase (Decrease)
Current and other assets	$ 274.2	$ 353.7	$ (79.5)
Capital assets	493.8	405.4	88.4
Total assets	$ 768.0	$ 759.1	$ 8.9
Long-term debt outstanding	$ 48.2	$ 25.9	$ 22.3
Other liabilities	48.3	124.5	(76.2)
Total liabilities	$ 96.5	$ 150.4	$ (53.9)
Net assets			
Invested in capital assets, net of related debt	$ 444.3	$ 378.1	$ 66.2
Restricted	137.0	190.8	(53.8)
Unrestricted	90.2	39.8	50.4
	$ 671.5	$ 608.7	$ 62.8

Change in Net Assets

The Department's total program revenues increased from $52.3 million in 2007 to $102.9 million in 2008 (see statement of activities). Approximately 3.9% of the Department's program revenues came from loan interest income, 4.1% came from interest income on short-term investments, 67.5% came from home sales, and 12.0% came from the general lease program. A portion of the Department's program revenue, approximately 12.5%, came from grants and contributions. Total general revenues increased by 59.8% to $54.0 million due to the $20 million allocation from the General Appropriations Act of 2007 in fiscal 2008 for the design and construction of the east-west collector road in Kapolei. The total cost of the Department's programs increased by $32.0 million, or 51.5%. The Department received $30 million as part of the annual settlement payment with the State of Hawaii in accordance with Act 14, SP SLH 1995. Cash was transferred from the Department of Budget and Finance for the Hawaiian Home Lands settlement payment.

Statement of Activities

The statement of activities presents how the Department's net assets changed during the current fiscal year. Revenues and expenses are reported as soon as the underlying event occurs, regardless of the timing of the related cash flows. As such, the statement includes information for some items that will result in cash flows in future fiscal periods (e.g., uncollected lease payments).

The following is a comparative statement of changes in net assets:

Summary of Changes in Net Assets
(in millions)

	2008	2007 (restated)	Increase (Decrease)
Revenues			
Program revenue			
Administration and support services	$ 4.2	$ 9.3	$ (5.1)
Homestead services	4.0	3.9	0.1
Land development	4.1	21.3	(17.2)
Home construction	65.4	1.9	63.5
Land management	12.3	10.0	2.3
Intergovernmental revenues	12.9	5.9	7.0
Appropriation, net of lapsed appropriations	4.0	3.8	0.2
Total revenues	106.9	56.1	50.8
Expenses			
Administration and support services	13.4	8.8	4.6
Homestead services	16.0	17.1	(1.1)
Land development	4.3	3.8	0.5
Home construction	58.5	29.9	28.6
Land management	1.9	2.5	(0.6)
Total expenses	94.1	62.1	32.0
Excess (deficiency) of revenues over (under) expenses	12.8	(6.0)	18.8
Transfers, net	50.0	30.0	20.0
Change in net assets	62.8	24.0	38.8
Net assets			
Beginning of year, as restated	608.7	584.7	24.0
End of year	$ 671.5	$ 608.7	$ 62.8

As noted, net assets increased by $62.8 million from operations, a 10.3% growth this year. This amount is higher than fiscal 2007, when net assets increased $24 million, a 4.1% growth. Total revenue increased 90.6% over last year, while expenses increased by 51.5%, primarily due to the increase in home sales.

As noted in Note 17 to the financial statements, the Department restated its June 30, 2007 net assets to correct an error resulting in the overstatement of the previously reported net assets.

Financial Analysis of the Department's Governmental Funds

Governmental Funds

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

As of the end of fiscal year 2008, the Department's governmental funds reported a combined decrease in fund balance of $2.6 million. The changes in fund balance for the governmental funds differ from the change in net assets for governmental activities. The differences relate to certain financial resources and expenditures such as debt financing and capital outlays that are included in the changes in fund balances but are not reported in the changes in net assets.

Comparison of Balance Sheet
(in millions)

	Assets			Liabilities			Fund Balances (Deficit)		
	2008	2007	Change	2008	2007	Change	2008	2007	Change
General Fund	$ 0.4	$ 0.1	$ 0.3	$ 0.2	$ -	$ 0.2	$ 0.2	$ 0.1	$ 0.1
General Loan Fund	66.4	65.0	1.4	11.1	9.4	1.7	55.3	55.6	(0.3)
Trust Fund	101.3	180.0	(78.7)	6.4	80.4	(74.0)	94.9	99.6	(4.7)
Federal Grants	20.8	24.8	(4.0)	17.4	23.5	(6.1)	3.4	1.3	2.1
Operating Fund	18.3	15.9	2.4	1.5	1.3	0.2	16.8	14.6	2.2
Receipts Fund	2.2	2.7	(0.5)	3.0	2.0	1.0	(0.8)	0.7	(1.5)
Administration Account	19.8	22.1	(2.3)	3.1	2.9	0.2	16.7	19.2	(2.5)
Other Funds	45.0	43.1	1.9	3.4	3.5	(0.1)	41.6	39.6	2.0
Total	$ 274.2	$ 353.7	$ (79.5)	$ 46.1	$ 123.0	$ (76.9)	$ 228.1	$ 230.7	$ (2.6)

Comparison of Statement of Revenues, Expenditures and
Changes in Fund Balances
(in millions)

	Revenues			Expenditures			Other Financing Sources and Lapsed Appropriations			Net Change in Fund Balance		
	2008	2007	Change	2008	2007	Change	2008	2007	Change	2008	2007	Change
General Fund	$ 1.3	$ 1.2	$ 0.1	$ 1.0	$ 1.0	$ -	$ (.2)	$ (.2)	$ -	$ 0.1	$ -	$ 0.1
General Loan Fund	-	-	-	-	4.2	(4.2)	(0.3)	0.0	(0.3)	(0.3)	(4.2)	3.9
Trust Fund	73.4	28.5	44.9	128.1	97.8	30.3	50.0	30.0	20.0	(4.7)	(39.3)	34.6
Federal Grants	13.0	5.9	7.1	10.9	5.9	5.0	-	-	-	2.1	-	2.1
Operating Fund	0.5	0.6	(0.1)	11.1	9.1	2.0	12.8	6.1	6.7	2.2	(2.4)	4.6
Receipts Fund	4.7	6.7	(2.0)	-	-	-	(6.2)	(5.7)	(0.5)	(1.5)	1.0	(2.5)
Administration Account	11.3	10.4	0.9	31.7	6.2	25.5	17.9	1.2	16.7	(2.5)	5.4	(7.9)
Other Funds	3.4	4.0	(0.6)	1.7	11.1	(9.4)	0.3	(1.6)	1.9	2.0	(8.7)	10.7
Total	$ 107.6	$ 57.3	$ 50.3	$ 184.5	$ 135.3	$ 49.2	$ 74.3	$ 29.8	$ 44.5	$ (2.6)	$ (48.2)	$ 45.6

Overall, the assets for the Department decreased by $79.5 million, liabilities decreased by $76.9 million, and fund balance decreased by $2.6 million.

Budgetary Highlights

Actual expenditures in the General Fund were less than budgetary estimates by $214,063 or 18.7%. The favorable variance was created by expenditure control measures.

In the Hawaiian Home Administration Account, the actual revenue exceeded the budgeted amount by $1.7 million and expenditures were $1.0 million less than the budgeted amount. The favorable variances were created by increased general lease collections and spending cuts.

Capital Asset and Debt Administration

Capital Assets
At the end of fiscal year 2008, the Department had invested $609.1 million in a broad range of capital assets, including land, building and improvements, furniture and equipment, and infrastructure. This amount represents a net increase (including additions, deductions and reclassifications) of $98.9 million, or 19.4%, over last year.

Capital Assets
(in millions)

	2008	2007 (restated)	Increase (Decrease)
Buildings and improvements	$ 27.8	$ 11.9	$ 15.9
Furniture and equipment	6.1	1.6	4.5
Motor vehicles	0.9	0.8	0.1
Infrastructure	357.6	306.0	51.6
Total depreciable assets	392.4	320.3	72.1
Less: Accumulated depreciation	(115.3)	(104.8)	(10.5)
Net depreciable assets	277.1	215.5	61.6
Land	41.8	40.0	1.8
Construction in progress	174.9	149.9	25.0
Total capital assets	$ 493.8	$ 405.4	$ 88.4

In fiscal year 2008, the Department expended $101.9 million for various capital projects, including $20 million for the Keokea/Waiohuli development, $24 million for the Kaupea development, and $23 million for the Department's Kapolei headquarters. In 2009, the Department raised approximately $42.5 million from the issuance of its revenue bonds. The bond proceeds will be used to finance additional capital projects and residential home developments.

Long-Term Debt

In 2008, the Department entered into a long-term capital lease of $24.5 million, which requires the Department to make semi-annual payments until 2031. The Department also has a note payable to reimburse the Housing and Community Development Corporation of Hawaii for infrastructure costs over a 15-year period. The Department is also obligated to repay a portion of the State general obligation bonds issued on the Department's behalf through reimbursable general obligation bonds. The total obligation is $0.8 million and will be paid in full through fiscal year 2018.

Outstanding Debt
(In thousands)

	2008	2007	Increase (Decrease)
Purchase note payable	$ 24.2	$ 26.4	$ (2.2)
Capital lease obligation	24.5	-	24.5
General obligation bonds	0.8	0.9	(0.1)
Total	$ 49.5	$ 27.3	$ 22.2

Economic Factors and Next Year's Budgets

In the 2008 – 2009 budget, the general fund appropriation is $0.9 million and reflects a decrease of $0.4 million, or 44% from fiscal year 2008.

Revenues generated from general leases, revocable permits, licenses and right of entry agreements are projected to total $9.8 million. This represents a decrease of 5.8% from the prior fiscal year projection. The decrease is primarily due to the downturn in the local economy.

Currently Known Facts or Decisions

The Department's five goals include providing every qualified beneficiary an opportunity for a homestead lease, providing the necessary tools for long-term homeownership, improving overall operational efficiency, attaining financial self-sufficiency, and effectively managing and protecting the trust.

State of Hawaii
Department of Hawaiian Home Lands
Statement of Net Assets
June 30, 2008

Assets	
Equity in cash and cash equivalents held in State Treasury	$ 185,902,918
Cash and short-term investments held outside of State Treasury	1,038,601
Investments	15,962,546
Receivables	
Due from State	6,864,831
Loans, net of allowance for losses of $7,790,557	55,673,533
Accrued interest	2,945,468
General leases and licenses, net of allowance for losses of $1,044,144	814,311
Other	1,106,342
Inventory of homes for sale and development	1,515,906
Other assets	2,325,496
Capital assets, net	493,825,823
Total assets	$ 767,975,775
Liabilities	
Vouchers and contracts payable	$ 7,926,056
Accrued wages and employee benefits payable	728,462
Advances of Federal grant funds	16,989,440
Interest payable	174,941
Other liabilities	16,857,220
Deferred revenue	2,661,824
Due within one year	
Purchase note payable	2,200,000
Bonds payable	265,000
Accrued vacation	498,178
Due in more than one year	
Purchase note payable	22,000,000
Capital lease obligation	24,500,000
Bonds payable	537,942
Accrued vacation	1,133,053
Total liabilities	96,472,116
Commitments and contingencies	
Net Assets	
Invested in capital assets, net of related debt	444,322,881
Restricted for	
Capital projects	69,943,754
Loans	56,055,663
Guaranteed and insured loans	11,000,100
Unrestricted	90,181,261
Total net assets	671,503,659
Total liabilities and net assets	$ 767,975,775

The accompanying notes are an integral part of the financial statements.

State of Hawaii
Department of Hawaiian Home Lands
Statement of Activities
Year Ended June 30, 2008

Functions/Programs	Program Expenses	Program Revenue: Charges for Services	Program Revenue: Operating Grants and Contributions	Net (Expense) Revenue and Changes in Net Assets
Administration and support services	$ 13,399,814	$ 4,142,210	$ 5,428,372	$ (3,829,232)
Homestead services	15,964,319	3,951,037	3,515	(12,009,767)
Land development	4,274,510	4,102,478	7,465,071	7,293,039
Home construction	58,561,248	65,456,071	-	6,894,823
Land management	1,868,177	12,261,229	-	10,393,052
Total governmental activities	$ 94,068,068	$ 89,913,025	$ 12,896,958	8,741,915
General revenues				
State appropriations, net of lapsed appropriations of $228,026				3,967,740
Transfers, net				50,000,000
Total general revenues and transfers				53,967,740
Change in net assets				62,709,655
Net assets at July 1, 2007, as previously reported				632,084,145
Prior period adjustment				(23,290,141)
Net assets at July 1, 2007, as restated				608,794,004
Net assets at June 30, 2008				$ 671,503,659

The accompanying notes are an integral part of the financial statements.

State of Hawaii
Department of Hawaiian Home Lands
Balance Sheet
Governmental Funds
June 30, 2008

	General Fund	Hawaiian Home General Loan Fund	Hawaiian Home Land Trust Fund	Hawaiian Home Operating Fund	Hawaiian Home Receipts Fund	Hawaiian Home Administration Account	Federal Grants	Other Funds	Total
Assets									
Equity in cash and cash equivalents held in State Treasury	$ -	$ 14,510,318	$ 99,268,261	$ 18,180,614	$ 2,509	$ 18,635,213	$ 27,718	$ 35,278,285	$ 185,902,918
Cash and short-term investments held outside of State Treasury	-	-	-	-	-	11,707	1,026,894	-	1,038,601
Investments	-	-	-	-	-	-	15,962,546	-	15,962,546
Receivables									
Due from State	447,655	-	-	-	-	-	-	6,417,176	6,864,831
Loans, net of allowance for losses of $7,790,557	-	49,206,028	-	-	-	-	3,413,374	3,054,131	55,673,533
Accrued interest	-	-	553,130	22,093	2,175,648	92,975	3,263	98,359	2,945,468
General leases and licenses, net of allowance for losses of $1,044,144	-	-	-	10,740	-	803,571	-	-	814,311
Other	-	404,515	-	88,564	-	232,292	380,971	-	1,106,342
Inventory of homes for sale and development	-	-	1,515,906	-	-	-	-	-	1,515,906
Other assets	-	2,229,360	-	-	-	-	-	96,136	2,325,496
Total assets	$ 447,655	$ 66,350,221	$ 101,337,297	$ 18,302,011	$ 2,178,157	$ 19,775,758	$ 20,814,766	$ 44,944,087	$ 274,149,952
Liabilities									
Vouchers and contracts payable	$ 200,000	$ 116,270	$ 6,390,506	$ 583,229	$ -	$ 142,182	$ 461,738	$ 32,131	$ 7,926,056
Accrued wages and employee benefits payable	27,190	-	-	361,099	-	340,173	-	-	728,462
Advances of Federal grant funds	-	-	-	-	-	-	16,989,440	-	16,989,440
Other liabilities	-	10,996,780	-	121,192	2,388,959	-	-	3,350,289	16,857,220
Deferred revenue	-	-	-	420,987	538,500	2,582,237	-	-	3,541,724
Total liabilities	227,190	11,113,050	6,390,506	1,486,507	2,927,459	3,064,592	17,451,178	3,382,420	46,042,902
Commitments and contingencies									
Fund Balances									
Reserved for									
Encumbrances	324,945	-	69,943,754	8,512,279	-	1,860,097	-	7,928,229	88,569,304
Receivables	-	49,206,028	-	-	-	-	3,797,608	3,152,490	56,156,126
Loan commitments	-	1,819,541	-	-	-	-	-	-	1,819,541
Unexpended Federal grants	-	-	-	-	-	-	7,591,552	-	7,591,552
Guaranteed and insured loans	-	150,000	-	-	-	-	-	10,850,100	11,000,100
Total reserved fund balances	324,945	51,175,569	69,943,754	8,512,279	-	1,860,097	11,389,160	21,930,819	165,136,623
Unreserved	(104,480)	4,061,602	25,003,037	8,303,225	(749,302)	14,851,069	(8,025,572)	17,290,840	60,630,419
Unreserved, reported in nonmajor Construction funds	-	-	-	-	-	-	-	2,340,008	2,340,008
Total unreserved fund balances (deficit)	(104,480)	4,061,602	25,003,037	8,303,225	(749,302)	14,851,069	(8,025,572)	19,630,848	62,970,427
Total fund balances (deficit)	220,465	55,237,171	94,946,791	16,815,504	(749,302)	16,711,166	3,363,588	41,561,667	228,107,050
Total liabilities and fund balances	$ 447,655	$ 66,350,221	$ 101,337,297	$ 18,302,011	$ 2,178,157	$ 19,775,758	$ 20,814,766	$ 44,944,087	$ 274,149,952

The accompanying notes are an integral part of the financial statements.

State of Hawaii
Department of Hawaiian Home Lands
Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets
June 30, 2008

Total fund balances – governmental funds		$ 228,107,050
Amounts reported for governmental activities in the statement of net assets are different because		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. These assets consists of:		
Infrastructure assets	$ 357,636,286	
Construction-in-progress	174,864,333	
Land	41,824,225	
Other capital assets	34,869,307	
Accumulated depreciation	(115,368,328)	
		493,825,823
Other assets are not available to pay for current-period expenditures and therefore, are deferred, or not recognized, in the funds.		879,900
Accrued interest payable is not recognized in governmental funds.		(174,941)
Some long-term liabilities are not due and payable in the current period and therefore are not reported in the funds, including:		
Purchase note payable		(24,200,000)
Capital lease obligation		(24,500,000)
Bonds payable		(802,942)
Accrued vacation		(1,631,231)
Net assets of governmental activities		$ 671,503,659

The accompanying notes are an integral part of the financial statements.

State of Hawaii
Department of Hawaiian Home Lands
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
Year Ended June 30, 2008

	General Fund	Hawaiian Home General Loan Fund	Hawaiian Home Land Trust Fund	Hawaiian Home Operating Fund	Hawaiian Home Receipts Fund	Hawaiian Home Administration Account	Federal Grants	Other Funds	Total
Revenues									
State appropriations	$ 1,320,434	$ -	$ -	$ 332	$ -	$ -	$ -	$ 2,875,000	$ 4,195,766
General leases	-	-	-	-	-	7,417,184	-	-	7,417,184
Licenses and permits	-	-	-	-	-	3,541,175	-	-	3,541,175
Interest from loans and note receivable	-	-	-	142,293	4,003,412	-	-	-	4,145,705
Interest from short-term investments	-	-	1,690,067	21,550	732,907	283,953	41,415	275,165	3,045,057
Intergovernmental revenues	-	-	5,675,373	-	-	-	12,896,958	-	18,572,331
Real property sold	-	-	65,456,071	-	-	-	-	-	65,456,071
Other	-	-	594,474	291,727	-	48,323	34,563	269,473	1,238,560
Total revenues	1,320,434	-	73,415,985	455,902	4,736,319	11,290,635	12,972,936	3,419,638	107,611,849
Expenditures									
Current									
Administration and support services	387,611	-	556,251	4,786,297	-	27,751,263	422,718	1,193,605	35,097,745
Homestead services	393,852	53,184	-	2,168,578	-	2,227,480	48,430	-	4,891,524
Land development	87,072	-	1,359,768	1,678,473	-	1,013,875	-	122,719	4,261,907
Land management	59,579	-	-	684,109	-	658,670	-	395,000	1,797,358
Capital outlay									
Home construction/capital projects	-	-	126,172,845	1,655,974	-	-	10,473,005	-	138,301,824
Debt service									
Principal	-	-	-	62,793	-	-	-	-	62,793
Interest	-	-	-	19,385	-	-	-	-	19,385
Total expenditures	928,114	53,184	128,088,864	11,055,609	-	31,651,288	10,944,153	1,711,324	184,432,536
Excess (deficiency) of revenues over (under) expenditures	392,320	(53,184)	(54,672,879)	(10,599,707)	4,736,319	(20,360,653)	2,028,783	1,708,314	(76,820,687)
Other financing sources (uses)									
Other financing source – capital lease	-	-	-	-	-	24,500,000	-	-	24,500,000
Transfers in	-	-	50,000,000	18,496,178	-	5,144,995	-	265,418	73,906,591
Transfers out	-	(262,918)	-	(5,700,000)	(6,189,032)	(11,752,500)	-	(2,141)	(23,906,591)
Total other financing sources (uses)	-	(262,918)	50,000,000	12,796,178	(6,189,032)	17,892,495	-	263,277	74,500,000
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	392,320	(316,102)	(4,672,879)	2,196,471	(1,452,713)	(2,468,158)	2,028,783	1,971,591	(2,320,687)
Lapsed appropriations	(228,026)	-	-	-	-	-	-	-	(228,026)
Net change in fund balances	164,294	(316,102)	(4,672,879)	2,196,471	(1,452,713)	(2,468,158)	2,028,783	1,971,591	(2,548,713)
Fund balances at July 1, 2007	56,171	55,553,273	99,619,670	14,619,033	703,411	19,179,324	1,334,805	39,590,076	230,655,763
Fund balances (deficit) at June 30, 2008	$ 220,465	$ 55,237,171	$ 94,946,791	$ 16,815,504	$ (749,302)	$ 16,711,166	$ 3,363,588	$ 41,561,667	$ 228,107,050

The accompanying notes are an integral part of the financial statements.

State of Hawaii
Department of Hawaiian Home Lands
Reconciliation of the Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balances to the Statement of Activities
Year Ended June 30, 2008

Net change in fund balances – governmental funds		$ (2,548,713)
Amounts reported for governmental activities in the statement of activities are different because:		
Capital outlays are reported as expenditures in governmental funds, however in the statement of activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense.		
In the current period, these amounts are:		
Capital outlay	$ 101,942,543	
Depreciation expense	(12,019,330)	
Loss on disposal	(1,513,512)	
Excess of capital outlay over depreciation expense and loss on disposal		88,409,701
Payment of note payable is reported as an expenditure in governmental funds, but the payment reduces note payable in the statement of net assets.		2,200,000
Repayment of bond principal is reported as an expenditure in governmental funds, but the repayment reduces bonds payable in the statement of net assets.		62,793
The net increase in accrued vacation is reported in the statement of activities and does not require the use of current financial resources and therefore is not reported as expenditures in governmental funds.		(133,085)
Interest payments associated with long term obligations do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.		(174,941)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues and are deferred in the governmental funds.		(606,100)
The capital lease obligation is reported as other financing sources in the governmental funds, but is reported as a liability in the statement of net assets.		(24,500,000)
Change in net assets of governmental activities		$ 62,709,655

The accompanying notes are an integral part of the financial statements.

State of Hawaii
Department of Hawaiian Home Lands
Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis)
General Fund
Year Ended June 30, 2008

	Budgeted Amounts		Actual (Budgetary Basis)	Variance Over (Under)
	Original	Final		
State appropriations	$ 1,107,562	$ 1,146,114	$ 1,320,434	$ 174,320
Expenditures				
Administration and support services	470,652	480,155	389,715	90,440
Homestead services	520,845	544,375	397,262	147,113
Land development	54,063	56,677	86,685	(30,008)
Land management	62,002	64,907	58,389	6,518
Total expenditures	1,107,562	1,146,114	932,051	214,063
Excess of revenues over expenditures	$ -	$ -	$ 388,383	$ 388,383

The accompanying notes are an integral part of the financial statements.

State of Hawaii
Department of Hawaiian Home Lands
Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis)
Other Major Funds
Year Ended June 30, 2008

	Budgeted Amounts		Actual	Variance
	Original	Final	(Budgetary Basis)	Over (Under)
Hawaiian Home Administration Account				
Revenues	$ 9,417,240	$ 9,570,670	$ 11,290,635	$ 1,719,965
Expenditures				
Administration and support services	4,277,035	4,332,887	4,615,198	(282,311)
Homestead services	2,875,529	2,928,221	2,226,501	701,720
Land development	1,396,522	1,425,793	1,003,349	422,444
Land management	868,154	883,769	745,609	138,160
Total expenditures	9,417,240	9,570,670	8,590,657	980,013
Excess of revenues over expenditures	$ -	$ -	$ 2,699,978	$ 2,699,978

The accompanying notes are an integral part of the financial statements.

1. Organization and Summary of Significant Accounting Policies

Financial Reporting Entity

The State of Hawaii, Department of Hawaiian Home Lands (the "Department"), is headed by the Hawaiian Homes Commission. The Department was established by Section 24, of Act 1 (the Hawaii State Government Reorganization Act of 1959), Second Special Session Laws of Hawaii 1959, and is responsible for the administration of the Hawaiian Homes Commission Act of 1920 enacted by the United States Congress. The Hawaiian Homes Commission Act ("HHCA") sets aside certain public lands as Hawaiian Home Lands to be utilized in the rehabilitation of native Hawaiians. The financial statements include the public trusts controlled by the Hawaiian Homes Commission.

The Department is part of the executive branch of the State of Hawaii (the "State"). The Department's financial statements are intended to present the financial position and the changes in financial position, of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the Department. The State Comptroller maintains the central accounts for all State funds and publishes financial statements for the State annually which includes the Department's assets, liabilities, net assets and financial activities.

The accompanying financial statements of the Department have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") for state and local governments as prescribed by the Governmental Accounting Standards Board ("GASB").

Department-wide Financial Statements

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

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges to customers who purchase, use or directly benefit from goods or services provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function.

Appropriations and other items not properly included among program revenues are reported instead as general revenues. Resources that are dedicated internally are reported as general revenues rather than as program revenues.

Net assets are restricted when constraints placed on them are either externally imposed or are imposed by constitutional provisions or enabling legislation.

Governmental Fund Financial Statements
The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Department considers revenues to be available if they are collected within 60 days of the end of the current fiscal year end. Principal revenue sources considered susceptible to accrual include lease payments, sales, federal grants and interest on loans and investments, and interest receivable. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditure, as well as expenditures related to compensated absences, are recorded only when payment is due.

Internally imposed designations of resources are presented as reserves of fund balances. Portions of fund balances are reserved for the following:

- *Encumbrances* – recorded obligations in the form of purchase orders or contracts.
- *Receivables* – amounts owed to the Department at year end and are shown as reserved to indicate that a portion of the fund balance is not available for funding current expenditures.
- *Loan commitments* – loans approved before year end but funded after year end.
- *Unexpended federal grants* – encumbrances of federal awards not yet received from the federal government.
- *Guaranteed and insured loans* – amounts designated to pay mortgage guarantees and insurance claims.

Unreserved fund balances represents resources that have not been internally designated.

Fund Accounting
The accounts of the Department are organized on the basis of funds, each of which is considered a separate accounting entity. The financial activities of each fund are accounted for with a separate set of self-balancing accounts which represent each fund's assets, liabilities, fund equity, revenues and expenditures.

The financial activities of the Department that are reported in the accompanying governmental fund financial statements have been classified into the following major governmental funds:

General fund – The general fund is used to account for all financial resources except those required to be accounted for in another fund. The annual operating budget as authorized by the State Legislature provides the basic framework within which the resources and obligations of the general fund are accounted for.

Special revenue funds – Special revenue funds are used to account for proceeds of specific revenue sources that are restricted to expenditures for specified purposes. Revenues are primarily from general leases, licenses and permits granted for commercial, residential, agricultural and pastoral uses, and interest and investment income. The Department's major special revenue funds are as follows:

- *Hawaiian Home General Loan Fund* – The Hawaiian Home General Loan Fund is used to account for Department loans made to native Hawaiian homesteaders.
- *Hawaiian Home Land Trust Fund* – The Hawaiian Home Land Trust Fund accounts for funds from the State to be expended by the Department, as provided by law upon approval by the Commission and used for capital improvements and other purposes undertaken in furtherance of the Hawaiian Homes Commission Act of 1920.
- *Hawaiian Home Operating Fund* – The Hawaiian Home Operating Fund is used to account for operations of the Department and is funded by monies transferred from the Hawaiian Home Receipts Fund.
- *Hawaiian Home Receipts Fund* – The Hawaiian Home Receipts Fund is used to account for receipts of investment interest and loan interest payments from the Department loans to homesteaders.
- *Hawaiian Home Administration Account* – The Hawaiian Home Administration Account is used to account for commercial general leases, revocable permits and licenses of homestead lands. Lease revenues are used to fund operations of the Department.
- *Federal Grants* – The Federal Grants fund is used to account for grants the Department has with the Federal Government.

Appropriations
An authorization granted by the State Legislature permitting a State agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are allotted quarterly. The allotted appropriations lapse if not expended by or encumbered at the end of the fiscal year, except for allotted appropriations related to capital projects.

Encumbrances
Encumbrance accounting, under which purchase orders, contracts and other commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation, is employed as an extension of formal budgetary integration in the governmental fund types. Encumbrances outstanding at fiscal year end are reported as reservations of fund balances, since they do not constitute expenditures or liabilities.

Equity in Cash and Cash Equivalents Held in State Treasury
The State Director of Finance is responsible for the safekeeping of cash in the State Treasury in accordance with State laws. The Director of Finance may invest any monies of the State, which in the Director's judgment, are in excess of the amounts necessary for meeting the immediate requirements of the State. Effective August 1, 1999, cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or in the State Treasury Investment Pool System. Funds in the investment pool accrue interest based on the average weighted cash balances of each account.

The State requires that depository banks pledge as collateral, government securities held in the name of the State for deposits not covered by federal deposit insurance.

GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, requires disclosures over common deposit and investment risks related to credit risk, interest rate risk, and foreign currency risk. Investments can be categorized by type, maturity and custodian to determine the level of interest rate, credit and custodial risk assumed by the Department. However, as these funds are held in the State cash pool, the Department does not manage these investments and the types of investments and related interest rate, credit, and custodial risks are not determinable at the Department level. The risk disclosures of the State's cash pool are included in the State's Comprehensive Annual Financial Report ("CAFR") for the fiscal year ended June 30, 2008. The State's CAFR can be found at the Department of Accounting and General Services' ("DAGS") website: http://hawaii.gov/dags/rpts.

Cash and short-term investments held outside of State Treasury are held in a financial institution in the State of Hawaii. At June 30, 2008, the depository bank had pledged investment securities with an approximate aggregate market value of $9,030,000 as collateral on certain of these deposits.

In April 2009, DAGS issued Comptroller's Memorandum No. 2009-11, informing state agencies participating in the State Treasury investment pool that the State's investments in auction rate securities were impaired as of and for the year ended June 30, 2008 and that each participating State agency would be allocated a portion of the impairment. The Department's total allocated impairment loss for fiscal 2008 amounted to $6,526,624.

Due from State
The State Director of Finance is responsible for the safekeeping of all cash in the State Treasury in accordance with State laws. Currently, separate accounts are not maintained in the State Treasury for the Department's general operating and capital appropriations. Although these appropriations are available to the Department to expend, custody and ownership of the funds remains with the State. Unspent general and capital appropriations that continue to be available to the Department for expenditure at the end of the fiscal year are reported as due from state in the accompanying fund and department-wide financial statements.

Investments
The Department invests advances received from the Native Hawaiian Housing Block Grant in obligations of the U.S. Government. The investments are carried at fair value and are valued at the last reported sale price on the last business day of the year or at the last bid price if no sale was reported on that date. Unrealized gains and losses are considered grant program income and must be used in the Native Hawaiian Housing Grant Program and is therefore recorded as advances from Federal Grants.

Inventory of Homes for Sale and Development
Inventory of homes for sale and development are stated at the lower of cost or estimated net realizable value and includes the costs of land development and home construction, capitalized interest, real estate taxes, and direct overhead costs incurred during development and home construction.

Intrafund and Interfund Transactions
Significant transfers of financial resources between activities and appropriations included within the same fund are eliminated. Transfers of revenues from funds authorized to receive them to funds authorized to expend them have been recorded as operating transfers in the financial statements.

All interfund transfers are reflected in the governmental fund financial statements but are eliminated in the departmental financial statements.

Capital Assets
Capital assets, which include land, buildings, improvements, equipment and infrastructure assets, are reported in the departmental financial statements. The capitalization thresholds are $5,000 for equipment, and $100,000 for infrastructure, and buildings and improvements with estimated useful lives of greater than one year. Maintenance and repairs are charged to operations when incurred. Purchased and constructed capital assets are valued at historical cost or estimated historical cost. Donated fixed assets are recorded at their fair market value at the date of donation.

Capital assets are depreciated on the straight-line method over the assets' estimated useful life. Generally, estimated useful lives are as follows:

Machinery and equipment	5 – 7 years
Vehicles	5 years
Buildings and improvements	15 – 40 years
Infrastructure	30 years

A portion of the Department's monthly base rent is paid by the Department of Accounting and General Services, State of Hawaii.

The Department also has land in various parts of the State, some of which were transferred to it at no cost or at nominal cost.

Accumulated Vacation and Sick Leave
Vacation pay is accrued as earned by employees. Vacation pay can accumulate at the rate of one and three-quarters working days for each month of service up to 720 hours at calendar year-end and is convertible to pay upon termination of employment. As accrued vacation does not require the use of current financial resources, it is not reported in the governmental funds balance sheet.

Sick leave accumulates at a rate of one and three-quarter days for each month of service without limit, but may be taken only in the event of illness or other incapacitation and is not convertible to pay upon termination of employment. Accordingly, accumulated sick leave is not included in the Department's statement of net assets or governmental fund balance sheet. However, an employee who retires or leaves government service in good standing with sixty days or more in unused sick leave is entitled to additional service credit in the Employees' Retirement System of the State of Hawaii ("ERS"). Accumulated sick leave as of June 30, 2008, was approximately $4,705,000.

General Leases and Licenses
General leases and licenses received in advance are recognized on a straight-line basis over the lease or license term.

Lease Rents and Interest Income
The Department's governmental fund financial statement recognizes lease rent and mortgage interest of its governmental funds as revenues when they are measurable and available. The available criterion is satisfied when revenues are collectible during the period or soon enough thereafter to pay liabilities of the current period. Amounts not collected within 60 days after the end of the year approximated $879,900 as of June 30, 2008, and are recorded as deferred

revenue. The departmental financial statements present lease rents and mortgage interest under the accrual method of accounting.

Use of Estimates
In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

New Accounting Pronouncements
In March 2009, the GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions.* This Statement provides clearer fund balance classifications that can be more consistently applied and clarifies the existing governmental fund type definitions. This Statement also establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds and provides for additional classifications such as restricted, committed, assigned, and unassigned fund balance. The provisions of this Statement are effective for the fiscal year beginning after June 15, 2010.

Fund balance reclassifications made to conform to the provisions of this Statement will be applied retroactively by restating the fund balance for all prior periods presented.

In April 2009, the GASB issued Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments.* The objective of this Statement is to identify the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of state and local governmental entities that are presented in conformity with GAAP. The requirements of this Statement became effective upon its issuance and did not materially impact the Department's financial statements.

2. Budgeting and Budgetary Control

The Department's annual budget is prepared on the cash basis utilizing encumbrance accounting. Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated throughout the fiscal year. Amounts reflected by the Department as budgeted revenues are those estimates as compiled by the State Director of Finance. Budgeted expenditures for the Department's general fund, and the Hawaiian Homes Administration Account, a special revenue fund, are provided to the Department of Budget and Finance, State of Hawaii, for accumulation with budgeted amounts of the other State agencies and included in the Governor's executive budget that is subject to legislative approval. In addition, the budget for all expenditures of the Department's funds is also presented annually to the Hawaiian Homes Commission for approval.

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

For purposes of budgeting, the Department's budgetary fund structure and accounting principles differ from those utilized to present the financial statements in conformity with accounting principles generally accepted in the United States of America. Since the budgetary basis differs from accounting principles generally accepted in the United States of America, budget and actual amounts in the statement of revenues and expenditures – budget and actual – general fund, are presented on the budgetary basis. A reconciliation of general fund revenues in excess of expenditures on a budgetary basis for the year ended June 30, 2008, to general fund revenues in excess of expenditures presented in conformity with accounting principles generally accepted in the United States of America, is set forth below.

Under Section 78-13 Hawaii Revised Statutes ("HRS"), staff salaries and wages amounting to approximately $27,000 and $17,000 in the general fund and Hawaiian Home Administration Account, respectively, for the period from June 16, 2008 through June 30, 2008, are to be funded with monies budgeted for fiscal year 2009. Accordingly, these amounts are excluded from the statements of revenues and expenditures – budget and actual of the general fund and Hawaiian Home Administration Account, but are included in the departmental and governmental fund financial statements in accordance with accounting principles generally accepted in the United States of America.

Salaries and wages amounting to approximately $31,000 and $286,000 in the general fund and Hawaiian Home Administration Account, respectively, for the period from June 16, 2007 to June 30, 2007, were funded with monies budgeted for fiscal year 2008. Accordingly, these amounts are included in the statements of revenues and expenditures – budget and actual of the general fund and Hawaiian Home Administration Account, for the year ended June 30, 2008.

The following schedule reconciles the budgetary amounts of the general fund and the Hawaiian Home Administration Account to the amounts presented in accordance with accounting principles generally accepted in the United States of America (GAAP basis).

	General Fund	Hawaiian Home Administration Account
Excess of revenues over expenditures – actual on budgetary basis	$ 388,383	$ 2,699,978
Current year's appropriations included in reserved for encumbrances at June 30, 2008	-	346,718
Expenditures for liquidation of prior year's encumbrances	-	(277,458)
Allowance for losses adjustment	-	9,000
Unbudgeted expenditures recognized in connection with a capital lease	-	(23,065,942)
Fiscal 2007 expenditures funded by fiscal 2008 budget	31,121	285,989
Fiscal 2008 expenditures funded by fiscal 2009 budget under Section 78-13 HRS	(27,184)	(358,938)
Excess (deficiency) of revenues over (under) expenditures – GAAP basis	$ 392,320	$ (20,360,653)

3. Cash and Investments

Equity in cash and cash equivalents include monies in the State Treasury. For financial statement reporting purposes, cash and cash equivalents consist of cash, time certificates of deposit, money market accounts, repurchase agreements and U.S. government securities with original maturities of three months or less.

The Department maintains advances from the Native Hawaiian Housing Block Grant in cash held outside of the State Treasury through a financial institution in the State of Hawaii. At June 30, 2008, the carrying balance of the Department's cash outside of the State Treasury aggregated $1,038,601, which exceeds federal deposit insurance limits. Accordingly, these deposits were exposed to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the Department's deposits may not be returned to it.

Investments in obligations of the U.S. government mature at various dates through August 2009. At June 30, 2008, the securities had an original cost of $15,938,759, fair value of $15,962,546 and a net unrealized gain of $23,787. Income from the investments is considered grant program income and must be used in the Native Hawaiian Housing Program and is therefore recorded as amounts due to other governments.

4. Loans Receivable

Loans receivable consist of approximately 1,400 loans made to native Hawaiian lessees for the purposes specified in the Hawaiian Homes Commission Act. Loans are for a maximum amount of approximately $235,000 and for a maximum term of 30 years. Loan payments expected to be collected within the next fiscal year approximates $1,600,000. Interest rates on outstanding loans range from 2.5% to 10.0%. The Department's loan portfolio consists of loans that the Department has originated and that generally are collateralized by improvements on the leased properties located in the State. Loan commitments as of June 30, 2008 were approximately $1,820,000. The Department has provided an allowance for loan losses of approximately $7,791,000 as of June 30, 2008. The allowance for loan losses is a valuation reserve, which has been provided through charges to operations. The reserve is based on management's assessment of loan balances deemed uncollectible as of June 30, 2008.

5. Inventory of Homes for Sale and Development

As of June 30, 2008, the Department constructed and sold a total of 356 homes for sale to native Hawaiians in various locations throughout Hawaii. As of June 30, 2008, the Department reflected development costs for a new project of $1,515,906.

Under certain circumstances, the Department purchases homes from former lessees due to voluntary and involuntary cancellations of land leases. The homes are subsequently resold to qualified lessees. During the year ended June 30, 2008, the Department had purchased homes from former lessees with costs aggregating $955,000.

6. Capital Assets

Capital assets activity for the year ended June 30, 2008, was as follows:

	Balance July 1, 2007 (restated)	Additions	Disposals / Transfers	Balance June 30, 2008
Capital assets, not being depreciated				
Land	$ 40,004,470	$ 1,819,755	$ -	$ 41,824,225
Construction in progress	149,901,225	72,179,803	(47,216,695)	174,864,333
Total capital assets, not being depreciated	189,905,695	73,999,558	(47,216,695)	216,688,558
Capital assets, being depreciated				
Buildings and improvements	11,905,029	18,144,614	(2,245,867)	27,803,776
Infrastructure	305,972,092	52,059,435	(395,241)	357,636,286
Furniture and equipment	1,589,618	4,854,380	(295,253)	6,148,745
Motor vehicles	815,535	101,251	-	916,786
Total capital assets, being depreciated	320,282,274	75,159,680	(2,936,361)	392,505,593
Less: Accumulated depreciation for				
Buildings and improvements	(4,072,208)	(568,130)	1,075,866	(3,564,472)
Infrastructure	(98,489,386)	(11,014,383)	46,111	(109,457,658)
Furniture and equipment	(1,542,072)	(371,823)	300,872	(1,613,023)
Motor vehicles	(668,181)	(64,994)	-	(733,175)
Total accumulated depreciation	(104,771,847)	(12,019,330)	1,422,849	(115,368,328)
Total capital assets, being depreciated, net	215,510,427	63,140,350	(1,513,512)	277,137,265
Capital assets, net	$ 405,416,122	$ 137,139,908	$ (48,730,207)	$ 493,825,823

Depreciation expense for the year ended June 30, 2008, were charged to functions of the Department as follows:

Administration and support services	$ 1,003,682
Homestead services	11,015,648
Total depreciation	$ 12,019,330

7. Due to State Treasury

In October 2006, the Department received a temporary, non-interest bearing loan from the State of Hawaii in the amount of $80,000,000, pursuant to HRS Section 36-24. The loan funds were used for home construction and the balance in the Hawaiian Home Land Trust Fund was paid off in January 2008.

As of June 30, 2008, the Department reflected a payable of approximately $2,209,000 to the State of Hawaii, which primarily represented a negative equity in cash and cash equivalents held in State Treasury of the Hawaiian Home Receipts Fund in the State Treasury investment pool. Accordingly, this amount has been recognized as other liabilities.

8. Long-Term Obligations

For the year ended June 30, 2008, changes in long-term obligations were as follows:

	Purchase Note Payable	Capital Lease Obligation	Bonds Payable	Accrued Vacation
Balances at July 1, 2007	$ 26,400,000	$ -	$ 865,735	$ 1,498,146
Increase	-	24,500,000	-	1,515,310
Decrease	(2,200,000)	-	(62,793)	(1,382,225)
Balances at June 30, 2008	$ 24,200,000	$ 24,500,000	$ 802,942	$ 1,631,231

Obligations for accrued vacation are generally liquidated by the general fund, the Hawaiian Home Operating Fund and the Hawaiian Home Administration Account.

9. Land Acquisition / Purchase Note Payable

In December 2004, the Department entered into a transfer agreement with the Housing and Community Development Corporation of Hawaii ("HCDCH"), State of Hawaii in connection with the acquisition of approximately 1,800 acres of land consisting of four properties on three islands, by the Department. A portion of the land is partially developed and is intended to be utilized for 3,500 homes for Native Hawaiians.

As part of the transfer agreement, the Department must pay $2.2 million a year for 15 years, for a total of $33 million, in the form of a note, to reimburse the Housing and Community Development Corporation of Hawaii, State of Hawaii, for infrastructure costs at three of the properties. This note is non-interest bearing. At June 30, 2008, the Department owed $24,200,000 to HCDCH. The note will be repaid with monies in the Department's Hawaiian Home Land Trust Fund. The annual payment requirements of the non-interest bearing note are as follows:

Year ending June 30,	
2009	$ 2,200,000
2010	2,200,000
2011	2,200,000
2012	2,200,000
2013	2,200,000
2014-2018	11,000,000
2019	2,200,000
	$ 24,200,000

10. Capital Lease Obligation

In December 2006, the Department entered into a 25-year facility lease agreement with Wells Fargo Bank, National Association (the "lessor"), to lease an office facility, which was constructed and completed in April 2008. The Department is required to make semi-annual interest-only payments through May 2009 and annual principal and interest payments beginning November 2009. Interest on the outstanding balance accrues at various rates throughout the term of the lease. At June 30, 2008, the interest rate was 2.19%. Upon expiration of the lease, the title of the facility will be transferred from the lessor to the Department. The following is a schedule by years of future minimum lease payments related to this agreement:

Year ending June 30,	
2009	$ 1,073,000
2010	1,710,000
2011	1,714,000
2012	1,711,000
2013	1,712,000
Thereafter	32,519,000
Total minimum lease payments	40,439,000
Amount representing interest	15,939,000
Present value of minimum lease payments	$ 24,500,000

The cost basis and accumulated depreciation of the leased assets at June 30, 2008 was as follows:

Cost	$ 23,065,942
Less: Accumulated depreciation	(624,326)
	$ 22,441,616

11. Bonds Payable

The following are portions of the State general obligation bonds allocated to the Department under acts of various Session Laws of Hawaii. These bonds are backed by the full faith, credit and taxing power of the State. Repayments of allocated bond debts are made to the State General Fund. Details of the allocated bonds as of June 30, 2008, are as follows:

$1,000,346 Series BW bonds dated March 1, 1992; $166,708 was refunded on February 15, 2002 and $112,089 was refunded on June 15, 2005; due in annual principal installments of $55,569 commencing March 1, 2006 through March 1, 2008 and $54,619 on March 1, 2011 and $55,569 on March 1, 2012; interest at 5.875% to 6.40% payable semi-annually.	$ 165,757
$124,303 Series BZ bonds dated October 1, 1992; $7,769 was refunded on April 1, 1998 and $23,307 was refunded on February 15, 2002; due in annual principal installments of $7,769 commencing October 1, 2005 through October 1, 2012; interest at 5.40% to 6.25% payable semi-annually.	38,844
$758,726 Series CI refunding bonds dated November 1, 1993; due in annual principal installments of $50,587 through November 1, 2003 and $50,575 through November 1, 2010; interest at 4.00% to 5.00% payable semi-annually.	151,726
$66,394 Series CH bonds dated November 1, 1993; $55,335 was refunded on October 1, 1997; due in annual principal installments of $3,689 through November 1, 2013; interest at 4.10% to 6.00% payable semi-annually.	22,128
$86,517 Series CO bonds dated March 1, 1997; $11,940 was refunded on April 1, 1998; due in semi-annual principal installments of $2,257 to $4,250 through March 1, 2011; interest at 4.50% to 6.00% payable semi-annually.	27,276
$321,472 Series CS refunding bonds dated April 1, 1998; due in annual principal installments of $45,740 to $53,074 from April 1, 2006 through April 1, 2009; interest at 5.00% to 5.25% payable semi-annually.	103,622
$65,992 Series CW refund bonds dated August 1, 2001; $2,118 was refunded on June 15, 2005; due in annual principal installments of $4,679 to $7,273 from August 1, 2005 to August 1, 2015; interest at 0.82% to 0.88% payable semi-annually.	49,249
$140,129 Series CY refunding bonds dated February 15, 2002; $680 was refunded on June 15, 2005; due in annual principal installments of $12,633 to $19,104 from February 1, 2007 through February 1, 2015; interest at 3.60% to 5.75% payable semi-annually.	126,816
$7,415 Series DB refunding bonds dated September 16, 2003; due in annual principal installments of $675 to $1,000 from September 1, 2008 through September 1, 2016; interest at 5.00% to 5.25% payable semi-annually.	7,415
$110,109 Series DG refunding bonds dated June 15, 2005; due in annual principal installments of $9,933 to $14,820 from July 1, 2009 through July 1, 2017; interest at 5.00% payable semi-annually.	110,109
	$ 802,942

The annual requirements of the general obligation bonds are as follows:

	Interest	Principal	Total
Year ending June 30,			
2009	$ 39,345	$ 265,339	$ 304,684
2010	19,527	100,052	119,579
2011	15,248	157,442	172,690
2012	8,816	101,175	109,991
2013	3,999	47,434	51,433
2014 – 2018	6,811	131,500	138,311
	$ 93,746	$ 802,942	$ 896,688

12. Retirement Benefits

Substantially all eligible employees of the Department are members of the Employees' Retirement System of the State of Hawaii ("ERS"), a cost-sharing, multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. All contributions, benefits and eligibility requirements are established by Chapter 88, HRS, and can be amended by legislative action.

The ERS is composed of a contributory retirement option and a noncontributory retirement option. Prior to July 1, 1984, the ERS 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 precluded 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 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 under the contributory and noncontributory options, respectively. Both options provide a monthly retirement allowance based on the employee's age, years of credited service and average final compensation ("AFC"). The AFC is the average salary earned during the five highest paid years of service including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date and prior to January 1, 2003, is based on the three highest paid years of service, excluding the vacation payment. Effective January 1, 2003, the AFC is the highest three calendar years or highest five calendar years plus lump sum vacation payment, highest three school contract years, or last 36 credited months or last 60 credited months plus lump sum vacation payment. Contributions for employees of the Department are paid from the State General Fund.

Most covered employees of the contributory option are required to contribute 7.8% of their salary. The funding method used to calculate the total employer contribution requirement is the entry age normal actuarial cost method. Effective July 1, 2005, employer contribution rates are a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability.

On July 1, 2006, a new hybrid contributory plan became effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan are eligible for retirement at age 62 with 5 years of credited service or age 55 and 30 years of credited service. Members will receive a benefit multiplier of 2% for each year of credited service in the hybrid plan. The benefit payment options are similar to the current contributory plan. Almost 58,000 members, all members of the noncontributory plan and certain members of the contributory plan were eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006 will be required to join the hybrid plan.

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.

ERS issues a CAFR that includes financial statements and required supplementary information which may be obtained from the following address:

Employees' Retirement System of the State of Hawaii
201 Merchant Street, Suite 1400
Honolulu, Hawaii 96813

Effective July 1, 2007, the State adopted the provisions of GASB Statement No. 50, *Pension Disclosures – An Amendment to GASB Statements No. 25 and 27.* The State has determined that the State funded the contribution requirement, and accordingly, the Department has not recorded a liability for pension benefits in its statement of net assets as of June 30, 2008. To obtain a copy of the State's CAFR, refer to the address listed in Note 1.

Post-retirement Health Care and Life Insurance Benefits
The State contributes to the Hawaii Employer-Union Health Benefits Trust Fund ("EUTF"), an agent multiple-employer defined benefit plan that replaced the Hawaii Public Employees Health Fund effective July 1, 2003, pursuant to Act 88, SLH of 2001. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The State also contributes to the Hawaii State Teachers Association ("HSTA") Voluntary Employees Beneficiary Association ("VEBA") Trust that was established effective March 1, 2006. HSTA VEBA provides health benefits only to HSTA members, retirees and their dependents. The eligibility requirements for retiree health benefits are the same for both plans as follows:

For employees hired before July 1, 1996, the State pays the entire base monthly contribution for employees retiring with 10 years or more of credited service, and 50% of the base monthly contribution for employees retiring with fewer than ten years of credited service. A retiree can elect a family plan to cover dependents.

For employees hired after June 30, 1996 but before July 1, 2001, and who retire with less than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Retirees in this category can elect a family plan to cover dependents.

For employees hired on or after July 1, 2001, and who retire with less than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Only single plan coverage is provided for retirees in this category. Retirees can elect family coverage but must pay the difference.

The actuarial valuation of the EUTF does not provide other postemployment benefits ("OPEB") information by department or agency. Accordingly, the State's policy on the accounting and reporting for OPEB is to allocate a portion of the State's Annual Required Contribution ("ARC"), interest, and any adjustment to the ARC, to component units and proprietary funds that are reported separately in the State's Comprehensive Annual Financial Report ("CAFR") or in stand alone departmental financial statements. The basis for the allocation is the proportionate share of contributions made by each component unit and proprietary fund for retiree health benefits.

Contributions are financed on a pay-as-you-go basis and the Department's contributions for the years ended June 30, 2008, 2007, and 2006 were approximately $614,000, $454,000, and $399,000, respectively.

The State's CAFR includes the required footnote disclosures and required supplementary information, on the State's OPEB plans, which can be found at the Department of Accounting and General Services' website.

Deferred Compensation Plan
The State established a deferred compensation plan ("Plan") in accordance with Section 457 of the Internal Revenue Code, which enable State employees to defer a portion of their compensation. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the Plan, as well as property and rights purchased with those amounts and income attributable to these amounts are held in trust by third party agents for the exclusive benefit of participants and their beneficiaries. The assets and liabilities of the Plan are not reflected in the State of Hawaii or Department's financial statements.

13. General Leases and Licenses

The Department's general leasing operations (Section 204 of Hawaiian Homes Commission Act of 1920, as amended) consist principally of the leasing of its Hawaiian home lands. The general leases have varying terms extending through 2070.

The future minimum lease income from general leases as of June 30, 2008, is as follows:

Year ending June 30,	
2009	$ 7,421,000
2010	7,648,000
2011	7,713,000
2012	7,809,000
2013	6,528,000
Thereafter	229,583,000
	$ 266,702,000

14. Commitments and Contingencies

Litigation
The Department is a party to various legal proceedings, the outcome of which, in the opinion of management, will not have a material adverse effect on the Department's financial position. Losses, if any, are either covered by insurance or will be paid from legislative appropriations of the State's General Fund.

Insurance
The State maintains certain insurance coverage to satisfy bond indenture agreements as well as for other purposes, but is substantially self-insured for all other perils including workers' compensation. The State records a liability for risk financing and insurance related losses, including incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies. At June 30, 2008, the State recorded an estimated loss for workers' compensation, automobile and general liability claims as long-term liabilities as the losses will not be liquidated with currently expendable available financial resources. The estimated losses will be paid from legislative appropriations of the State's General Fund. The Department's portion of the State's workers' compensation liability was not material at June 30, 2008.

Guaranteed and Insured Loans
As of June 30, 2008, the Department was contingently liable for approximately $9,918,000 in loans originated primarily by the U.S. Department of Agriculture Rural Development for which the Department has guaranteed repayment. Approximately $647,000 of these loans have been reported delinquent as of June 30, 2008.

The Department is also a party to a mortgage loan insurance agreement with the U.S. Department of Housing and Urban Development ("HUD"). The agreement provides that HUD will perform underwriting processing for the insurance program and will administer an insurance fund for mortgages originated and held by HUD-approved lenders. The Department will maintain and provide the necessary and proper funds for payment of any mortgage insurance claims and expenditures incurred by HUD in connection with the lessee borrowers. The Department has reserved cash of approximately $10,850,000 in the special revenue fund and has deposited $150,000 with HUD. As of June 30, 2008, loans outstanding totaled approximately $365,887,000 under this agreement, of which approximately $12,204,000 has been reported as delinquent.

As of June 30, 2008, the Department was also contingently liable for approximately $10,340,000 in loans originated by financial institutions and other lenders for which it had guaranteed repayment. Approximately $371,000 of these loans has been reported delinquent as of June 30, 2008.

As of June 30, 2008, the Department paid approximately $9,084,000 for delinquent mortgage loan payments of lessees. These payments are carried as loans receivable from lessees and bear similar terms as stipulated in the lessees' mortgage notes with the lenders.

The Department has certain loans for which the collateral for the loans is not covered by casualty insurance. The number of such loans was not known as of June 30, 2008.

Other
As of June 30, 2008, the reserve for encumbrances relating to construction contracts approximated $88,569,000.

Pursuant to Act 14, Special SLH 1995, the Hawaiian Home Land Trust Fund was established to account for funds to be paid by the State beginning in the fiscal year ended June 30, 1996. The primary purpose of Act 14 is to resolve controversies and claims related to the Hawaiian Home Land Trust which arose between August 21, 1959 and June 30, 1988.

Act 14 requires the State to make twenty annual payments of $30,000,000 in cash or such other consideration as agreed to between the State and the Department of Hawaiian Home Lands. Interest is determined as provided in Act 14 on the unpaid balance of any funds due, but not appropriated, by the end of each respective fiscal year. The Department received $30,000,000 in the current year as a transfer from the Department of Budget and Finance, State of Hawaii, to the Hawaiian Home Land Trust Fund. As of June 30, 2008, the Department received approximately $390,000,000 from the State to the Hawaiian Home Land Trust Fund.

Under the General Appropriations Act of 2007, Section 133, $20,000,000 was allocated to the Department's Trust fund for the design and construction of the east-west collector road in Kapolei, Hawaii.

15. Hawaiian Home Land Trust Individual Claims

In 1991, the Legislature enacted HRS Chapter 674, *Individual Claims Resolution Under the Hawaiian Home Land Trust*, which established a process for individual beneficiaries of the Hawaiian Home Lands Commission Act of 1920 to file claims to recover actual economic damages they believed they suffered from a breach of trust caused by an act or omission of an official of the State between August 21, 1959, when Hawaii became a state, and June 30, 1988.

The process was a three-step process which (1) began when informal proceedings presided over by the Hawaiian Home Land Trust Individual Claims Review Panel (the "Panel") to provide the State Legislature with non-binding findings and advisory opinions for each claim; (2) provided for the State Legislature's review and consideration of the Panel's findings and advisory opinions, and appropriations of funds to pay the actual economic damages the State Legislature deemed appropriate by October 1, 1999; and (3) allowed claimants to bring de novo civil actions by December 31, 1999 if they were not satisfied with the Panel's findings and advisory opinions, or the State Legislature's response to the Panel's recommendations.

The deadline to file a claim with the Panel was August 31, 1995. A total of 4,327 claims were filed by 2,753 individuals. As of June 30, 2008, claims from 1,376 claimants had not been reviewed by the Panel, and all but the claims of two claimants had not been acted upon by the Legislature. In 1997, the Legislature declared it to be its intent to postpone acting upon the Panel's recommendations until all claims had been reviewed and forwarded to it.

In December 1999, three claimants filed a class action lawsuit in the First Circuit Court for declaratory and injunctive relief, and for general, special, and punitive damages under HRS Chapter 673 for the Panel's and Legislature's alleged failure to remedy their breach of trust claims under HRS Chapter 674. In August 2000, the Circuit Court entered an order granting the plaintiffs' motion for summary judgment and declaratory relief as to Count I of the Complaint, and denied the State's motions on the pleadings. The plaintiff appealed the judgment relating to the other Counts in the lawsuit with the Hawaii Supreme Court. In June 2006, the Hawaii Supreme Court affirmed the plaintiffs' right to pursue their claims under HRS Chapter 674, which reversed the Circuit Court's determination that Act 14 is a settlement agreement and that the plaintiff's have a right to sue under HRS Chapter 661 and remanded the case to the Circuit Court for further proceedings. Five other claimants filed similar individual claims actions for themselves. The plaintiffs in these other actions have stipulated to stay all proceedings in their actions pending the resolution of all questions of law in the class action lawsuit that are common to the questions of law presented in their suits. The plaintiffs have since filed a first and second amended complaint to add 11 plaintiffs, and to divide the class into nine subclasses to include those with claims for injuries allegedly suffered. The court granted the plaintiffs' motion to try the waiting subclass' claims separately and first. It is unknown when the trial on the waiting subclass' claims will begin.

Claims for actual damages under Chapter 674 are made against the State of Hawaii. Accordingly, the Department does not believe that the final settlement of the claims will have a material, adverse effect on the financial statements of the Department.

16. Assessments for Central Service and Administrative Expenses

The State of Hawaii has asserted that the Department is liable for its pro rata share of central service and administrative expenses incurred by the State in accordance with Sections 36-27 and 36-30, Hawaii Revised Statutes. Pursuant to Section 36-31, Hawaii Revised Statutes, the Department maintains that their funds are trust funds and are not subject to the special fund assessments. Accordingly, no provision for any liability has been made in the accompanying financial statements.

Effective July 1, 1998, Act 27, SLH 1998 amended Section 213 of the Hawaiian Homes Commissions Act and reclassified certain special funds as trust funds.

As of June 30, 2008, the Department's estimate of the accumulated asserted assessments since the inception of the aforementioned law approximated $17,622,000.

17. Restatement to the Department-wide Net Assets

The Department has restated its June 30, 2007 department-wide net assets to correct an error in accounting for capital assets and home construction expenditures of $23,290,141. The restatement adjustment reduced construction costs that were inappropriately capitalized as construction in progress in 2007 and accordingly, reduced the previously reported June 30, 2007 department-wide net assets by $23,290,141.

18. Subsequent Event

In March 2009, the Department raised approximately $42.5 million in proceeds from the issuance of its revenue bonds. The bond issuance was authorized by House Bill 200, Section 45, for the purpose of financing the Department's capital improvement projects. Any revenues generated from these capital improvement projects will be used to service the outstanding principal and interest of the bonds. The bond issuance costs will be paid from the bond proceeds.

The revenue bonds are scheduled to mature in various dates beginning in April 2023 through April 2039, and the interest rates range from 4.00% to 6.00%. The first interest-only payment is scheduled to be made in October 2009, with semi-annual principal and interest payments commencing in April 2010.

State of Hawaii
Department of Hawaiian Home Lands
Combining Balance Sheet
Nonmajor Governmental Funds
June 30, 2008

	Hawaiian Home Loan Fund	Department of Hawaiian Home Lands Revenue Bond Special Fund	Hawaiian Home Trust	Native Hawaiian Rehabilitation Fund	Protocol Funds	Temporary Deposits	Construction Funds	Total Other Governmental Funds
Assets								
Equity in cash and cash equivalents held in State Treasury	$ 1,469,368	$ 9,693,095	$ 10,850,100	$ 9,545,065	$ 1,890	$ 3,718,767	$ -	$ 35,278,285
Receivables								
Due from State	-	-	-	-	-	-	6,417,176	6,417,176
Loans, net of allowance for losses	3,052,027	-	-	2,104	-	-	-	3,054,131
Accrued interest	-	49,476	-	48,883	-	-	-	98,359
Other assets	96,136	-	-	-	-	-	-	96,136
Total assets	$ 4,617,531	$ 9,742,571	$ 10,850,100	$ 9,596,052	$ 1,890	$ 3,718,767	$ 6,417,176	$ 44,944,087
Liabilities								
Vouchers and contracts payable	$ -	$ -	$ -	$ 32,131	$ -	$ -	$ -	$ 32,131
Other liabilities	-	-	-	-	-	3,350,289	-	3,350,289
Total liabilities	-	-	-	32,131	-	3,350,289	-	3,382,420
Fund Balances								
Reserved for								
Encumbrances	-	-	-	3,806,261	-	44,800	4,077,168	7,928,229
Receivables	3,052,027	49,476	-	50,987	-	-	-	3,152,490
Guaranteed and insured loans	-	-	10,850,100	-	-	-	-	10,850,100
Total reserved fund balances	3,052,027	49,476	10,850,100	3,857,248	-	44,800	4,077,168	21,930,819
Unreserved	1,565,504	9,693,095	-	5,706,673	1,890	323,678	2,340,008	19,630,848
Total fund balances	4,617,531	9,742,571	10,850,100	9,563,921	1,890	368,478	6,417,176	41,561,667
Total liabilities and fund balances	$ 4,617,531	$ 9,742,571	$ 10,850,100	$ 9,596,052	$ 1,890	$ 3,718,767	$ 6,417,176	$ 44,944,087

State of Hawaii
Department of Hawaiian Home Lands
Combining Statement of Revenues, Expenditures and Changes in Fund Balances
Nonmajor Governmental Funds
Year Ended June 30, 2008

Supplemental Information

	Hawaiian Home Loan Fund	Department of Hawaiian Home Lands Revenue Bond Special Fund	Hawaiian Home Trust	Native Hawaiian Rehabilitation Fund	Protocol Funds	Temporary Deposits	Construction Funds	Total Other Governmental Funds
Revenues								
Appropriations	$ -	$ -	$ -	$ -	$ -	$ -	$ 2,875,000	$ 2,875,000
Interest from short-term investments	-	137,790	-	137,375	-	-	-	275,165
Other	-	-	-	269,473	-	-	-	269,473
Total revenues	-	137,790	-	406,848	-	-	2,875,000	3,419,638
Expenditures								
Current								
Administration and support services	-	-	-	1,192,996	609	-	-	1,193,605
Land development	-	-	-	-	-	122,719		122,719
Land management	-	-	-	-	-	-	395,000	395,000
Total expenditures	-	-	-	1,192,996	609	122,719	395,000	1,711,324
Excess (deficiency) of revenues over (under) expenditures	-	137,790	-	(786,148)	(609)	(122,719)	2,480,000	1,708,314
Other financing sources (uses)								
Transfers in	262,918	-	-	-	2,500	-	-	265,418
Transfers out	-	-	-	-	(2,141)	-	-	(2,141)
Total other financing sources	262,918	-	-	-	359	-	-	263,277
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	262,918	137,790	-	(786,148)	(250)	(122,719)	2,480,000	1,971,591
Fund balances at July 1, 2007	4,354,613	9,604,781	10,850,100	10,350,069	2,140	491,197	3,937,176	39,590,076
Fund balances at June 30, 2008	$ 4,617,531	$ 9,742,571	$ 10,850,100	$ 9,563,921	$ 1,890	$ 368,478	$ 6,417,176	$ 41,561,667

State of Hawaii
Department of Hawaiian Home Lands
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2008

Federal Program or Pass Through Entity	CFDA Number	Identifying Number	Expenditures
U.S. Department of Housing and Urban Development			
Native Hawaiian Housing Block Grant, Year 2	14.873	03NHGHI0001	$ 2,036,993
Native Hawaiian Housing Block Grant, Year 3	14.873	04NH4HI0001	5,261,556
Native Hawaiian Housing Block Grant, Year 4	14.873	05NH4HI0001	5,149,387
Native Hawaiian Housing Block Grant, Year 5	14.873	06HBGHI0001	166,325
TOTAL FEDERAL EXPENDITURES			$ 12,614,261

1. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Department and is presented on the cash basis of accounting. The information on this schedule is presented in accordance with the requirements of OMB Circular A-133, *Auditing of States, Local Governments, and Non-Profit Organizations.* Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

2. Loans Outstanding

The Department had the following loan balances outstanding as of June 30, 2008. Loans made during the year are included in the federal expenditures presented in the schedule.

Program Title	CFDA Number	Amount Outstanding
U.S. Department of Housing and Urban Development		
Native Hawaiian Housing Block Grant	14.873	$ 3,610,864

3. Subrecipients

Of the federal expenditures presented in the schedule, the Department provided federal awards to subrecipients as follows:

Program Title/Subrecipient	CFDA No.	Amount Provided to Subrecipients
U.S. Department of Housing and Urban Development		
Native Hawaiian Housing Block Grant, Year 2		
Consuelo Zobel Alger	14.873	$ 3,371
Hawaii Island Community Development		7,335
Hawaiian Community Assets		35,527
Hawaiian Community Development		17,100
Menehune Development Corp.		49,687
Habitat for Humanity – Molokai		3,607
		116,627
Native Hawaiian Housing Block Grant, Year 3		
Consuelo Zobel Alger	14.873	332
Hawaiian Community Assets		30,000
Hawaiian Community Development		37,600
Habitat for Humanity – Honolulu		23,662
Kikiaola Construction Corporation		236,038
Nanakuli Housing Corporation		5,412
Hawaii Island Community Development		19,000
		352,044
Native Hawaiian Housing Block Grant, Year 4		
Council for Native Hawaiian Advancement	14.873	60,323
Habitat for Humanity – Maui		225,700
Habitat for Humanity – Molokai		19,663
Nanakuli Housing Corporation		31,637
		337,323
Native Hawaiian Housing Block Grant, Year 5		
Nanakuli Housing Corporation	14.873	90,477
Habitat for Humanity – Leeward		8,681
		99,158
		$ 905,152

PART II

Government Auditing Standards

Accuity LLP
CERTIFIED PUBLIC ACCOUNTANTS

Report of Independent Auditors on Internal Control Over Financial Reporting and On Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Auditor and the Hawaiian Homes Commission
State of Hawaii

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii, Department of Hawaiian Home Lands (the "Department") as of and for the year ended June 30, 2008, which collectively comprise the Department's basic financial statements and have issued our report thereon dated June 10, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Department's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Department's financial statements that is more than inconsequential will not be prevented or detected by the Department's internal control. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as items 08-01, 08-02, 08-03, 07-01, and 07-02 to be significant deficiencies in internal control over financial reporting.

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A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Department's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider item 08-01 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted certain other matters that we reported to the State Auditor and the Hawaiian Homes Commission in a separate letter dated June 10, 2009.

The Department's responses to the findings identified in our audit are described in the Department's Corrective Action Plan. We did not audit the Department's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the State Auditor, the Hawaiian Homes Commission, the Department's management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Accuity LLP

Honolulu, Hawaii
June 10, 2009

Accuity LLP
CERTIFIED PUBLIC ACCOUNTANTS

Report of Independent Auditors on Compliance with Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133

The Auditor and the Hawaiian Homes Commission
State of Hawaii

Compliance

We have audited the compliance of the State of Hawaii, Department of Hawaiian Home Lands (the "Department") with the types of compliance requirements described in the U.S. Office of Management and Budget ("OMB") *Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended June 30, 2008. The Department's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Department's compliance with those requirements.

In our opinion, the Department complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2008. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 08-04, 08-05, and 07-03.

Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with the requirements that could have a direct and material effect on a major federal

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program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies.

A *control deficiency* in the Department's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the Department's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the Department's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 08-04 and 08-05 to be significant deficiencies.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the Department's internal control. We do not consider any of the deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses.

The Department's responses to the findings identified in our audit are described in the Department's Corrective Action Plan. We did not audit the Department's responses and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the State Auditor, the Hawaiian Homes Commission, the Department's management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Accuity LLP

Honolulu, Hawaii
June 10, 2009

PART III

Schedule of Findings and Questioned Costs

Section I – Summary of Auditor's Results

Financial Statements

Type of auditor's report issued	Unqualified
Internal control over financial reporting	
• Material weaknesses identified?	X yes ___ no
• Significant deficiencies identified that are not considered to be material weaknesses?	X yes ___ none reported
Noncompliance material to financial statements noted?	___ yes X no

Federal Awards

Internal control over major programs	
• Material weaknesses identified?	___ yes X no
• Significant deficiencies identified that are not considered to be material weaknesses?	X yes ___ none reported
Type of auditor's report issued on compliance for major programs	Unqualified
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?	X yes ___ no

Identification of major programs

CFDA Number	Name of Federal Program or Cluster
14.873	Native Hawaiian Housing Block Grant

Dollar threshold used to distinguish between type A and type B programs	$378,428
Auditee qualified as low-risk auditee?	___ yes X no

Section II – Financial Statement Findings

Material Weakness

		Questioned Cost
Finding No. 08-01:	Restatement of Beginning Net Assets Due to Improper Accounting of Construction Costs	$ -

Federal Agency: Finding is not specific to a Federal Agency

CFDA Number and Title: Finding is not specific to a Federal Agency

Award Number and Award Year: Not applicable

Condition
During our audit, we noted various construction costs related to inventory of homes for sale and development incurred in prior years that were improperly classified as capital assets. As of June 30, 2007, approximately $23 million of these construction costs were included in the construction in progress balance, but related to inventory of homes which were constructed and sold during fiscal 2007. Therefore, the capital assets balance was overstated and home construction expenses were understated in the department-wide financial statements as of June 30, 2007. Accordingly, the Department restated its opening net assets balance as of July 1, 2007 to correct this error.

Criteria
§___.310 of OMB Circular A-133 requires the auditee to prepare financial statements that reflect its financial position, results of operations or changes in net assets and, where appropriate, cash flows for the fiscal year audited.

§___.320 requires the auditee to submit a reporting package that includes:

1. Financial statements and schedule of expenditures of federal awards.
2. Summary schedule of prior audit findings.
3. Auditor's report.
4. Corrective action plan.

Although audited financial statements were prepared and submitted as of and for the year ended June 30, 2007, the financial statements submitted were misstated, and restated beginning balances are reported in the financial statements as of and for the year ended June 30, 2008.

Effect
The Department restated its opening net assets balance as of July 1, 2007 to correct this error which related to the improper accounting of construction costs.

The following adjustment was made:

Net assets at July 1, 2007, as previously reported	$ 632,084,145
Prior period adjustment	(23,290,141)
Net assets at July 1, 2007, as restated	$ 608,794,004

Cause
We noted that the Department tracks construction costs related to inventory of homes for sale and development on the same spreadsheet that is used to track construction costs related to the Department's capital assets, increasing the likelihood of future misstatements.

Recommendation
We recommend that, and the Department has already restated the beginning balances in its basic financial statements for the year ended June 30, 2008 to correct the error identified. We also recommend that the Department track construction costs related to the inventory of homes for sale and development separately from construction costs related to the Department's capital assets. The fiscal management of the Department should provide greater oversight to ensure that the financial statements are prepared and presented in accordance with generally accepted accounting principles.

Significant Deficiencies

		Questioned Cost
Finding No. 08-02:	Untimely Reconciliation of Financial Reports	$ -

Federal Agency: Finding is not specific to a Federal Agency

CFDA Number and Title: Finding is not specific to a Federal Agency

Award Number and Award Year: Not applicable

Condition
During our audit, we noted that the Department did not reconcile its financial records to the underlying source data in a timely manner. We noted that the Department's monthly reconciliations related to cash and its expenditures took as long as six months to be prepared.

Criteria
The Department should reconcile its financial records to the underlying source data in a timely manner to ensure its financial records are complete and accurate, and that all unreconciled differences are investigated and resolved immediately. More importantly, since the Department is a direct recipient of federal award monies, it is subject to provisions of OMB Circular A-133, which states that federal financial reports should be reconciled to the underlying accounting records.

Effect
Failure to reconcile the financial records to the underlying source data in a timely manner could result in a material misstatement of the Department's financial statements. Furthermore, failure to comply with the provisions of OMB Circular A-133 could result in the loss or reduction of federal award monies.

Cause
Despite having policies in place that requires the preparation and review of all financial statement reconciliations to the underlying source data on a monthly basis, we noted that the Department did not comply with its own internal policies consistently throughout the year.

Recommendation
We recommend that the Department comply with its internal policies and ensure that the monthly reconciliation of the financial records to the underlying accounting records are prepared and reviewed in a timely manner.

		Questioned Cost
Finding No. 08-03:	Cash Held Outside of State Treasury Was Not Recorded	$ -
Federal Agency:	Finding is not specific to a Federal Agency	
CFDA Number and Title:	Finding is not specific to a Federal Agency	
Award Number and Award Year:	Not applicable	

Condition
During our audit, we noted that the Department's financial accounting records excluded a cash balance that was held in an account with an external financial institution. As of June 30, 2008, the balance of the account was approximately $11,000. Although this amount was not material to the Department's fiscal 2008 financial statements, we noted that the opening balance of the account was approximately $1.5 million. Furthermore, we noted that the Department failed to record all cash outflows from this account, which resulted in an understatement of the Department's expenditures. Proper audit adjustments were recorded as of June 30, 2008 to reflect the cash balance and expenditures.

Criteria
All assets that are legally owned by the Department and all expenditures incurred during the year should be reflected in the Department's financial statements.

Effect
Failure to include all cash balances that are legally owned by the Department could result in a material misstatement of the Department's financial statements.

Cause
We noted that the Department did not have a full understanding of the accounting implications associated with the agreement it had with the financial institution. Due to this lack of understanding, the Department assumed that the cash balance was not required to be included in the Department's financial statements.

Recommendation
We recommend that the Department attain a full understanding of the legal and accounting implications associated with agreements it executes with outside entities. The Department should ensure it records the proper cash and expenditures going forward.

Section III – Federal Award Findings and Questioned Costs

Significant Deficiencies

		Questioned Cost
Finding No. 08-04:	Noncompliance with Davis-Bacon Act Requirements	$ -

Federal Agency: U.S. Department of Housing and Urban Development

CFDA Number and Title: 14.873 – Native Hawaiian Housing Block Grant

Award Number and Award Year:

03NHGHI0001	7/1/2003 – 6/30/2004
04NH4HI0001	7/1/2004 – 6/30/2005
05NH4HI0001	7/1/2005 – 6/30/2006
06HBGHI0001	7/1/2006 – 6/30/2007
07HBGHI0001	7/1/2007 – 6/30/2008

Condition
During our audit, we noted that the Department failed to review the payroll reports of one of its construction contractors to verify that all laborers and mechanics employed by the contractor were paid wages not less than those established by the Department of Labor ("DOL"). We noted that this construction contractor received more than $2,000 in funding from the Department's federal award monies, thereby making it subject to the provisions of the Davis-Bacon Act.

Criteria
The Davis-Bacon Act requires that each contract over $2,000 to which the United States is a party for the construction, alteration, or repair of public buildings or public works shall contain a clause setting forth the minimum wages to be paid by various classes of laborers and mechanics employed under the contract.

Title 29, Section 5.5 of the Code of Federal Regulations ("CFR") also provides that "the contractor shall submit weekly for each week in which any contract work is performed a copy of all payrolls to the agency if the agency is a party to the contract."

Effect
The Department should review the contractors' weekly payrolls to ensure that the contractor is paying its laborers and mechanics wages not less than wages established by the DOL. Failure to review the weekly payrolls of contractors that receive more than $2,000 in funding from federal award monies could result in the Department's noncompliance with the Davis-Bacon Act.

Cause
The Department does not have formal policies or procedures to review the payrolls for contractors that receive more than $2,000 in funding from federal award monies due to its ineffective monitoring over federal compliance.

Recommendation

We recommend that the Department implement formal policies and procedures that require the Department to review contractors' payrolls to ensure that all laborers and mechanics employed by contractors that receive more than $2,000 in funding from federal awards are paid wages not less than those established by the DOL.

Questioned Cost

Finding No. 08-05: Violation of State Procurement Requirements $ -

Federal Agency:	U.S. Department of Housing and Urban Development	
CFDA Number and Title:	14.873 – Native Hawaiian Housing Block Grant	
Award Number and Award Year:	03NHGHI0001	7/1/2003 – 6/30/2004
	04NH4HI0001	7/1/2004 – 6/30/2005
	05NH4HI0001	7/1/2005 – 6/30/2006
	06HBGHI0001	7/1/2006 – 6/30/2007
	07HBGHI0001	7/1/2007 – 6/30/2008

Condition
During our audit, we noted that the Department did not comply with Hawaii Revised Statutes ("HRS") Section 103D-407(b), which is a violation of the Hawaii Public Procurement Code and the Code of Federal Regulations ("CFR"). Specifically, we noted that a contract with a vendor that was hired for road construction work did not communicate the requirements of HRS Section 103D-407(b) to the vendor, and therefore, the minimum requirement of crushed glass aggregate was not utilized.

Criteria
In accordance with Title 24, Section 85.36 (a) of the CFR, "when procuring property and services under a grant, a State will follow the same policies and procedures used for procurements from its non-Federal funds. The State will ensure that every purchase order or other contract includes any clauses required by Federal statutes and executive orders and their implementing regulations."

Accordingly, the Department is required to adhere to the requirements of HRS Chapter 103D in ensuring that procurements comply with the Hawaii Public Procurement Code.

HRS Chapter 103D-407(b) provides the following:

"All highway and road construction and improvement projects funded by the State or a county or roadways that are to be accepted by the State or a county as public roads shall utilize a minimum of ten percent crushed glass aggregate as specified by the department of transportation in all base course (treated or untreated) and sub-base when the glass is available to the quarry or contractor at a price no greater than that of the equivalent aggregate."

Effect
Failure to comply with Chapter 103D, HRS, is a violation of both State law and federal compliance requirements, and could result in the loss of federal award monies.

Cause
We noted that the Department's project managers, who are responsible for procuring goods and services, were not aware of this requirement, and therefore, the vendor was not informed of this requirement.

Recommendation

We recommend that the Department familiarize its project managers with the various provisions of Chapter 103D, HRS, prior to the awarding of contracts for goods and services.

Section IV – Status of Prior Year Findings and Questioned Costs

Finding No. 07-01: Policies and Procedures over Accounting for Capital Assets Should be Implemented (Significant Deficiency)

Condition
The Department did not formalize any procedures regarding the reconciliation of the capital asset detail to the report received from the Department of Accounting and General Services ("DAGS"). During the fiscal 2007 audit, we noted the following issues related to the Department's capital assets account:

- A reconciliation of the Department's capital asset detail to the DAGS report was not performed by management;
- An unreconciled difference of $1.4 million between the Department's capital asset detail to the DAGS report, which management was unable to reconcile without our assistance;
- Several infrastructure items which totaled $2.4 million that should have been recorded as of June 30, 2006, but were recorded in fiscal 2007;
- An infrastructure item that was recorded twice, which resulted in a $150,000 overstatement of the Department's capital asset detail.

We also noted that the Department's fiscal 2007 infrastructure rollforward schedule reflected approximately $116 million of additions that were already recorded on the Department's June 30, 2006 financial statements. Since this amount appeared highly unusual, we examined the various assets and noted they were previously recorded as infrastructure additions in previous years.

Criteria
A reconciliation of the capital asset detail to the report received from DAGS should be performed to ensure that all capital assets are properly recorded and accounted for in the accounting records and financial statements.

Effect
The Department's capital assets balance is the most significant account in the Department's financial statements, and thus, a material misstatement of its capital assets balance could cause a material misstatement of the Department's financial statement. Additionally, without a reconciliation of the capital asset detail and the report received from DAGS, the Department would be unable to determine if there are any unrecorded or misappropriated assets.

Cause
As the Department did not have formal written procedures to ensure the Department's capital asset detail was reconciled to the DAGS report, this important procedure was not performed by the Department.

Status
Unresolved. During the current year audit, we noted that the Department reconciled its capital asset detail to the report received from DAGS. However, the Department has not yet formalized written procedures to ensure the capital asset detail is reconciled to the report received from DAGS. Also, refer to the current year finding no. 08-01 related to the restatement of beginning net assets due to improper accounting of construction costs.

Finding No. 07-02: Significant Audit Adjustments and Reclassifications (Significant Deficiency)

Condition

During our fiscal 2007 audit, we noted that the Department did not record any of the audit adjustments that were proposed during the prior year audit, which resulted in these adjustments being re-proposed during the fiscal 2007 audit. In addition, we proposed a total of 80 adjusting journal entries and 19 reclassification journal entries in fiscal 2007 to ensure the financial statements were fairly stated.

Criteria

The financial statements are the responsibility of the management of the Department. Thus, the Department should take full responsibility of its financial statements by recording all auditor-proposed adjusting journal entries and reclassification journal entries to ensure that its financial statements are accurate and reliable and to avoid having prior year entries being re-proposed each year.

Effect

If the Department continues to rely on its external auditors to record all of its prior year audit adjustments, the Department will not be capable of properly monitoring its financial position throughout the year.

Cause

The Department experienced significant turnover within its fiscal office during fiscal 2007, which may have resulted in the Department's lack of qualified accounting personnel to properly record the necessary journal entries to reflect accurate financial statements. In addition, the Department has historically relied on its external auditors to track and accumulate certain adjusting journal entries.

Status

Unresolved. During the current year audit, we noted that the Department attempted to record all auditor-proposed adjusting journal entries from the prior year. However, while there was a reduction in the number of auditor-proposed adjusting journal entries in the current year, we noted that many journal entries were recorded to the wrong accounts, which required additional auditor-proposed adjusting or reclassification journal entries. The Department should continue to assess the qualifications of the accounting personnel to perform these responsibilities.

Finding No. 07-03: Insurance Coverage Requirement (Control Deficiency)

Condition
During our fiscal 2007 audit, we noted that four out of eight loans tested did not have any evidence that the borrowers obtained adequate insurance coverage to cover the replacement cost of the housing units that were either owned, operated, or assisted with more than $5,000 in federal funding.

Criteria
In accordance with *§1006.330 of 24 CFR Part 1006 and 1007 Housing Assistance for Native Hawaiians: Native Hawaiian Housing Block Grant Program and Loan Guarantees for Native Hawaiian Housing; Interim Rule,* as a condition to receiving Native Hawaiian Housing Block Grant ("NHHBG") funds, the Department must:

- Require adequate insurance coverage for housing units that are owned, operated or assisted with more than $5,000 of NHHBG funds, including a loan of more than $5,000 that includes payback provisions;
- Ensure that insurance is purchased from an insurance provider or a plan of self-insurance in an amount to cover replacement cost; and
- Provide for or require insurance in adequate amounts to indemnify against loss from fire, weather, and liability claims for all housing units owned, operated or assisted by the Department.

Effect
The lack of adequate insurance coverage by the borrowers will increase the Department's exposure to credit risk for any replacement costs of the housing units.

Cause
We reviewed the Department's Policies and Procedures Manual and noted that there was no policy that required the Department to obtain evidence that its borrowers maintain adequate insurance coverage for housing units that are owned, operated or assisted with more than $5,000 in federal funding. Such policies would have ensured that the loan officers complied with this requirement during the loan origination process, which would have prevented loans from being approved until the proper documentation was obtained and filed.

Status
Unresolved. During the current year audit, we reviewed the Department's Policies and Procedures Manual noting the inclusion of a policy requiring loan officers to obtain evidence that the borrower purchased an insurance policy sufficient to cover the replacement cost of the housing unit. However, we also noted that for one out of eleven loans tested had no evidence that the borrower obtained adequate insurance coverage sufficient to cover the replacement cost of the housing unit. Therefore, we recommend that the Department ensure these policies are properly implemented.

LINDA LINGLE
GOVERNOR
STATE OF HAWAI'I

MICAH A. KĀNE
CHAIRMAN
HAWAIIAN HOMES COMMISSION

KAULANA H. PARK
DEPUTY TO THE CHAIRMAN

ROBERT J. HALL
EXECUTIVE ASSISTANT

STATE OF HAWAI'I
DEPARTMENT OF HAWAIIAN HOME LANDS
P.O. BOX 1879
HONOLULU, HAWAI'I 96805

April 13, 2009

Ms. Cindy Yee
Accuity LLP
999 Bishop Street, Suite 1900
Honolulu, HI 96813

Dear Ms. Yee:

The Department of Hawaiian Home Lands' (DHHL) Financial Audit Report, conducted by Accuity LLP, for the Fiscal Year ending on June 30, 2008, lists five findings. Below is DHHL's corrective action plan to address these findings.

- **Action Plan regarding Properly Accounting of Construction Costs**

During the financial audit, Accuity LLP noted various construction costs related to inventory of homes for sale and development incurred in prior years that were improperly classified as capital assets. As a result, the construction in progress balance was overstated as of June 30, 2007.

Corrective action has been taken by restating the beginning balances of the financial statements for the year ended June 30, 2008. DHHL will keep separate schedules to monitor the construction costs related to homes and the construction costs related to capital assets. DHHL will also monitor the cost of homes sold and the inventory of homes at the end of the fiscal year.

- **Correction Actions taken regarding Untimely Reconciliation of Financial Report**

During fiscal year 2008 DHHL's Fiscal office physically moved its operations twice. The office moves reduced DHHL's ability to provide timely reconciliations. Since moving to Kapolei, DHHL has kept current on its reconciliations and monthly reconciliations for fiscal year ending June 30, 2008 were completed by September 2008.

- **Correction Actions taken regarding Cash Held Outside of State Treasury was not recorded**

During the audit, Accuity LLP noted cash balances held in Wells Fargo Bank as a result of Certificate of Participation financing. DHHL consulted with its Bond Counsel and determined that DHHL should record the cash balances and outflows on its financial accounting records. In the future DHHL will ensure properly recording of all funds outside the state treasury.
The necessary corrective action will be made in fiscal 2009.

- **Action Plan regarding Compliance with Davis Bacon Act Requirements**

In December 2008, DHHL made an action plan to comply with the Davis-Bacon Act. "Labor Compliance Audit Procedures" were set up. The audit procedures detail the daily and weekly tasks necessary to ensure the compliance with the Davis-Bacon Act. A detailed step by step audit program was also written. The adhering to policies and procedures will aid DHHL to ensure compliance with the Davis-Bacon Act requirements.

- **Action Plan regarding Compliance with HRS Section 103D-407(b)**

During the financial audit, Accuity LLP noted that DHHL did not comply with Hawaii Revised Statutes Section 103D-407(b) which requires state or a county utilizes a minimum of ten percent crushed glass aggregate as specified by the department of transportation in all base course and sub-base.

In response, DHHL sent its project managers to attend State Procurement Office trainings. DHHL has included the requirement in its bid documents for the East-West Road, and all future DHHL bid documents for roadways to satisfy with HRS 103D-107(b).

Furthermore, since DHHL heavily relies on its consultants to incorporate changes in laws, rules, and standards into its construction documents, DHHL proposes to take the following:

1. As the procurement process takes place, consultants should ensure that work practices and material specifications comply with existing laws, rules and regulations.

2. Encourage consultants to be members of any state or national association or organization which keeps abreast with new laws, rules and regulations.

- **Status of Prior Year Findings and Questioned Costs Status regarding Policies and Procedures over Accounting for Capital Assets**

During fiscal year 2007 financial audit, Accuity LLP noted that reconciliation between DHHL financial records and the Department of Accounting and General Services (DAGS) report did not occur. DHHL made an action plan to resolve the problem. By December 2008, DHHL formalized written procedures to ensure the capital assets are reconciled to the reports received from DAGS. DHHL will continue to improve its accounting of capital assets according to its fiscal year 2007 action plan.
The necessary corrective action will be made in fiscal 2009.

- **Status regarding Significant Audit Adjustments and Reclassifications**

During the fiscal 2007 audit, Accuity LLP noted that DHHL did not record any prior year audit adjustments. An action plan was made and DHHL implemented the plan that included the recordation of prior year and current year adjustments. DHHL will continue to record significant audit adjustments and reclassifications on its accounting records.
The necessary corrective action will be made in fiscal 2009.

- **Status regarding Insurance Coverage Requirement**

During the fiscal year 2007 audit, Accuity LLP noted that four out of eight loans tested did not have any evidence that the borrowers obtained adequate insurance coverage to cover the replacement cost of the housing units that were either owned, operated, or assisted with more than $5,000 in federal funding.

DHHL implemented the action plan made after the fiscal year 2007 audit finding. For housing units that were assisted with more than $5,000 of federal funds and financed by private mortgages prior to this funding, DHHL will request that the homeowner provide a copy of the current insurance binder for our file records. This process may take several months to complete as it requires coordination between several offices within DHHL and is dependent on the homeowner submitting the documentation in a timely manner. DHHL's existing data system is currently being modified to provide a reporting mechanism to manage federal fund assisted units. DHHL is working on outsourcing the servicing of its direct loans. The scope of work includes establishing a Customer Trust Fund (CTF) for the monthly collection of funds for property taxes and insurance. DHHL will use this service to set up accounts for housing units that are assisted with more than $5,000 of federal funds and are either financed by a DHHL direct loan or have no loan. Anticipated completion date for procurement of this service is July 2009.

Should there be any questions about the Department's corrective action plan, please feel free to contact James Pao, Fiscal Management Officer, at (808) 620-9561.

Aloha and Mahalo,

fr Micah A. Kane, Chairman
Hawaiian Homes Commission