

State of Hawai'i
Department of Hawaiian Home Lands
Financial and Compliance Audit
June 30, 2011

Submitted by
The Auditor
State of Hawai'i

State of Hawai‘i
Department of Hawaiian Home Lands
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June 30, 2011

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PART I
Financial Section

Report of Independent Auditors

The Auditor and Hawaiian Homes Commission
State of Hawai'i

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawai'i, Department of Hawaiian Home Lands (the "Department"), as of and for the year ended June 30, 2011, which collectively comprise the Department's basic financial statements, as listed in the index. These financial statements are the responsibility of the Department's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 Hawai'i 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 Hawai'i as of June 30, 2011, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Department, as of June 30, 2011, and the respective changes in financial position thereof and the budgetary comparison for the Hawaiian Home Administration Account for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 30, 2012 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 management's discussion and analysis on pages 3 through 10 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding methods of measurement and presentation of the required supplementary information. However, we did not audit the information and we 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, Hawai'i
January 30, 2012

State of Hawai'i

Department of Hawaiian Home Lands

Management's Discussion and Analysis

June 30, 2011

The following Management's Discussion and Analysis ("MD&A") is designed to provide an overview of the financial performance of the State of Hawai'i, Department of Hawaiian Home Lands (the "Department") for the fiscal year ended June 30, 2011. Please read it in conjunction with the Department's financial statements, which follow this section.

Financial Highlights for Fiscal Year 2011

- The Department's total net assets, the amount of assets exceeding liabilities, totaled \$717.1 million. Of this amount, \$137.7 million is unrestricted, \$115.5 million is restricted, and \$463.9 million is invested in capital assets, net of related debt.
- The Department's total net assets increased \$21.1 million over the course of this year's operation.
- In fiscal year 2011, the Department's expenditures exceeded revenues (before transfers) by \$8.9 million. In fiscal year 2010, expenditures exceeded revenues (before transfers) by \$3.9 million.
- The total expenses of the Department increased by \$2.0 million, or 3.1%.
- The total fund balance of the Department's governmental funds increased by \$14.5 million.

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.

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Management's Discussion and Analysis

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- 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 Act. 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 fifteen governmental funds, nine 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 the Hawaiian Homestead Program.
- **Hawaiian Home General Loan Fund** – Act 249, SLH 1986, amended this revolving loan fund and consolidated 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.

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- **Hawaiian Home Lands 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 Lands 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 the construction, operation and maintenance of revenue-producing activities that are intended to serve principally occupants on Hawaiian home lands. The fund is also 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, Department of Hawaiian Home Lands Revenue Bond Special Fund and Hawaiian Home Lands 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.
- **East West Collector Road Fund** – Act 213, Session Law of Hawai'i (“SLH”) 2007, authorized and appropriated fund for design and construction of the East-West Collector Road. The revenue source of this fund is the State of Hawai'i general obligation bonds.
- **Hawaiian Home Trust Fund** – Monies deposited into this fund are available for transfers into any other fund or account authorized by the Act or for any public purpose to further the purposes of the Act. Public purpose includes using the Hawaiian Home Trust Fund as a reserve for loans insured or guaranteed by the U.S. Department of Housing and Urban Development (“HUD”) Federal Housing Administration, Veteran Administration or any other federal agency authorized to insure or guarantee loans. A major deposit in the Hawaiian Home Trust Fund is the reserve for loans insured by the HUD Federal Housing Administration.

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.

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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 \$21.1 million to \$717.1 million between fiscal year 2011 and 2010, primarily due to the \$30 million annual settlement payment from the State of Hawai'i in accordance with Act 14, Sp SLH 1995. A large portion of the Department's net assets (65%) 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 improvements on a special class of public lands, which are leased to native Hawaiians; consequently, these assets cannot be sold. 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)**

	2011	2010	Increase (Decrease)
Current and other assets	\$ 294.4	\$ 277.0	\$ 17.4
Capital assets	546.4	542.7	3.7
Total assets	<u>\$ 840.8</u>	<u>\$ 819.7</u>	<u>\$ 21.1</u>
Long-term debt outstanding	\$ 80.8	\$ 82.2	\$ (1.4)
Other liabilities	42.9	41.5	1.4
Total liabilities	<u>\$ 123.7</u>	<u>\$ 123.7</u>	<u>\$ -</u>
Net assets			
Invested in capital assets, net of related debt	\$ 463.9	\$ 457.8	\$ 6.1
Restricted	115.5	142.2	(26.7)
Unrestricted	137.7	96.0	41.7
	<u>\$ 717.1</u>	<u>\$ 696.0</u>	<u>\$ 21.1</u>

Change in Net Assets

The Department's total program revenues decreased from \$58.5 million in 2010 to \$57.1 million in 2011 (see statement of activities). Approximately 23.8% of the Department's program revenues came from interest income, 32.2% came from home sales, 21.4% came from grants and contributions, and 22.6% came from the general lease program. Total general revenues decreased by 4.5% to \$34.0 million due to the State of Hawai'i Bond Funds allotment for water source development, water system improvements and La'iohua 2020, a regional recreation and community center complex. The total cost of the Department's programs increased by \$2.0 million, or 2.9%. The Department received \$30 million as part of its annual settlement payment with the State of Hawai'i in accordance with Act 14, SP SLH 1995.

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Cash was transferred from the Department of Budget and Finance as its annual installment 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 summary of changes in net assets:

Summary of Changes in Net Assets
(in millions)

	2011	2010	Increase (Decrease)
Revenues			
Program revenue			
Administration and support services	\$ 8.2	\$ 14.6	\$ (6.4)
Homestead services	5.4	5.8	(0.4)
Land development	8.1	2.4	5.7
Home construction	10.3	12.5	(2.2)
Land management	12.9	12.5	0.4
Intergovernmental revenues	12.2	10.7	1.5
Appropriation, net of lapsed appropriations	4.0	5.6	(1.6)
Total revenues	<u>61.1</u>	<u>64.1</u>	<u>(3.0)</u>
Expenses			
Administration and support services	13.6	15.7	(2.1)
Homestead services	28.6	29.3	(0.7)
Land development	1.5	2.7	(1.2)
Home construction	24.1	18.0	6.1
Land management	2.2	2.3	(0.1)
Total expenses	<u>70.0</u>	<u>68.0</u>	<u>2.0</u>
Deficiency of revenues under expenses	(8.9)	(3.9)	(5.0)
Transfers, net	<u>30.0</u>	<u>30.0</u>	<u>-</u>
Change in net assets	21.1	26.1	(5.0)
Net assets			
Beginning of year	<u>696.0</u>	<u>669.9</u>	<u>26.1</u>
End of year	<u>\$ 717.1</u>	<u>\$ 696.0</u>	<u>\$ 21.1</u>

As noted, net assets increased by \$21.1 million from operations, a 3.0% growth this year. This amount is lower than fiscal 2010, when net assets increased \$26.1 million, a 3.9% growth. Total revenue decreased 4.7% and expenses increased by 2.9%, primarily due to the decrease in home sales.

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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, unassigned 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 2011, the Department's governmental funds reported a combined increase in fund balance of \$14.5 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)		
	2011	2010	Change	2011	2010	Change	2011	2010	Change
General Fund	\$ 0.1	\$ 0.1	\$ -	\$ -	\$ -	\$ -	\$ 0.1	\$ 0.1	\$ -
General Loan Fund	73.5	70.2	3.3	24.5	20.0	4.5	49.0	50.2	(1.2)
Land Trust Fund	116.5	99.8	16.7	4.3	4.9	(0.6)	112.2	94.9	17.3
Operating Fund	15.5	14.7	0.8	1.8	1.5	0.3	13.7	13.2	0.5
Receipts Fund	2.6	2.5	0.1	2.5	3.1	(0.6)	0.1	(0.6)	0.7
Administration									
Account	23.7	22.0	1.7	3.5	3.6	(0.1)	20.2	18.4	1.8
Federal Grants	8.6	4.6	4.0	1.0	1.7	(0.7)	7.6	2.9	4.7
East West Collector									
Road Fund	7.1	14.2	(7.1)	0.7	0.6	0.1	6.4	13.6	(7.2)
Trust Fund	36.5	31.0	5.5	25.6	20.1	5.5	10.9	10.9	-
Other Funds	35.8	37.5	(1.7)	2.7	2.3	0.4	33.1	35.2	(2.1)
Total	\$ 319.9	\$ 296.6	\$ 23.3	\$ 66.6	\$ 57.8	\$ 8.8	\$ 253.3	\$ 238.8	\$ 14.5

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

	Revenues			Expenditures			Other Financing Sources and Lapsed Appropriations			Net Changes in Fund Balances (Deficit)		
	2011	2010	Change	2011	2010	Change	2011	2010	Change	2011	2010	Change
General Loan Fund	\$ -	\$ -	\$ -	\$ 1.2	\$ 2.7	\$ (1.5)	\$ -	\$ -	\$ -	\$ (1.2)	\$ (2.7)	\$ 1.5
Land Trust Fund	15.1	22.1	(7.0)	29.3	46.7	(17.4)	31.5	16.0	15.5	17.3	(8.6)	25.9
Operating Fund	1.1	1.2	(0.1)	7.6	9.3	(1.7)	7.0	8.7	(1.7)	0.5	0.6	(0.1)
Receipts Fund	5.7	7.4	(1.7)	-	-	-	(5.0)	(5.0)	-	0.7	2.4	(1.7)
Administration												
Account	12.6	12.1	0.5	8.8	10.3	(1.5)	(2.0)	(3.7)	1.7	1.8	(1.9)	3.7
Federal Grants	16.7	10.8	5.9	12.0	10.5	1.5	-	-	-	4.7	0.3	4.4
East West Collector												
Road Fund	-	-	-	7.2	0.9	6.3	-	14.5	(14.5)	(7.2)	13.6	(20.8)
Other Funds	7.8	10.5	(2.7)	9.9	5.5	4.4	-	(0.3)	0.3	(2.1)	4.7	(6.8)
Total	\$ 59.0	\$ 64.1	\$ (5.1)	\$ 76.0	\$ 85.9	\$ (9.9)	\$ 31.5	\$ 30.2	\$ 1.3	\$ 14.5	\$ 8.4	\$ 6.1

Overall, the assets for the Department increased by \$23.3 million, liabilities increased by \$8.8 million, and fund balance increased by \$14.5 million.

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Budgetary Highlights

In the Hawaiian Home Administration Account, the actual revenue was greater than the budgeted amount by \$0.5 million and expenditures were \$3.8 million less than the budgeted amount. The overall favorable variance of \$4.3 million was created by expenditure control measures.

Capital Asset and Debt Administration

Capital Assets

At the end of fiscal year 2011, the Department had invested \$714.0 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 \$24.5 million, or 3.6%, over last year.

**Capital Assets
(in millions)**

	2011	2010	Increase (Decrease)
Buildings and improvements	\$ 28.5	\$ 28.5	\$ -
Furniture and equipment	6.3	6.3	-
Motor vehicles	0.9	0.9	-
Infrastructure	<u>606.3</u>	<u>594.9</u>	<u>11.4</u>
Total depreciable assets	642.0	630.6	11.4
Less: Accumulated depreciation	<u>(167.6)</u>	<u>(146.8)</u>	<u>(20.8)</u>
Net depreciable assets	474.4	483.8	(9.4)
Land	41.8	41.8	-
Construction in progress	<u>30.2</u>	<u>17.1</u>	<u>13.1</u>
Total capital assets	<u>\$ 546.4</u>	<u>\$ 542.7</u>	<u>\$ 3.7</u>

In fiscal year 2011, the Department expended \$24.5 million for various capital projects, including \$4.4 million for the Lalamilo development, \$2.4 million for the La'iohua Villages development, \$1.8 million for Puukapu Hybrid Water System project, and \$14.2 million for an East Kapolei development.

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Long-Term Debt

In 2009, the Department issued Revenue Bonds, Series 2009, to fund the planning, design and construction projects on the Hawaiian Home Lands. The Department also has a note payable to reimburse the Housing and Community Development Corporation of Hawai'i 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.

**Outstanding Debt
(in millions)**

	2011	2010	Increase (Decrease)
Notes payable	\$ 19.4	\$ 20.2	\$ (0.8)
Capital lease obligation	23.2	23.9	(0.7)
Bonds payable, net	41.0	41.8	(0.8)
Total	<u>\$ 83.6</u>	<u>\$ 85.9</u>	<u>\$ (2.3)</u>

Economic Factors and Next Year's Budgets

Revenues generated from general leases, revocable permits, licenses and right of entry agreements are projected to total \$8.7 million. This represents an increase of 0.1% from the prior fiscal year projection. The increase is primarily due to scheduled increase of rents and fees.

Currently Known Facts or Decisions

In 1921, the United States Congress, through the enactment of the Hawaiian Homes Commission Act, set aside lands in the Territory of Hawai'i for the purpose of returning native Hawaiians onto Hawaiian home lands. Today, the Department of Hawaiian Home Lands administers this trust, and serves more than 29 communities in 20 regions throughout the State of Hawai'i. The mission of the Department of Hawaiian Home Lands is to manage the Hawaiian home lands trust effectively and to develop and deliver lands to native Hawaiians. The Department of Hawaiian Home Lands also partners with others towards the development of self-sufficient and healthy communities.

The Department of Hawaiian Home Lands has recently revised its strategic plan with four goals, which include: 1) reaffirm the trust status, 2) ensure the financial well-being of the trust, 3) provide excellent customer service to the beneficiaries and 4) deliver diverse homesteading opportunities to the beneficiaries.

In the past, the Department of Hawaiian Home Lands focused primarily on delivering single-family homes to its beneficiaries. Due to the need to place more native Hawaiians on Hawaiian home lands, coupled with the current and challenging financial times, the trust and the Department is seeking to expand the type of products it will offer to its beneficiaries. Multi-family homes, rental, and transitional housing will be explored to determine if such products will provide relief to applicants on the wait list. Agricultural and pastoral awards will be reinstated as a priority, and aquaculture will also be considered.

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Statement of Net Assets
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Assets

Equity in cash and cash equivalents and investments held in State Treasury	\$ 196,982,068
Cash and short-term investments held outside of State Treasury	1,403
Receivables	
Due from State Treasury	6,062,882
Loans, net of allowance for losses of \$15,094,000	70,423,306
Accrued interest	2,724,854
General leases and licenses, net of allowance for losses of \$1,575,000	1,440,738
Other	883,226
Inventory of homes for sale and development	7,448,058
Restricted cash and investments	5,896,884
Other assets	2,512,053
Capital assets, net	<u>546,465,039</u>
Total assets	<u>\$ 840,840,511</u>

Liabilities

Vouchers and contracts payable	\$ 6,783,740
Accrued wages and employee benefits payable	835,254
Due to State Treasury	227,459
Due to Federal agency	1,918,408
Interest payable	752,091
Temporary deposits payable	23,693,883
Other liabilities	2,397,394
Deferred revenue	2,114,746
Due within one year	
Notes payable	2,200,000
Capital lease obligation	705,000
Bonds payable	781,175
Accrued vacation	467,223
Due in more than one year	
Notes payable	17,170,000
Capital lease obligation	22,465,000
Bonds payable, net of discount of \$483,000	40,220,604
Accrued vacation	<u>991,483</u>
Total liabilities	<u>123,723,460</u>

Commitments and contingencies

Net Assets

Invested in capital assets, net of related debt	463,883,608
Restricted for	
Capital projects	36,758,040
Debt reserve agreements	5,896,884
Loans and loan commitments	70,423,306
Guaranteed and insured loans	2,500,000
Unrestricted	<u>137,655,213</u>
Total net assets	<u>717,117,051</u>
Total liabilities and net assets	<u>\$ 840,840,511</u>

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

State of Hawai'i
Department of Hawaiian Home Lands
Statement of Activities
Year Ended June 30, 2011

Functions/Programs	Program Expenses	Program Revenue		Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	
Administration and support services	\$ 13,574,398	\$ 8,257,240	\$ 2,303,734	\$ (3,013,424)
Homestead services	28,552,791	5,383,660	1,046,157	(22,122,974)
Land development	1,517,968	8,166,339	8,831,923	15,480,294
Home construction	24,101,535	10,270,979	-	(13,830,556)
Land management	2,240,651	12,878,815	-	10,638,164
Total governmental activities	\$ 69,987,343	\$ 44,957,033	\$ 12,181,814	(12,848,496)
General revenues				
State appropriations, net of lapsed appropriations of \$36,466				3,989,534
Transfers, net				<u>30,000,000</u>
Total general revenues and transfers				<u>33,989,534</u>
Change in net assets				21,141,038
Net assets at July 1, 2010				<u>695,976,013</u>
Net assets at June 30, 2011				<u>\$ 717,117,051</u>

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

State of Hawai'i
Department of Hawaiian Home Lands
Balance Sheet
Governmental Funds
June 30, 2011

	General Fund	Hawaiian Home General Loan Fund	Hawaiian Home Lands Trust Fund	Hawaiian Home Operating Fund	Hawaiian Home Receipts Fund	Hawaiian Home Administration Account	Federal Grants	East West Collector Road Fund	Hawaiian Home Trust Fund	Other Funds	Total
Assets											
Equity in cash and cash equivalents and investments held in State Treasury	\$ -	\$ 11,504,810	\$ 108,748,146	\$ 15,151,804	\$ -	\$ 19,622,619	\$ 145,927	\$ 7,074,794	\$ 10,850,100	\$ 23,883,868	\$ 196,982,068
Cash and short-term investments held outside of State Treasury	-	-	-	-	-	-	-	-	-	1,403	1,403
Receivables											
Due from other funds	-	118,134	235,033	-	-	-	32,875	-	25,612,291	-	25,998,333
Due from State	86,020	-	-	-	-	-	-	-	-	5,976,862	6,062,882
Loans, net of allowance for losses of \$15,094,000	-	59,857,445	-	-	-	-	8,028,694	-	-	2,537,167	70,423,306
Accrued interest	-	-	65,357	11,323	2,598,449	15,651	19,457	-	-	14,617	2,724,854
General leases and licenses, net of allowance for losses of \$1,575,000	-	-	-	-	-	1,440,738	-	-	-	-	1,440,738
Other	-	150,214	-	350,272	-	-	382,740	-	-	-	883,226
Inventory of homes for sale and development	-	-	7,448,058	-	-	-	-	-	-	-	7,448,058
Restricted cash and investments	-	-	-	-	-	2,601,479	-	-	-	3,295,405	5,896,884
Other assets	-	1,899,002	-	-	-	-	-	-	-	153,279	2,052,281
Total assets	\$ 86,020	\$ 73,529,605	\$ 116,496,594	\$ 15,513,399	\$ 2,598,449	\$ 23,680,487	\$ 8,609,693	\$ 7,074,794	\$ 36,462,391	\$ 35,862,601	\$ 319,914,033
Liabilities											
Vouchers and contracts payable	\$ -	\$ -	\$ 4,299,354	\$ 318,367	\$ -	\$ 766,911	\$ 838,643	\$ 693,149	\$ -	\$ 1,259,407	\$ 8,175,831
Accrued wages and employee benefits payable	-	-	-	407,552	-	427,702	-	-	-	-	835,254
Due to other funds	-	23,581,627	-	449,294	1,849,278	-	118,134	-	-	-	25,998,333
Due to State Treasury	-	-	-	172,690	54,769	-	-	-	-	-	227,459
Due to Federal agency	-	-	-	-	-	-	-	-	1,918,408	-	1,918,408
Temporary deposits payable	-	-	-	-	-	-	-	-	23,693,883	-	23,693,883
Other liabilities	-	964,456	-	-	-	-	-	-	-	1,432,938	2,397,394
Deferred revenue	-	-	-	441,658	560,991	2,327,171	-	-	-	-	3,329,820
Total liabilities	-	24,546,083	4,299,354	1,789,561	2,465,038	3,521,784	956,777	693,149	25,612,291	2,692,345	66,576,382
Fund Balances											
Restricted for											
Debt agreements	-	-	-	-	-	2,601,479	-	-	-	3,295,405	5,896,884
Guaranteed and insured loans	-	150,000	-	-	-	-	-	-	2,350,000	-	2,500,000
Federal loan programs	-	-	-	-	-	-	7,652,916	-	-	-	7,652,916
Assigned to											
Home loans and homestead services	-	60,846,930	-	-	133,411	-	-	-	8,500,100	4,672,992	74,153,433
Land management	76,020	-	-	13,723,838	-	17,557,224	-	-	-	-	31,357,082
Home construction and land development	-	-	112,197,240	-	-	-	-	7,072,444	-	25,625,396	144,895,080
Unassigned	10,000	(12,013,408)	-	-	-	-	-	(690,799)	-	(423,537)	(13,117,744)
Total fund balances	86,020	48,983,522	112,197,240	13,723,838	133,411	20,158,703	7,652,916	6,381,645	10,850,100	33,170,256	253,337,651
Total liabilities and fund balances	\$ 86,020	\$ 73,529,605	\$ 116,496,594	\$ 15,513,399	\$ 2,598,449	\$ 23,680,487	\$ 8,609,693	\$ 7,074,794	\$ 36,462,391	\$ 35,862,601	\$ 319,914,033

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

State of Hawai'i
Department of Hawaiian Home Lands
Reconciliation of the Governmental Funds Balance Sheet
to the Statement of Net Assets
June 30, 2011

Total fund balances – governmental funds		\$ 253,337,651
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	\$ 606,314,130	
Land	41,824,230	
Building and improvements	28,509,298	
Construction-in-progress	30,239,057	
Other capital assets	7,227,071	
Accumulated depreciation	<u>(167,648,747)</u>	546,465,039
Other assets are not available to pay for current-period expenditures and therefore, are deferred, or not recognized, in the funds.		459,772
Certain revenues not collected within 60 days after the end of the year are deferred in the funds.		1,215,074
Accrued interest payable is not recognized in governmental funds.		(752,091)
Long-term debt payment accruals are included as an expenditure for governmental funds but are included in bonds payable and capital lease obligation in the statement of net assets.		1,392,091
Some long-term liabilities are not due and payable in the current period and therefore are not reported in the funds, including		
Notes payable		(19,370,000)
Capital lease obligation		(23,170,000)
Bonds payable		(41,001,779)
Accrued vacation		<u>(1,458,706)</u>
Net assets of governmental activities		<u>\$ 717,117,051</u>

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

State of Hawai'i
Department of Hawaiian Home Lands
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
Year Ended June 30, 2011

	General Fund	Hawaiian Home General Loan Fund	Hawaiian Home Lands Trust Fund	Hawaiian Home Operating Fund	Hawaiian Home Receipts Fund	Hawaiian Home Administration Account	Federal Grants	East West Collector Road Fund	Hawaiian Home Trust Fund	Other Funds	Total
Revenues											
State appropriations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 4,026,000	\$ 4,026,000
General leases	-	-	-	-	-	8,146,766	-	-	-	-	8,146,766
Licenses and permits	-	-	-	-	-	3,889,240	-	-	-	-	3,889,240
Interest from loans and note receivable	-	-	-	275	4,299,002	-	114,725	-	-	-	4,414,002
Investment income	-	-	2,822,908	45,918	1,280,139	515,968	-	-	-	581,523	5,246,456
Intergovernmental revenues	-	-	612,178	-	-	-	12,181,814	-	-	3,000,000	15,793,992
Real property sold	-	-	10,270,979	-	-	-	-	-	-	-	10,270,979
Other	-	-	1,378,613	1,077,696	-	38,528	4,480,484	-	-	321,453	7,296,774
Total revenues	-	-	15,084,678	1,123,889	5,579,141	12,590,502	16,777,023	-	-	7,928,976	59,084,209
Expenditures											
Current											
Administration and support services	1,925	-	939,314	3,272,699	-	5,013,810	2,252,110	-	-	1,164,583	12,644,441
Homestead services	-	1,220,161	434,780	2,184,605	-	2,313,986	915,040	-	-	4,735	7,073,307
Land development	-	-	610,979	750,496	-	875,635	-	-	-	-	2,237,110
Land management	-	-	515,966	1,102,627	-	619,336	-	-	-	-	2,237,929
Capital outlay											
Home construction/capital projects	-	-	26,746,744	117,782	-	-	8,817,327	7,210,942	-	5,767,317	48,660,112
Debt service											
Principal	-	-	-	172,690	-	-	-	-	-	661,250	833,940
Interest	-	-	-	-	-	-	-	-	-	2,347,669	2,347,669
Total expenditures	1,925	1,220,161	29,247,783	7,600,899	-	8,822,767	11,984,477	7,210,942	-	9,945,554	76,034,508
Excess (deficiency) of revenues over (under) expenditures	(1,925)	(1,220,161)	(14,163,105)	(6,477,010)	5,579,141	3,767,735	4,792,546	(7,210,942)	-	(2,016,578)	(16,950,299)
Other financing sources (uses)											
Other financing source	-	-	1,517,900	-	-	-	-	-	-	-	1,517,900
Transfers in	-	-	30,000,000	6,960,243	-	2,004,667	-	-	-	2,500	38,967,410
Transfers out	-	-	-	-	(4,960,244)	(4,002,500)	-	-	-	(4,666)	(8,967,410)
Total other financing sources (uses)	-	-	31,517,900	6,960,243	(4,960,244)	(1,997,833)	-	-	-	(2,166)	31,517,900
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(1,925)	(1,220,161)	17,354,795	483,233	618,897	1,769,902	4,792,546	(7,210,942)	-	(2,018,744)	14,567,601
Lapsed appropriations	-	-	-	-	-	-	-	-	-	(36,466)	(36,466)
Net change in fund balances	(1,925)	(1,220,161)	17,354,795	483,233	618,897	1,769,902	4,792,546	(7,210,942)	-	(2,055,210)	14,531,135
Fund balances (deficit) at July 1, 2010	87,945	50,203,683	94,842,445	13,240,605	(485,486)	18,388,801	2,860,370	13,592,587	10,850,100	35,225,466	238,806,516
Fund balances at June 30, 2011	\$ 86,020	\$ 48,983,522	\$ 112,197,240	\$ 13,723,838	\$ 133,411	\$ 20,158,703	\$ 7,652,916	\$ 6,381,645	\$ 10,850,100	\$ 33,170,256	\$ 253,337,651

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

State of Hawai'i
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, 2011

Net change in fund balances – governmental funds		\$ 14,531,135
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	\$ 24,558,577	
Depreciation expense	<u>(20,780,917)</u>	
Excess of capital outlay over depreciation expense		3,777,660
Repayment 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.		795,025
Repayment of capital lease obligation is reported as an expenditure in governmental funds, but the repayment reduces the capital lease obligation in the statement of net assets.		680,000
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.		408,637
The net decrease 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.		105,691
Long-term debt payment accruals are included as an expenditure for governmental funds but are included in bonds payable and capital lease obligation in the statement of net assets.		23,256
The amortization of the bond issuance costs do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.		(16,568)
Proceeds from a note payable are reported as other financing sources in the governmental funds, but are reported as an increase in notes payable in the statement of net assets.		<u>(1,363,798)</u>
Change in net assets of governmental activities		<u>\$ 21,141,038</u>

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

State of Hawai‘i
Department of Hawaiian Home Lands
Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis)
Hawaiian Home Administration Account
Year Ended June 30, 2011

	<u>Budgeted Amounts</u>		Actual (Budgetary Basis)	Variance Over (Under)
	<u>Original</u>	<u>Final</u>		
Revenues	<u>\$ 12,102,420</u>	<u>\$ 12,102,420</u>	<u>\$ 12,590,502</u>	<u>\$ 488,082</u>
Expenditures				
Administration and support services	6,322,563	6,322,563	4,651,876	1,670,687
Homestead services	3,553,724	3,553,724	2,201,124	1,352,600
Land development	1,480,367	1,480,367	842,782	637,585
Land management	<u>745,766</u>	<u>745,766</u>	<u>603,024</u>	<u>142,742</u>
Total expenditures	<u>12,102,420</u>	<u>12,102,420</u>	<u>8,298,806</u>	<u>3,803,614</u>
Excess of revenues over expenditures	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,291,696</u>	<u>\$ 4,291,696</u>

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

State of Hawai'i
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2011

1. Organization and Summary of Significant Accounting Policies

Financial Reporting Entity

The State of Hawai'i, 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 Hawai'i State Government Reorganization Act of 1959), Second Special Session Laws of Hawai'i 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 Hawai'i (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.

State of Hawai‘i
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2011

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.

As of June 30, 2011, fund balances of the governmental funds are classified as follows:

- *Nonspendable* – amounts that cannot be spent because they are either in nonspendable form or they are legally or contractually required to be maintained intact.
- *Restricted* – amounts that are restricted for specific purposes due to constitutional provisions or enabling legislation or constraints that are externally imposed by creditors, grantors, contributors, or laws or regulations of other governments.
- *Committed* – amounts that can be used only for specific purposes determined by a formal action of the State Legislature. The State Legislature is the highest level of decision-making authority for the Department. Commitments may be established, modified, or rescinded only through formal acts by the State Legislature.
- *Assigned* – amounts that do not meet the criteria to be classified as restricted or committed but that are intended to be used for specific purposes. Under the Department's adopted policy, only the Hawaiian Homes Commission may assign amounts for specific purposes.
- *Unassigned* – all other spendable amounts.

When both restricted and unrestricted balances are available for use, it is the Department's policy to use restricted fund balance first, then unrestricted fund balance. Furthermore, committed fund balances are reduced first, followed by assigned amounts, and then unassigned amounts when expenditures are incurred for purposes for which amounts in any of those unrestricted classifications can be used.

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.

State of Hawai‘i
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2011

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 Lands Trust Fund* – The Hawaiian Home Lands 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 “available” lands as defined under the HHCA. 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.
- *East West Connector Road Fund* – The East West Connector Road Fund is used to account for expenditures related to the construction of the East West Connector Road.
- *Hawaiian Home Trust Fund* – The Hawaiian Home Trust Fund is used to account for the loan principal and interest payments the Department collects on assumed loans from HUD as part of the mortgage loan insurance agreement. The amounts maintained in this fund provide for payment of any mortgage insurance claims and expenditures incurred by HUD in connection with the lessee borrowings.

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.

State of Hawai'i
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2011

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 at June 30, 2011 for the Department's governmental funds were as follows:

	Contracts	Claims
General Fund	\$ 76,000	\$ -
Lands Trust Fund	23,222,000	1,534,000
Operating Fund	3,710,000	2,848,000
Administration Account	486,000	871,000
Federal Grants	-	1,377,000
East West Collector Road Fund	7,072,000	-
Other Funds	<u>8,117,000</u>	<u>1,997,000</u>
Total	<u>\$ 42,683,000</u>	<u>\$ 8,627,000</u>

Equity in Cash and Cash Equivalents and Investments Held in State Treasury

The State Director of Finance is responsible for the safekeeping of cash and investments 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. 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, 2011. The State's CAFR can be found at the Department of Accounting and General Services' website: <http://hawaii.gov/dags/rpts>.

Cash and short-term investments held outside of State Treasury are held in a financial institution outside of the State of Hawai'i.

In January 2012, DAGS informed state agencies participating in the State Treasury Investment Pool that the State's investments in auction rate securities would be adjusted as of and for the year ended June 30, 2011 and that each participating State agency would be allocated a portion of the adjustment. The Department's total allocated adjustment for fiscal 2011 amounted to \$3,936,426.

State of Hawai‘i
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2011

Restricted Cash and Investments

Cash and cash equivalents held with an escrow agent and invested until the repayment of certain obligations have been classified as restricted assets. Cash equivalents are primarily comprised of cash held in money market funds.

The Department invests funds held by Wells Fargo related to the capital lease obligation. 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 are considered investment income and the funds are restricted to funding future capital lease payments.

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.

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

State of Hawai'i
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2011

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.

Temporary Deposits Payable

As part of the mortgage loan insurance agreement, the Department assumes delinquent mortgage loans from HUD. The temporary deposits payable balance represents the amount of loans assumed, less any payments made to HUD, for the payment of future mortgage insurance claims.

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 Hawai'i ("ERS"). Accumulated sick leave as of June 30, 2011, was approximately \$4,247,000.

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 \$1,215,000 as of June 30, 2011, and are recorded as deferred revenue in the governmental funds balance sheet. The departmental financial statements present lease rents and mortgage interest under the accrual method of accounting.

Fund Balance Deficits

The Hawaiian Home General Loan, the East West Collector Road, and Hawaiian Home Lands Bond funds had a deficit in the unassigned fund balance at June 30, 2011. The deficits resulted primarily from expenditures being recorded on the accrual basis when incurred, and revenue being recognized only when funds are measurable and available.

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 December 2010, the GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The objective of this Statement is to enhance the usefulness of the Codification of Governmental Accounting and Financial Reporting Standards by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board and American Institute of Certified Public Accountants pronouncements. The requirements of this Statement are effective for reporting

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periods beginning after December 15, 2011. Management does not expect that this Statement will have a material effect on the Department's financial statements.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The Statement is intended to improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. The provisions of this Statement are effective for periods beginning after December 15, 2011. The Department has not yet determined the effect this Statement will have on 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 Hawai'i, 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. During the year ended June 30, 2011, the general fund had no revenues or expenditures budgeted.

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 – Hawaiian Home Administration Account, is presented on the budgetary basis. A reconciliation of Hawaiian Home Administration Account revenues in excess of expenditures on a budgetary basis for the year ended June 30, 2011, to Hawaiian Home Administration Account 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 Hawai'i Revised Statutes ("HRS"), staff salaries and wages amounting to approximately \$428,000 in the Hawaiian Home Administration Account, for the period from June 16, 2011 through June 30, 2011, are to be funded with monies budgeted for fiscal year 2011. Accordingly, these amounts are excluded from the statements of revenues and expenditures – budget and actual of the 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.

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Salaries and wages amounting to approximately \$335,000 in the Hawaiian Home Administration Account, for the period from June 16, 2010 to June 30, 2010, were funded with monies budgeted for fiscal year 2011. Accordingly, these amounts are included in the statements of revenues and expenditures – budget and actual of the Hawaiian Home Administration Account, for the year ended June 30, 2011.

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

Excess of revenues over expenditures – actual on budgetary basis	\$ 4,291,696
Current year's appropriations encumbered at June 30, 2011	729,369
Current year encumbrances included in vouchers payable	(766,271)
Expenditures for liquidation of prior year's encumbrances	(392,290)
Fiscal 2010 expenditures funded by fiscal 2011 budget	332,934
Fiscal 2011 expenditures funded by fiscal 2012 budget under Section 78-13 HRS	<u>(427,703)</u>
Excess of revenues over expenditures – GAAP basis	<u>\$ 3,767,735</u>

3. Cash and Investments

Equity in cash and cash equivalents and investments include monies in the State Treasury. For financial statement reporting purposes, cash and cash equivalents and investments consist of cash, time certificates of deposit, money market accounts, repurchase agreements, auction rate securities and U.S. government securities.

The Department maintains cash related to the capital lease obligation and revenue bonds in cash held outside of the State Treasury through a financial institution outside of the State of Hawai'i. At June 30, 2011, the carrying balance of the Department's cash outside of the State Treasury aggregated \$4,145,996, which exceeds federal deposit insurance limits.

Investments in obligations of the U.S. government mature at various dates through December 2011. At June 30, 2011, the securities had an original cost of \$1,748,998, fair value of \$1,752,291, and a net unrealized gain of \$3,293.

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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 \$397,000 and for a maximum term of 30 years. Loan payments expected to be collected within the next fiscal year approximates \$2,180,000. Interest rates on outstanding loans range from 2.5% to 9.5%. 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, 2011 were approximately \$989,000. The Department has provided an allowance for loan losses of approximately \$15,094,000 as of June 30, 2011. 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, 2011.

5. Inventory of Homes for Sale and Development

As of June 30, 2011, the Department constructed and sold a total of 557 homes to native Hawaiians in various locations throughout Hawai'i. As of June 30, 2011, the Department reflected development costs for new projects of approximately \$7,448,000.

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, 2011, the Department had purchased homes from former lessees with costs aggregating \$2,052,000.

6. Capital Assets

Capital assets activity for the year ended June 30, 2011, was as follows:

	Balance July 1, 2010	Additions	Disposals / Transfers	Balance June 30, 2011
Capital assets, not being depreciated				
Land	\$ 41,824,230	\$ -	\$ -	\$ 41,824,230
Works of art, historical treasures	29,426	-	-	29,426
Construction in progress	17,136,652	24,369,460	(11,267,055)	30,239,057
Total capital assets, not being depreciated	<u>58,990,308</u>	<u>24,369,460</u>	<u>(11,267,055)</u>	<u>72,092,713</u>
Capital assets, being depreciated				
Buildings and improvements	28,509,298	-	-	28,509,298
Infrastructure	594,857,958	11,456,172	-	606,314,130
Furniture and equipment	6,266,098	-	-	6,266,098
Motor vehicles	931,547	-	-	931,547
Total capital assets, being depreciated	<u>630,564,901</u>	<u>11,456,172</u>	<u>-</u>	<u>642,021,073</u>
Less: Accumulated depreciation for				
Buildings and improvements	(5,523,137)	(912,135)	-	(6,435,272)
Infrastructure	(137,423,420)	(19,107,135)	-	(156,530,555)
Furniture and equipment	(3,048,743)	(727,374)	-	(3,776,117)
Motor vehicles	(872,530)	(34,273)	-	(906,803)
Total accumulated depreciation	<u>(146,867,830)</u>	<u>(20,780,917)</u>	<u>-</u>	<u>(167,648,747)</u>
Total capital assets, being depreciated, net	<u>483,697,071</u>	<u>(9,324,745)</u>	<u>-</u>	<u>474,372,326</u>
Capital assets, net	<u>\$ 542,687,379</u>	<u>\$ 15,044,715</u>	<u>\$ (11,267,055)</u>	<u>\$ 546,465,039</u>

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Depreciation expense for the year ended June 30, 2011 was charged to functions of the Department as follows:

Administration and support services	\$ 1,669,331
Homestead services	19,109,814
Land management	<u>1,772</u>
Total depreciation	<u>\$ 20,780,917</u>

7. Long-Term Obligations

For the year ended June 30, 2011, changes in long-term obligations were as follows:

	Notes Payable	Capital Lease Obligation	Bonds Payable, Net	Accrued Vacation
Balances at July 1, 2010	\$ 20,206,202	\$ 23,850,000	\$ 41,796,804	\$ 1,564,397
Increase	1,363,798	-	-	574,906
Decrease	<u>(2,200,000)</u>	<u>(680,000)</u>	<u>(795,025)</u>	<u>(680,597)</u>
Balances at June 30, 2011	<u>\$ 19,370,000</u>	<u>\$ 23,170,000</u>	<u>\$ 41,001,779</u>	<u>\$ 1,458,706</u>

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

8. Notes Payable

Land Acquisition / Purchase Note Payable

In December 2004, the Department entered into a transfer agreement with the Housing and Community Development Corporation of Hawai'i ("HCDCH"), State of Hawai'i 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 HCDCH, for infrastructure costs at three of the properties. This note is non-interest bearing. At June 30, 2011, the Department owed \$17,600,000 to HCDCH. The note will be repaid with monies in the Department's Hawaiian Home Land Trust Fund.

Note Payable to Department of Business, Economic Development and Tourism

In June 2009, the Department entered into a loan agreement with the Department of Business, Economic Development and Tourism ("DBEDT") for the environmental remediation of real property located in Ewa Beach, Hawai'i. The promissory note included a 20% discount not to exceed \$200,000 and is payable on the earlier of June 1, 2013 or six months following the satisfactory completion of the environmental remediation. This note is non-interest bearing. During 2011, the Department received proceeds of \$1,517,900. As of June 30, 2011, the Department owed \$1,770,000, net of a \$200,000 discount, to DBEDT.

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The annual payment requirements of the notes are as follows:

	Purchase Note Payable	DBEDT Note Payable	Total
Year ending June 30,			
2012	\$ 2,200,000	\$ -	\$ 2,200,000
2013	2,200,000	1,770,000	3,970,000
2014	2,200,000		2,200,000
2015	2,200,000	-	2,200,000
2016	2,200,000	-	2,200,000
2017 – 2019	6,600,000	-	6,600,000
	<u>\$ 17,600,000</u>	<u>\$ 1,770,000</u>	<u>\$ 19,370,000</u>

9. 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 was 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, 2011, the interest rate was 2.20%. 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,	
2012	\$ 1,711,000
2013	1,712,000
2014	1,711,000
2015	1,713,000
2016	1,712,000
Thereafter	<u>27,383,000</u>
Total minimum lease payments	35,942,000
Amount representing interest	<u>12,772,000</u>
Present value of minimum lease payments	23,170,000
Less: Current portion	<u>705,000</u>
Long-term portion	<u>\$ 22,465,000</u>

The cost basis and accumulated depreciation of the leased assets at June 30, 2011 was as follows:

Cost	\$ 25,513,266
Less: Accumulated depreciation	<u>(4,540,470)</u>
	<u>\$ 20,972,796</u>

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10. Bonds Payable

The following are the revenue bonds issued by the Department and portions of the State general obligation bonds allocated to the Department under acts of various Session Laws of Hawai'i. The revenue bonds are payable from and collateralized by the Department's revenues generated from certain capital improvement projects. The general obligation 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 Department's revenue and allocated general obligation bonds as of June 30, 2011, are as follows:

\$42,500,000 revenue bonds dated March 18, 2009; due in annual principal installments of \$640,000 to \$2,840,000 from October 1, 2009 through October 1, 2039; interest at 2.00% to 6.00% payable semi-annually.	\$ 41,205,000
\$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.	55,569
\$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.	15,538
\$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.	11,063
\$65,992 Series CW refunding 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.	32,467
\$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.	70,440
\$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.	5,299
\$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.	89,733
	<u>41,485,109</u>
Less: Unamortized discount on revenue bonds	<u>(483,330)</u>
	<u>\$ 41,001,779</u>

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

	Interest	Principal	Total
Year ending June 30,			
2012	\$ 2,337,210	\$ 781,175	\$ 3,118,385
2013	2,305,193	757,434	3,062,627
2014	2,273,130	781,638	3,054,768
2015	2,238,997	815,032	3,054,029
2016	2,202,167	829,913	3,032,080
2017 – 2021	10,367,699	4,729,917	15,097,616
2022 – 2026	8,987,570	6,070,000	15,057,570
2027 – 2031	7,039,194	8,010,000	15,049,194
2032 – 2036	4,391,951	10,660,000	15,051,951
2037 – 2039	984,600	8,050,000	9,034,600
	<u>\$ 43,127,711</u>	<u>\$ 41,485,109</u>	<u>\$ 84,612,820</u>

11. Employee Benefit Plans

Substantially all employees of the Fund participate in the State's various employee benefit plans, including the Employees' Retirement System ("ERS") of the State of Hawai'i, post-employment healthcare and life insurance plan, and a deferred compensation plan. For more information on the State's benefit plans, refer to the State of Hawai'i and ERS' Comprehensive Annual Financial Reports ("CAFR"). The State's CAFR can be found at the Department of Accounting and General Services' ("DAGS") website: <http://hawaii.gov/dags/rpts>. The ERS CAFR can be found at the ERS website: <http://ers.ehawaii.gov/Financials.htm>.

Employees' Retirement System

The ERS is 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.

Deferred Compensation Plan

The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all State employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or an unforeseeable emergency.

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but has the duty of due care that would be required of an ordinary prudent investor.

Post-Employment Healthcare and Life Insurance Benefits

The State contributes to the Hawai'i Employer-Union Health Benefits Trust Fund ("EUTF"), an agent multiple-employer defined benefit plan. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The eligibility requirements for retiree health benefits are based on date of hire.

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State Policy

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 stand-alone departmental financial statements or in the State’s CAFR. The basis for the allocation is the proportionate share of contributions made by each component unit and proprietary fund for retiree health benefits.

Amount of Contributions Made

Contributions are financed on a pay-as-you-go basis and the Department’s contributions for the years June 30, 2011, 2010, and 2009 were approximately \$1,036,000, \$1,122,000, and \$1,148,000, respectively.

Required Supplementary Information and Disclosures

The State’s CAFR includes the required footnote disclosures and supplementary information on the State’s OPEB plan.

12. 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, 2011, is as follows:

Year ending June 30,	
2012	\$ 8,698,000
2013	9,057,000
2014	9,061,000
2015	9,108,000
2016	9,432,000
2017 – 2021	52,770,000
2022 – 2026	62,062,000
2027 – 2031	55,400,000
2032 – 2036	51,023,000
2037 – 2041	49,181,000
2042 – 2046	46,384,000
2047 – 2051	44,301,000
2052 – 2056	43,019,000
2057 – 2061	10,193,000
2062 – 2066	7,443,000
2067 – 2070	3,536,000
	<u>\$ 470,668,000</u>

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13. 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, 2011, 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, 2011.

Guaranteed and Insured Loans

As of June 30, 2011, the Department was contingently liable for approximately \$34,858,000 in loans originated primarily by the U.S. Department of Agriculture Rural Development for which the Department has guaranteed repayment. Approximately \$2,973,000 of these loans have been reported delinquent as of June 30, 2011.

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, 2011, loans outstanding totaled approximately \$385,831,000 under this agreement, of which approximately \$41,489,000 has been reported as delinquent.

As of June 30, 2011, the Department was also contingently liable for approximately \$5,233,000 in loans originated by financial institutions and other lenders for which it had guaranteed repayment. Approximately \$1,846,000 of these loans has been reported delinquent as of June 30, 2011.

As of June 30, 2011, the Department paid approximately \$5,026,000 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, 2011.

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Other

Pursuant to Act 14, Special SLH 1995, the Hawaiian Home Lands 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 Lands 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 Hawai'i, to the Hawaiian Home Lands Trust Fund. As of June 30, 2011, the Department received approximately \$480,000,000 from the State to the Hawaiian Home Lands Trust Fund.

In December 2008, the Department entered into a collaborative financing arrangement with the Office of Hawaiian Affairs, State of Hawai'i ("OHA") in which OHA will provide funds for the Department's use in the planning, design, and construction of infrastructure for homesteads for native Hawaiians on properties owned and controlled by the Department. Under the agreement, OHA will pay the Department on an annual basis the lesser of \$3,000,000 or the debt service of the revenue bonds issued by the Department in 2009. As of June 30, 2011, the Department received \$9,000,000 from OHA.

14. 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 Hawai'i 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, 2011, 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.

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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 Hawai'i Supreme Court. In June 2006, the Hawai'i 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 plaintiffs 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.

By orders entered in August 2009, two new waiting list subclass representative plaintiffs were added, and the claims of one of the two previously named waiting list subclass representatives were dismissed. Trial on the liability portion of the waiting list subclass' claims began in August 2009 and, in November 2009, the circuit judge for the case ruled that the State of Hawai'i committed various breaches of trust between 1959 and 1988, and further proceedings were necessary to determine the amount of out-of-pocket damages the waiting list subclass members sustained, if any, as a result of those breaches. Trial to determine whether, and to what extent, if any, subclass members sustained out-of-pocket damages is yet to be scheduled. Management is unable to quantify the magnitude of potential liability, if any, for such claims.

Furthermore, claims for actual damages under Chapter 674 are made against the State of Hawai'i. 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.

15. Assessments for Central Service and Administrative Expenses

The State of Hawai'i 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, Hawai'i Revised Statutes. Pursuant to Section 36-31, Hawai'i 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, 2011, the Department's estimate of the accumulated asserted assessments since the inception of the aforementioned law approximated \$19,602,000.

Supplemental Information

**State of Hawai'i
 Department of Hawaiian Home Lands
 Combining Balance Sheet
 Nonmajor Governmental Funds
 June 30, 2011**

Supplemental Information

	Hawaiian Home Lands Bond Funds	Hawaiian Home Loan Fund	Department of Hawaiian Home Lands Revenue Bond Special Fund	Native Hawaiian Rehabilitation Fund	Protocol Funds	Temporary Deposits	Total Other Governmental Funds
Assets							
Equity in cash and cash equivalents and investments held in State Treasury	\$ -	\$ 1,990,104	\$ 13,343,237	\$ 7,124,250	\$ 1,406	\$ 1,424,871	\$ 23,883,868
Cash and short-term investments held outside of State Treasury	1,403	-	-	-	-	-	1,403
Receivables							
Due from State	5,976,862	-	-	-	-	-	5,976,862
Loans, net of allowance for losses	-	2,536,352	-	815	-	-	2,537,167
Accrued interest	-	-	8,530	6,087	-	-	14,617
Restricted cash and investments	-	-	3,295,405	-	-	-	3,295,405
Other assets	-	153,279	-	-	-	-	153,279
Total assets	\$ 5,978,265	\$ 4,679,735	\$ 16,647,172	\$ 7,131,152	\$ 1,406	\$ 1,424,871	\$ 35,862,601
Liabilities							
Vouchers and contracts payable	\$ 424,941	\$ -	\$ 752,101	\$ 82,283	\$ 82	\$ -	\$ 1,259,407
Other liabilities	-	8,067	-	-	-	1,424,871	1,432,938
Total liabilities	424,941	8,067	752,101	82,283	82	1,424,871	2,692,345
Fund Balances							
Restricted for							
Debt agreements	-	-	3,295,405	-	-	-	3,295,405
Assigned to							
Home loans and homestead services	-	4,671,668	-	-	1,324	-	4,672,992
Home construction and land development	5,976,861	-	12,599,666	7,048,869	-	-	25,625,396
Unassigned	(423,537)	-	-	-	-	-	(423,537)
Total fund balances	5,553,324	4,671,668	15,895,071	7,048,869	1,324	-	33,170,256
Total liabilities and fund balances	\$ 5,978,265	\$ 4,679,735	\$ 16,647,172	\$ 7,131,152	\$ 1,406	\$ 1,424,871	\$ 35,862,601

State of Hawai'i
Department of Hawaiian Home Lands
Combining Statement of Revenues, Expenditures and Changes in Fund Balances
Nonmajor Governmental Funds
Year Ended June 30, 2011

Supplemental Information

	Hawaiian Home Lands Bond Funds	Hawaiian Home Loan Fund	Department of Hawaiian Home Lands Revenue Bond Special Fund	Native Hawaiian Rehabilitation Fund	Protocol Funds	Temporary Deposits	Total Other Governmental Funds
Revenues							
State appropriations	\$ 4,026,000	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 4,026,000
Investment income	1,126	-	316,987	263,410	-	-	581,523
Intergovernmental revenues	-	-	3,000,000	-	-	-	3,000,000
Other	-	-	-	321,453	-	-	321,453
Total revenues	<u>4,027,126</u>	<u>-</u>	<u>3,316,987</u>	<u>584,863</u>	<u>-</u>	<u>-</u>	<u>7,928,976</u>
Expenditures							
Current							
Administration and support services	-	-	-	1,163,344	1,239	-	1,164,583
Homestead services	-	4,735	-	-	-	-	4,735
Capital outlay							
Home construction/capital projects	5,767,317	-	-	-	-	-	5,767,317
Debt service							
Principal	-	-	661,250	-	-	-	661,250
Interest	-	-	2,347,669	-	-	-	2,347,669
Total expenditures	<u>5,767,317</u>	<u>4,735</u>	<u>3,008,919</u>	<u>1,163,344</u>	<u>1,239</u>	<u>-</u>	<u>9,945,554</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(1,740,191)</u>	<u>(4,735)</u>	<u>308,068</u>	<u>(578,481)</u>	<u>(1,239)</u>	<u>-</u>	<u>(2,016,578)</u>
Other financing sources (uses)							
Transfers in	-	-	-	-	2,500	-	2,500
Transfers out	-	-	-	-	(4,666)	-	(4,666)
Total other financing sources (uses)	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(2,166)</u>	<u>-</u>	<u>(2,166)</u>
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	<u>(1,740,191)</u>	<u>(4,735)</u>	<u>308,068</u>	<u>(578,481)</u>	<u>(3,405)</u>	<u>-</u>	<u>(2,018,744)</u>
Lapsed appropriations	<u>(36,466)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(36,466)</u>
Net change in fund balances	<u>(1,776,657)</u>	<u>(4,735)</u>	<u>308,068</u>	<u>(578,481)</u>	<u>(3,405)</u>	<u>-</u>	<u>(2,055,210)</u>
Fund balances at July 1, 2010	<u>7,329,981</u>	<u>4,676,403</u>	<u>15,587,003</u>	<u>7,627,350</u>	<u>4,729</u>	<u>-</u>	<u>35,225,466</u>
Fund balances at June 30, 2011	<u>\$ 5,553,324</u>	<u>\$ 4,671,668</u>	<u>\$ 15,895,071</u>	<u>\$ 7,048,869</u>	<u>\$ 1,324</u>	<u>\$ -</u>	<u>\$ 33,170,256</u>

Schedule of Expenditures of Federal Awards

State of Hawai'i
Department of Hawaiian Home Lands
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2011

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 6	14.873	07HBGHI0002	\$ 6,065,209
Native Hawaiian Housing Block Grant, Year 7	14.873	08HBGHI0002	411,002
Native Hawaiian Housing Block Grant, Year 8	14.873	09HBGHI0001	26,612
Native Hawaiian Housing Block Grant (Recovery Act Funded)	14.883	08SHGHI0001	<u>5,886,484</u>
TOTAL FEDERAL EXPENDITURES			<u>\$ 12,389,307</u>

State of Hawai‘i
Department of Hawaiian Home Lands
Notes to the Schedule of Expenditures of Federal Awards
June 30, 2011

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, 2011. 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	\$ <u>8,028,694</u>

State of Hawai'i
Department of Hawaiian Home Lands
Notes to the Schedule of Expenditures of Federal Awards
June 30, 2011

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 6		
City and County of Honolulu	14.873	\$ 310,275
First Hawaiian Title Co.		306,900
Habitat for Humanity – Maui		48,374
Habitat for Humanity – Kauai		40,000
Council for Native Hawaiian Advancement		37,500
Hawai'i First Federal Credit Union		37,021
Habitat for Humanity – West Hawai'i		34,939
Habitat for Humanity – Honolulu		23,662
Habitat for Humanity – Molokai		17,573
Papakolea Community Development		15,161
County of Hawai'i		15,000
Hawaii Community Development		15,000
Habitat for Humanity – Leeward		10,500
Alu Like Inc.		3,000
		<u>914,905</u>
Native Hawaiian Housing Block Grant, Year 7		
Nanakuli Housing Corporation	14.873	342,439
Habitat for Humanity – Molokai		58,569
Habitat for Humanity – Honolulu		9,994
		<u>411,002</u>
Native Hawaiian Housing Block Grant, Year 8		
Nanakuli Housing Corporation	14.873	26,612
		<u>\$ 1,352,519</u>

PART II
Government Auditing Standards



CERTIFIED PUBLIC ACCOUNTANTS

**Report 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 Hawai'i

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawai'i, Department of Hawaiian Home Lands (the "Department") as of and for the year ended June 30, 2011, which collectively comprise the Department's basic financial statements and have issued our report thereon dated January 30, 2012. 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

Management of the Department is responsible for establishing and maintaining effective 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 opinion 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.

A *deficiency in internal control* 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 and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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*.

We noted certain other matters that we reported to the State Auditor and the Hawaiian Homes Commission in a separate letter dated January 30, 2012.

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, Hawai'i
January 30, 2012

**Report on Compliance With Requirements That Could Have a Direct
and Material Effect on Each Major Program and on Internal Control
Over Compliance With OMB Circular A-133**

The Auditor and the Hawaiian Homes Commission
State of Hawai'i

Compliance

We have audited the State of Hawai'i, Department of Hawaiian Home Lands' (the "Department") compliance with the types of compliance requirements described in the U.S. Office of Management and Budget ("OMB") *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Department's major federal programs for the year ended June 30, 2011. The Department's major federal programs are 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 each of its major federal programs 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 compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011.

Internal Control Over Compliance

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 program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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.

A deficiency in 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 and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

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, Hawai'i
January 30, 2012

PART III

Schedule of Findings and Questioned Costs

**State of Hawai'i
 Department of Hawaiian Home Lands
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2011**

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditor’s report issued Unqualified

Internal control over financial reporting

- Material weaknesses identified? ___ yes X no
- Significant deficiencies identified? ___ yes X 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? ___ yes X 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? ___ yes X no

Identification of major programs

CFDA Number	Name of Federal Program or Cluster
14.873	Native Hawaiian Housing Block Grant
14.883	Native Hawaiian Housing Block Grant (Recovery Act Funded)

Dollar threshold used to distinguish between type A and type B programs \$300,000

Auditee qualified as low-risk auditee? ___ yes X no

**State of Hawai'i
Department of Hawaiian Home Lands
Schedule of Findings and Questioned Costs
Year Ended June 30, 2011**

Section II – Financial Statement Findings

None noted.

Section III – Federal Award Findings and Questioned Costs

None noted.

**State of Hawai‘i
Department of Hawaiian Home Lands
Schedule of Findings and Questioned Costs
Year Ended June 30, 2011**

Section IV – Status of Prior Year Findings and Questioned Costs

Finding No. 10-01: Cash Management (Control Deficiency)

During our prior year audit, we noted 3 instances where the Department did not comply with the cash management procedures as set forth by the Office of Management and Budget (“OMB”). While the Department is required to disburse funds within an administratively reasonable period upon receipt, the Department did not disburse the drawdowns for 3 of the 13 items tested in a timely manner and held the funds for 8 to 10 days.

Status

Resolved. During the current year audit, we noted no instances of untimely cash disbursements. The Department also implemented procedures to ensure they have adequate funds prior to making a federal fund disbursement.