
A Report to the Governor and the Legislature of the State of Hawai‘i

Report No. 13-07
September 2013
Office of the Auditor

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

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

1. Financial audits attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.

2. Management audits, which are also referred to as performance audits, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called program audits, when they focus on whether programs are attaining the objectives and results expected of them, and operations audits, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.

3. Sunset evaluations evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.

4. Sunrise analyses are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.

5. Health insurance analyses examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.

6. Analyses of proposed special funds and existing trust and revolving funds determine if proposals to establish these funds are existing funds meet legislative criteria.

7. Procurement compliance audits and other procurement-related monitoring assist the Legislature in overseeing government procurement practices.

8. Fiscal accountability reports analyze expenditures by the state Department of Education in various areas.

9. Special studies respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

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

Report No. 13-07, September 2013

Better land planning and grant monitoring would help OHA fulfill its duties

Acquisition and management of real estate holdings are inadequately planned

As of February 2013, OHA owned or leased 28,206 acres, making it Hawai‘i’s 13th largest landowner. While these numbers may be impressive, we found that the OHA’s land management infrastructure is inadequate, unable to support the office’s growing portfolio nor any future land involvements. Without the policies, procedures, and staff to help guide and support the increased real estate activity, OHA’s Board of Trustees cannot ensure that its acquisitions are based on a strong financial foundation. For instance, we found that OHA’s real estate portfolio is unbalanced, with revenues generated from commercial properties unable to offset expenses from legacy and programmatic land holdings. In 2008, OHA trustees disregarded a consultant’s proposal to expand its Land and Property Management division as well as proposals for a real estate business plan and investment policy. Instead, in 2010, the trustees adopted a one-page real estate investment policy.

Grant oversight and accountability is lacking

During FY2012, OHA awarded more than $14 million in grants and sponsorships, with the largest going to education and housing programs and services. We found that OHA’s grant administration has been remiss in developing procedures and guidelines that are in accordance with all applicable statutes and board of trustees policies. This has led to inadequate and inconsistent grant monitoring that fails to ensure that grants are achieving their intended results. For example, files for the 30 grants we examined contained incomplete documentation of monitoring activities, which made it difficult to determine whether such activities were performed and reviewed by management or to determine their nature and extent. In addition, ten of the 30 files contained no evidence that grant monitors fulfilled responsibilities to address inadequate progress by grantees and/or non-compliance with reporting requirements. Finally, the office could not provide the grantee reports or other records for a $228,000 grant awarded to the Department of Land and Natural Resources in FY2012.

Agency Response

The board chair responded that OHA appreciated our recommendations and intends to further develop land policies to integrate cultural and commercial values that best support its lāhui (people). Regarding our finding about OHA’s lack of land policies, the chair said trustees waited until the Kaka’ako Makai land settlement was approved by the State before approving additional positions to manage OHA’s land holdings. This misses our broader point that OHA’s lack of a policy framework and other infrastructure to implement its real estate vision, mission, and strategy and other best practices is contrary to fulfillment of the board’s role as fiduciary and policymaker and undermines the board’s ability to ensure that real estate acquisitions are based on a strong financial foundation.

Regarding the significant stewardship costs of OHA-acquired lands, the chair said OHA will at times acquire land with the primary purpose of preservation and protection of “our ‘āina and rights,” and that the goal of financial return and sustainability must not compromise that purpose. We maintain that OHA is not following best practices for a conservation land trust nor its own stated strategy to ensure financial sustainability.

Regarding our grant-related findings and recommendations, the chair said OHA sincerely appreciates the intent of the audit and views our recommendations as an opportunity to improve its grants program—a process the chair says has been underway since July 2012.

The chair disagreed with our finding that trustees’ vote in favor of the Gentry acquisition violated OHA investment policy, and pointed to a State Ethics Commission letter closing its probe into a possible violation of the State ethics code. We maintain that the trustees’ action was contrary to OHA’s Native Hawaiian Trust Fund investment policy.
OHA has taken steps to implement most of our 2009 recommendations

To ensure agency accountability over audit recommendations, the 2008 Legislature amended the Auditor’s governing statute to require follow-up reporting on our audit recommendations. The purpose of this change was to inform the Legislature of unimplemented recommendations and require agencies to submit a written report not later than 30 days after issuance of our follow-up report explaining why the recommendation was not implemented and the estimated date of its implementation. This follow-up covered 19 recommendations made in 2009, 13 of which are closed (68 percent), two open but in progress (11 percent), and four open and not likely to be pursued (21 percent).

Management Audit of Information Technology Within the Office of Hawaiian Affairs, Report No. 09-08

Our 2009 report found OHA had not fully recognized the need for information systems to be managed at a strategic level and was not applying a strategic approach to updating its information systems. We also found that major information technology (IT) components were dispersed throughout OHA without oversight and coordination. Our follow-up found that OHA has taken steps to improve management of information technology. The office has designated CIO responsibilities to its chief financial officer and created an Information Technology Framework. OHA also uses work plans to carry out its high level goals for IT systems.

Investment Portfolio Review of the Office of Hawaiian Affairs, Report No. 09-10

Our 2009 report found that OHA must improve its investment framework and process to ensure it meets its fiduciary duties to beneficiaries and that the board as a whole lacked adequate investment or financial knowledge to properly oversee its trust investments. Our follow-up found oversight of investment management has progressed, but some concerns remain. OHA now assesses its investment advisors’ performance annually through year-end evaluations presented to the board. Although trustees are required to abide by an ethics policy in OHA’s Investment Policy Statement, they are not required to certify that they abide by the policy. OHA also has no whistleblower policy.

A Report to the Governor and the Legislature of the State of Hawai‘i

Submitted by

THE AUDITOR
STATE OF HAWAI‘I

Report No. 13-07
September 2013
Foreword

This report on our Audit of the Office of Hawaiian Affairs and Report on the Implementation of State Auditor’s 2009 OHA Recommendations was prepared pursuant to Sections 10-14.55 and 23-7.5, Hawai‘i Revised Statutes. Section 10-14.55 requires the Auditor to conduct an audit of OHA at least every four years and Section 23-7.5 requires the Auditor to report to the Legislature annually on each audit recommendation more than one year old that has not been implemented by the audited agency.

We wish to express our appreciation for the cooperation and assistance extended to us by members of the Office of Hawaiian Affairs Board of Trustees, staff of the Office of Hawaiian Affairs, and other individuals whom we contacted during the course of our audit.

Jan K. Yamane
Acting State Auditor
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Chapter 1
Introduction

This audit of the Office of Hawaiian Affairs (OHA) was conducted pursuant to Sections 10-14.55 and 23-7.5, Hawai‘i Revised Statutes (HRS). Section 10-14.55 requires the Auditor to conduct an audit of OHA at least every four years; this is our sixth report pursuant to this mandate. Section 23-7.5 requires the Auditor to report to the Legislature annually on each audit recommendation more than one year old that has not been implemented by the audited agency. Part of this report responds to that requirement in relation to our 2009 reports on OHA’s information technology (IT) systems and its investment portfolio (Report Nos. 09-08 and 09-10, respectively).

Background

In March 1959, Hawai‘i was granted statehood by Congress under the Admission Act. Under terms of the act, 1.8 million acres of land that had been ceded to the United States were conveyed to the State. The State was required to hold the lands and any sales or income proceeds they may generate in public trust. In addition, the proceeds or disposition of the lands can be used for five purposes: 1) the support of public schools and other public educational institutions; 2) the betterment of the conditions of native Hawaiians; 3) the development of farm and home ownership on a widespread basis; 4) for the making of public improvements; and 5) for the provision of lands for public use. Initially, the State channeled the revenues from the public lands trust to the Department of Education. However, the 1978 Constitutional Convention produced a new section to the State Constitution that clarified the principal beneficiaries of the public lands trust established in the Admissions Act to be native Hawaiians and the general public.

The 1978 convention proposed the establishment of an Office of Hawaiian Affairs whose purpose would include the betterment of conditions of all Hawaiians. Article XII, Section 5 of the State Constitution established OHA, and Act 196, Session Laws of Hawai‘i (SLH) 1979, codified as Chapter 10, HRS, implemented this constitutional amendment. Section 10-3, HRS, defines OHA’s purpose as including the betterment of the conditions of native Hawaiians and Hawaiians. “Native Hawaiian” includes any descendant of at least one-half part of the races inhabiting the Hawaiian islands prior to 1778; “Hawaiian” is any descendent of the aboriginal peoples inhabiting the Hawaiian islands in 1778.
Section 10-3, HRS, also designates OHA as the principal public agency in Hawai‘i responsible for the performance, development, and coordination of programs and activities relating to native Hawaiians and Hawaiians, excluding the administration of the Hawaiian Homes Commission Act. The Office of Hawaiian Affairs is also required to assess the policies and practices of other agencies that impact native Hawaiians and Hawaiians; conduct advocacy efforts for native Hawaiians and Hawaiians; apply for, receive, and disburse grants and donations from all sources for native Hawaiian and Hawaiian programs and services; and serve as a receptacle for reparations.

Mission and organization

The Office of Hawaiian Affairs receives funds, land, or other resources earmarked for native Hawaiians. The office holds a unique status in that it is considered a state agency even though it is independent from the executive branch. The office has the power to acquire and sell property and its primary purpose is for the betterment of conditions of native Hawaiians and Hawaiians. The office is also tasked to serve as the principal public agency in the State responsible for the performance, development, and coordination of programs and activities relating to native Hawaiians and Hawaiians. The office’s other purposes are to assess the policies and practices of other agencies impacting on the Hawaiian community and to conduct advocacy efforts for the Hawaiian community.

Board of Trustees and staff

Hawai‘i’s constitution requires that OHA be governed by a board of at least nine trustees who are chosen by the state’s electorate. Trustees serve staggered four-year terms. There is no limit on the number of terms a trustee may serve. O‘ahu, Kaua‘i, Maui, Moloka‘i, and Hawai‘i each must have at least one representative on the board. The board is organized into two leadership positions and two standing committees. The two standing committees are the Committee on Asset and Resource Management (ARM) and the Committee on Beneficiary Advocacy and Empowerment (BAE). The board also creates ad hoc committees as needed. The board has adopted and amended its bylaws numerous times and meets at least once annually on each of the islands of Hawai‘i, Maui, Moloka‘i, Lāna‘i, Kaua‘i, and O‘ahu.

Trustees are bound by fiduciary duties that include marshaling OHA’s resources, loyalty, and prudence. The duty of undivided loyalty requires that the trust be administered solely in the interest of beneficiaries. Furthermore, Chapter 554A, HRS, the Uniform Trustees’ Powers Act, defines a prudent person as one who, in exercising trust powers, is reasonable and equitable from the viewpoint of the beneficiaries’ interests and acts with the same diligence, discretion, and judgment as would be expected in managing the trustee’s own affairs.
Chapter 1: Introduction

According to the State Constitution, the board is to exercise its control over OHA through the administrator that it appoints.

An administrator—the chief executive officer (CEO) of OHA—is appointed by a majority of the board, and leads OHA’s staff. The administrator can be removed at any time by a two-thirds vote of the board. The board sets the administrator’s salary, which cannot exceed that of state cabinet officers. The CEO is assisted by a chief operating officer (COO) and the directors of four lines of business. As of June 30, 2012, OHA had 168.5 full-time equivalent positions, of which 157.5 were filled and 11 vacant. Most OHA staff work in the Honolulu office; one person staffs the Washington, D.C. office; and OHA also has six neighbor island offices, in East Hawai‘i, West Hawai‘i, Maui, Moloka‘i, Lāna‘i, and Kaua‘i.

OHA programs

The office’s 2010–2016 strategic plan shifted its focus from serving individual Hawaiians’ needs to applying its resources to programs and activities meant to result in systemic change, a redefinition of OHA’s roles, and an organizational realignment. To promote systemic change, OHA’s Board of Trustees adopted six strategic priorities: economic self-sufficiency, land and water, culture, health, governance, and education.

The Office of the Chief Executive Officer manages the internal operations of OHA and provides leadership guidance, direction, and executive oversight. The Office of the Chief Operating Officer, which is under the Office of the CEO, oversees the development of all advocacy initiatives and provides knowledge management and leadership services to the CEO and executive team. Corporation Counsel, also under the Office of the CEO, provides general counsel and legal support services to help the CEO make informed and legally sound decisions that protect OHA trust assets and interests and improve the conditions of native Hawaiians. As of June 30, 2012, there were 20 positions under the Office of the CEO, two of which were vacant.

Following its most recent reorganization, in addition to the Office of the CEO, the agency now has four lines of business:

1. The Resource Management line of business provides fiscal and technical support, leadership direction, decision support, and management services for OHA as well as land management and grant administration for beneficiaries. Resource Management consists of the Administrative Services, Information Systems and Records Management, Investment Transactions, Land Management, and Transitional Assistance Programs (grants) and the Halawa-Luluku
Interpretive Development (HLID) Project. As of June 30, 2012, this line of business had 48 positions, of which three were vacant.

This line of business covers several of the major foci of this audit. In particular, the Investment Transactions Program provides oversight, analyses, and transactional services to help the board and executive leadership manage OHA’s portfolio investments. The Land and Property Management Program provides land and property acquisition, land and facilities management and oversight, and consulting services to OHA. The Information Systems and Records Management Program provides business and technology tools, applications, network services, and records management services to staff. The Transitional Assistance Program provides access to social services through grants and partnerships with non-profit organizations or other government agencies, and through providing loans to native Hawaiians and Hawaiians.

2. The Community Engagement line of business aims to connect OHA with Hawaiian communities and the general public and mobilizing communities for the betterment of native Hawaiians and Hawaiians. As of June 30, 2012, this line of business had 30 positions, of which one was vacant.

3. The Advocacy line of business provides public policy, compliance monitoring, and advocacy services to OHA. Also within this line of business is the Washington, D.C. Bureau, which provides federal policy and program advocacy, monitoring, education, congressional and executive branch liaison and native nations and national alliance-building services to OHA. One person staffs the D.C. office. As of June 30, 2012, the whole Advocacy line of business had 24 positions, of which three were vacant.

4. The Research line of business compiles and researches information relating to Hawaiian demographics; performs historical analyses about native Hawaiians, their relationship to the land, and their cultural traditions and practices; and provides applied research services to help identify issues and trends to guide advocacy, policy, and operational initiatives. As of June 30, 2012, this line of business had 18 positions, of which one was vacant.
Exhibit 1.1 illustrates OHA’s organizational structure.

**Exhibit 1.1**
Office of Hawaiian Affairs Organizational Chart

OHA grants

Chapter 10, HRS, requires OHA to disburse grants to individuals and to public or private organizations for programs and services that serve to better the conditions of native Hawaiians and Hawaiians consistent with statutorily set standards. In the year ending June 30, 2012, OHA awarded 220 grants and sponsorships totaling more than $14 million.
Through its Granting for Results and Community Partners programs, OHA supports projects and activities that target needs in the Hawaiian community to achieve specific, agency-defined goals in the areas of education, health, and family income. Between FY2010 and FY2012, OHA implemented a strategic plan that altered the way it uses its resources and resulted in modifications to the grants program and grant administration to focus on achieving systemic change and measurable results. Among these modifications were the introduction of performance-based criteria to measure grant effectiveness, consolidation of the all-grant functions and operations into the Transitional Assistance Program (TAP), use of a third-party grant administrator to perform grant management and monitoring activities, and use of a program to perform in-depth evaluations for certain grants.

The office also awards sponsorships for various community events that serve or support native Hawaiians or their culture and history. These sponsorships provide financial or other assistance (goods or services) in support of an activity or event. Total annual funding for the OHA Community Grants Program has been established by the Board of Trustees at no less than 10 percent of the spending limit for OHA’s annual total operating budget.

**OHA land holdings**

The office’s land holdings as of June 30, 2011, had a value of $24.4 million and were primarily comprised of Waimea Ahupua’a on O’ahu ($13 million) and Wao Kele o Puna on Hawai’i Island ($11.3 million). The office acquired the 1,800-acre Waimea Ahupua’a for $3.9 million in 2006 to protect in perpetuity the cultural and natural resources on the property. The office acquired Wao Kele o Puna, which includes 25,856 acres of forest land, in FY2007 from The Trust for Public Land. In addition to Waimea Ahupua’a and Wao Kele o Puna, land owned, leased, and managed by OHA includes the Pahuia Heiau, Kekaha Armory, and the Waialua Courthouse in Hale’iwa. In April 2012, Governor Abercrombie signed an agreement settling claims dating back to 1978 regarding revenue generated by Hawai’i’s ceded lands. The settlement gave OHA 30.7 acres of state land on the Kaka’ako waterfront, known as the Kaka’ako Makai area, estimated to be worth $200 million. Subsequent to June 30, 2012, OHA also acquired the Gentry Pacific Design Center and 511 acres of former Galbraith Estate land.

**Funding**

The Admission Act, which granted statehood to Hawai’i in 1959, returned 1.8 million acres of ceded lands to the new state and provided that certain public lands should be held as a public trust. The act stated that management and disposition of such lands should be used as called for by the constitution and laws of Hawai’i.
In 1980, the State Legislature exercised its right to determine a proportionate allocation of all funds derived from the public land trust to OHA. Lawmakers voted to provide 20 percent to OHA, which is codified under Section 10-13.5, HRS. In 1990, the Legislature amended the law to address a Hawai‘i Supreme Court ruling that determined Chapter 10, HRS, as written, did not support the 20 percent funding threshold to OHA for the benefit of native Hawaiians. The bill, which eventually became Act 304, SLH 1990, generated more than $130 million in back payments and interest, as well as about $8 million annually for OHA. However, in September 2001, the Hawai‘i Supreme Court invalidated the 1990 state law, which effectively halted revenue payments to OHA.

Currently, Executive Order 03-03 provides funding for OHA. The order was issued by then-Governor Lingle in February 2003 and directs all departments to collect and transfer, on a quarterly basis, 20 percent of all receipts they derive from the public land trust to OHA. The Department of the Attorney General opined that the transfer can be made directly to OHA by agencies without legislative appropriation. Although the Admission Act restricts OHA’s use of ceded land revenues to programs that benefit native Hawaiians, the State’s general fund, federal funds, and other private donations support all Hawaiians.

In 2006, the Legislature passed Act 178, SLH 2006, which established a guaranteed ceded land revenue stream to OHA of $15.1 million a year. The Legislature deemed the amount to be adequate for OHA to fulfill its mission and objectives. These revenue transfers are to continue until further action is taken by the Legislature and are not affected by a $200 million land settlement reached with the State in April 2012.

The office receives funding from state general fund appropriations, ceded land revenue payments, federal grants, and miscellaneous other income. In addition, a substantial portion of OHA’s funding comes from the Native Hawaiian Trust Fund (NHTF). Investments held in the trust fund and Native Hawaiian Revolving Loan Fund (NHRLF) comprise a significant portion of OHA’s total assets. As of June 30, 2011, these investments totaled $360.6 million (80.7 percent of total assets). Such assets are invested in mutual and commingled funds, private equity funds, hedge funds, government-backed securities, and other investment vehicles. Accordingly, OHA’s assets and net assets are sensitive to fluctuations in the financial markets. Between June 30, 2007, and June 30, 2011, total assets and net assets decreased by $67.1 million (13.1 percent) and $76.8 million (15.2 percent), respectively; however, the totals for fiscal years 2010 and 2011 trended positively due to investment portfolio gains during those years. This is consistent with fluctuations in the financial markets during the same period. Exhibit 1.2 shows OHA’s revenue by source for FY2007 through FY2011.
Chapter 1: Introduction

Exhibit 1.2
Office of Hawaiian Affairs Revenues, FY2007 through FY2011

<table>
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<tr>
<td>Charges for services</td>
<td>$57,821</td>
<td>$151,187</td>
<td>$573,560</td>
<td>$388,043</td>
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<td>Operating grants</td>
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<td>-</td>
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<td>-</td>
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<td>Interest and investment</td>
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<td>earnings (loss)</td>
<td></td>
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<td>Appropriations, net of lapses</td>
<td>2,828,459</td>
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<td>Public Land Trust</td>
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<tr>
<td>Newspaper ads</td>
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<td>Donations and other</td>
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<td>Non-imposed fringe</td>
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<td>228,957</td>
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<td>Total revenues</td>
<td>$89,721,862</td>
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<td>$(52,072,676)</td>
<td>58,615,027</td>
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Source: Office of Hawaiian Affairs

The goal of the trust fund is to provide investment returns to sustain beneficiaries in perpetuity and uphold OHA’s mission. The Board of Trustees has established a spending policy that limits withdrawals from the fund in any given fiscal year to 5 percent of the trust fund’s 20-quarter rolling average market value to ensure that trust resources are available for future spending.

The office records expenses separately for each of these divisions—the Board of Trustees, Support Services, and Beneficiary Advocacy. As shown in Exhibit 1.3, the bulk of OHA’s FY2011 expenditures of $42.3 million were for Beneficiary Advocacy and Support Services. In the year ending June 30, 2011, OHA provided more than $12 million in grants, which are included under Beneficiary Advocacy.
Prior Audits

We have conducted seven audits of OHA as well as three reviews covering the office’s revolving funds, trust funds, and trust accounts. Of our previous reports, four are relevant to this current audit.

In our 2001 Report No. 01-06, *Audit of the Office of Hawaiian Affairs*, we found that the board allowed OHA’s master and functional plans to remain outdated. We recommended that the board focus its attention on identifying the agency’s role in improving the conditions of all Hawaiians, fulfilling its fiduciary duties, and improving its management of OHA’s grants program. In addition, we reported the office did not ensure that funds disbursed from its grant and Native Hawaiian Revolving Loan Fund programs were well spent.

In our 2005 Report No. 05-03, *Audit of the Office of Hawaiian Affairs*, we found that OHA lacked a comprehensive master plan for bettering the conditions of Hawaiians; continued to struggle with the effects of poorly planned reorganizations; and casually administered its finances. The office’s investment policy and investment oversight lacked key components, and the lack of investment advisor oversight prevented trustees from receiving sufficient information to evaluate advisor performance.

In our 2009 Report No. 09-08, *Management Audit of Information Technology Within the Office of Hawaiian Affairs*, we found that OHA needed to recognize the critical strategic importance of electronic information and information systems, and its information systems were decentralized and lacked focused oversight and coordination.

Also in 2009, our Report No. 09-10, *Investment Portfolio Review of the Office of Hawaiian Affairs*, found OHA’s investment framework and process needed improvement to ensure fiduciary obligations to
beneficiaries were met. We found the board as a whole did not possess an adequate level of general investment or financial knowledge to properly oversee the trust’s investments and that investments were underperforming for the majority of the review period.

Objectives of the Audit

1. Assess whether the Office of Hawaiian Affairs’ Board of Trustees has adequately planned for the acquisition and management of OHA’s real estate holdings.

2. Assess whether OHA appropriately administers its grant program.

3. Make recommendations as appropriate.

Scope and Methodology

This audit focused on the management and finances of the Office of Hawaiian Affairs for the previous three fiscal years (FY2010–FY2012). Our review of real estate transactions included relevant activities between July 1, 2006 and June 30, 2012.

We conducted interviews with trustees, office personnel, legislators, and other stakeholders as applicable. We reviewed planning, grant, real estate, personnel, and other documentation as appropriate; and judgmentally tested items for compliance with applicable policies, procedures, agreements, and other relevant criteria.

Our audit was performed from October 2012 through March 2013 and conducted pursuant to the Office of the Auditor’s Manual of Guides and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence we obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.
Chapter 2
OHA Land and Grants Programs Lack Organizational Infrastructure

Last year, the Office of Hawaiian Affairs (OHA) significantly expanded its real estate portfolio, acquiring ten land parcels (30.7 acres) in downtown Honolulu’s Kaka’ako Makai area and purchasing the nearby Gentry Pacific Design Center (4.98 acres) as well as the Galbraith Estate lands in Central O’ahu (511 acres). The real estate holdings, which are the office’s first acquisitions in six years, have an aggregate value of $224.4 million and are part of a diverse portfolio that with 28,206 acres of leased and owned land is one of the state’s largest.

While these numbers may be impressive, we found that the OHA’s land management infrastructure is inadequate, unable to support its growing portfolio nor any future real estate involvements. In 2007, OHA adopted its Real Estate Vision, Mission, and Strategy (REVMS), a guiding document for land acquisition and policy that articulated the office’s mission, vision, strategic goals, and priorities. However, six years and more than $200 million later, OHA has not adopted many of the policies to implement REVMS. In addition, in 2008, OHA trustees disagreed with a consultant’s proposal to greatly expand its Land and Property Management Program as well as a proposal for a detailed investment policy. Instead, in 2010, the trustees adopted the one-page Hawai’i Direct Investment Policy that governed certain real estate investments, which it included as an amendment to its Native Hawaiian Trust Fund Investment Policy Statement, but neglected to expand the program’s infrastructure.

Without a policy framework to implement REVMS and other best practices, OHA’s Board of Trustees cannot ensure that its real estate acquisitions are based on a strong financial foundation. Indeed, we found indications that OHA’s real estate portfolio is unbalanced, with revenues generated from commercial properties unable to offset expenses from legacy and programmatic land holdings.

We also found that OHA continues to be remiss of one of its core responsibilities—improving the conditions of all Hawaiians—in its grants programs. For instance, the office continues to lack policies and procedures to adequately monitor compliance and performance and ensure that grants achieve intended benefits for Hawaiians. In addition, grant outcomes are not consistently brought to the attention of trustees.
Chapter 2: OHA Land and Grants Programs Lack Organizational Infrastructure

Summary of Findings

1. The Board of Trustees has neglected to establish adequate organizational infrastructure before expanding the Office of Hawaiian Affairs’ real estate holdings.

2. Ineffectual oversight bars OHA from ensuring grants achieve intended results as mandated, and hampers trust fund transparency and accountability.

The Board of Trustees Neglected to Establish Adequate Organizational Infrastructure Before Expanding OHA’s Real Estate Holdings

The Office of Hawaiian Affairs administers a public trust that must serve native Hawaiians and Hawaiians. Its investments are bound by fiduciary duties that include a duty of prudence, requiring decisions be made in the context of a portfolio as part of an investment strategy, with suitable risk and return objectives. We found that trustees have significantly increased the trust’s real estate assets without providing adequate guidance and other infrastructure to ensure implementation of the board’s real estate vision, mission, and strategy. Lacking trustee leadership, OHA opportunistically acquired land without accounting for stewardship costs and otherwise adhering to best practices. This non-strategic approach has resulted in an unbalanced real estate portfolio that generates insufficient income to offset OHA’s overall property costs. This lack of accountability was also manifested in a Board of Trustee vote to acquire a $21.4 million building in Iwilei, which hinged on the vote of a trustee who may have violated an ethics provision contained within OHA’s investment policy.

The Board of Trustees, OHA’s policymaking body, recognized the need for a strategic approach to real estate investment and management in 2007 when it adopted a real estate vision, mission, and strategy. However, the board neglected to adopt policies to implement the strategy and OHA has been remiss in establishing other infrastructure needed to adequately invest and manage its more than $228 million real estate portfolio.

OHA’s real estate vision, mission, and strategy is not supported by board-adopted land policies

The Office of Hawaiian Affairs’ Board of Trustees is responsible for overall management of trust fund assets, and trustees are to act as fiduciaries pursuant to the Hawai‘i Uniform Prudent Investor Act. According to OHA’s Board of Trustees Executive Policy Manual, each trustee has a fiduciary duty to exercise his or her best-reasoned skill and judgment by acting in the best interests of OHA and its beneficiaries consistent with OHA’s mission, vision, strategic goals, and priorities.
The office’s approach to real estate is set forth in OHA’s Real Estate Vision, Mission, and Strategy (REVMS), which was developed with the assistance of a consultant in 2007 and is regarded as the agency’s guiding document for land acquisition and policy. The REVMS was part of an effort to establish policies intended to put OHA on a solid foundation in anticipation of a number of real estate involvements, most notably a $200 million ceded land settlement with the State of Hawai‘i.

The strategy component of the REVMS contains sections calling for OHA to champion best practices, increase its real estate portfolio, establish a superior real estate organization and infrastructure, and build a strong financial foundation for its real estate involvements. The best practices component calls for OHA to develop a real estate business plan and a real estate investment policy. It also calls for a real estate allocation model to prioritize spending on four types of properties: legacy land made up of conservation, preservation and culturally important properties; real estate for corporate purposes; land for OHA programs; and investment land. Additionally, the strategy calls for OHA to take leadership in articulating and documenting a “Hawaiian sense of place” and for each important OHA property to be managed by a separate legal entity and supported by an independent foundation. Land management best practices also call for properties to have asset management plans.

Although a land trust’s board is supposed to set up its land management policies in a timely fashion to carry out the organization’s mission, we found that OHA’s Board of Trustees neglected to implement policies called for in a consultant’s proposed strategy. We also found that, contrary to best practices, not all legacy properties have asset management plans.

When briefed on the plans in January 2008, OHA trustees balked at the consultant’s proposal to create a more than 50-person land and property management division and to divide OHA’s investment funds between corporate securities and real estate. In the end, OHA’s board never approved the proposed real estate business plan or investment policy, which trustees deemed overly aggressive; however, it did not propose an alternative plan that was less aggressive but could have provided more staff guidance. Trustees did adopt an investment policy governing certain real estate investments in a 2010 amendment of its Native Hawaiians Trust Fund Investment Policy Statement; however, that one-page policy lacked guidelines for asset allocation, portfolio composition, return expectations for different property types, and portfolio reporting as contained within the more comprehensive policy that was aborted in 2009.

The office’s chief operating officer acknowledged that policies called for in the REVMS have not been adopted, saying that the Office of the
Auditor “hit the nail on the head” in identifying the lack of real estate policies.

Without a guiding, strategic document like REVMS the Board of Trustees is unable to ensure that real estate acquisitions are based on a strong financial foundation. The office’s pursuit of real estate acquisitions without adequate policies increases the risk that acquisitions do not comport with OHA’s land strategy at a time when the office is seeking a larger role as a landowner. The office is entering a new land ownership era as developments are planned for 30.7 acres of Kaka‘ako Makai land received in a $200 million ceded lands settlement with the State of Hawai‘i.

As of February 2013, OHA was planning to seek an investment consultant to help draft a real estate policy statement that would include procedures for acquisition, disposition, asset allocation, debt origination, and other guidelines; however, this may retrace some of the work done by the previous consultant. The office also established a Kaka‘ako Makai policy and sought a consultant to help produce a development framework for that area.

**Rapid expansion of OHA’s real estate portfolio and high staff turnover have contributed to inconsistent land acquisition and management practices**

Managing a large real estate portfolio requires a plan, including adequate staff to execute that plan. Trustees have a fiduciary duty to act in the best interests of OHA and its beneficiaries consistent with OHA’s mission, vision, strategic goals, and priorities. In addition, best practices require land trusts to carefully evaluate and select land they acquire for conservation projects as well as non-conservation investment purposes. According to the Land Trust Alliance, an organization of more than 1,700 land trusts, a land trust should determine the immediate and long-term financial and management implications of each transaction and secure the dedicated and/or operating funds needed to manage the property, including money for insurance, maintenance, improvements, monitoring, and enforcement. If stewardship funding is not secured by the transaction closing, the trust should have a plan to obtain this money.

Moreover, according to the U.S. Government Accountability Office (GAO), managers have a responsibility to use resources in an effective and efficient manner and to provide appropriate reports to those who oversee their actions. The GAO’s standards also say that proper documentation of events and transactions is integral to an agency’s accountability for the stewardship of government resources. Finally, OHA’s real estate vision, mission, and strategy plan called for the establishment of a superior real estate organization and infrastructure.
Chapter 2: OHA Land and Grants Programs Lack Organizational Infrastructure

Having an effective plan and staff has become increasingly important since 2006, when the office acquired the bulk of its real estate, purchasing Wao Kele o Puna, a 25,856-acre lowland native rainforest tract on Hawai‘i Island, and added another 1,800 acres when it purchased Waimea Valley on O‘ahu. In 2012, the office acquired properties with an aggregate value of $224.4 million. Exhibit 2.1 shows the acreage and use of OHA lands in the order in which they were acquired.

Acquisition of the Galbraith Estate and Palauea lands on O‘ahu and Maui raises concerns about whether OHA is following its own policies. We found that when evaluating those acquisitions, Land and Property Management Program staff used a proposed real estate allocation model that the board had never adopted. Trustees also acquired the 511 acres of Galbraith land, which surround the historically significant Kukaniloko birthing stones site, knowing that the property needed water infrastructure and soil remediation work but approved the purchase without estimates of those future costs. In another case, we found the board approved the Palauea land donation after considering immediate management costs but without information on long-term management expenses and whether transferred funding for the parcels would be sufficient to cover those costs. Land management best practices call for financial reporting on governance and performance of land assets. But we found the office did not have an annual report summing up real estate activity and finances.

In addition to these lapses, OHA has not adequately maintained documentation of its real estate operations. When responding to our requests for information, OHA could not locate key land-related documents, including a five-year financial plan, five-year business activities plan, or software and system requirements, all of which were products of $860,000 in consultant work produced in 2007 and 2008. In addition, it took about a month for OHA to provide us with other portions of the work produced by the consultant. The office finally provided many of the documents after a former Land and Property Management Program manager, now in another position at OHA, located them. It also took repeated requests to obtain Land and Property Management Program work plans, which are prepared to implement the OHA strategic plan.

Administrators at OHA cited a lack of staff as the cause for the office’s inability to locate key land-related documents. “There’s been high turnover and they are short-staffed,” said OHA’s chief financial officer. She said that in the past land had been an afterthought at OHA. “When you only have three or four staff you just save the filing until a rainy day.”
Exhibit 2.1
OHA Properties (as of February 2013)

<table>
<thead>
<tr>
<th>Property</th>
<th>Year Acquired</th>
<th>Size</th>
<th>Type</th>
<th>Cost to OHA</th>
<th>Tenure and Use</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Pahua Heiau</td>
<td>1988</td>
<td>1.15 acres</td>
<td>Legacy</td>
<td>Donated by Kamehameha Schools</td>
<td>Owned fee simple; deed restricts use to historic purposes</td>
</tr>
<tr>
<td>2. Old Waialua Court House</td>
<td>1998</td>
<td>1.06 acres</td>
<td>Programmatic</td>
<td>35-year DLNR gratis lease, but OHA pays operating and repair costs</td>
<td>Long-term lease; usage is in planning phase</td>
</tr>
<tr>
<td>3. Kekaha Armory</td>
<td>1998</td>
<td>1.46 acres</td>
<td>Programmatic</td>
<td>Executive order set aside to OHA for Hawaiian culture and education</td>
<td>Leased to Ke Kula Ni’ihau o Kekaha Charter School</td>
</tr>
<tr>
<td>4. Wao Kele o Puna</td>
<td>2006</td>
<td>25,856 acres</td>
<td>Legacy</td>
<td>OHA paid $300,000 of the $3.65 million purchase price; federal Forest Legacy</td>
<td>Owned fee simple; OHA pays DLNR up to $228,000 a year to co-manage this conservation land</td>
</tr>
<tr>
<td>5. Waimea Valley</td>
<td>2006</td>
<td>Approx. 1,800 acres</td>
<td>Legacy/Programmatic</td>
<td>Owned $3.9 million of the $14 million overall price</td>
<td>Owned and managed by Hi’ipaka LLC, a subsidiary of OHA</td>
</tr>
<tr>
<td>6. Kaka’ako Makai</td>
<td>2012</td>
<td>30.72 acres</td>
<td>Commercial/Investment</td>
<td>$200 million settlement from the State of Hawai’i</td>
<td>Owned fee simple; OHA has a contract with HCDA to manage</td>
</tr>
<tr>
<td>7. Gentry Pacific Design Center</td>
<td>2012</td>
<td>183,000 sf building; 4.98 acres land</td>
<td>Commercial/Investment</td>
<td>OHA paid $21.4 million</td>
<td>Owned fee simple; managed by Colliers International</td>
</tr>
<tr>
<td>8. Galbraith Estate lands</td>
<td>2012</td>
<td>511 acres</td>
<td>Legacy/Programmatic</td>
<td>OHA paid $3 million for the acreage, which was part of a $25 million purchase of 1,718 acres</td>
<td>Owned fee simple</td>
</tr>
<tr>
<td>9. Palauea Cultural Preserve</td>
<td>Pending as of February 2013</td>
<td>20.7 acres</td>
<td>Legacy/Programmatic</td>
<td>Maui land donation from Palauea Developers, LLC</td>
<td>To be owned fee simple</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>28,206 acres*</td>
<td></td>
<td>$228.6 million paid or accepted through settlement</td>
<td></td>
</tr>
</tbody>
</table>

*Acreage total does not include the Palauea Cultural Preserve, a donation which had yet to be transferred to OHA as of early February 2013. Also not included is space that OHA owns at Kaulana Oiwi, a Moloka’i building. The building is included in OHA’s Annual Inventory Report of Property, and is not listed among its properties owned but is among OHA’s leased offices on the Neighbor Islands and in Washington, D.C.

Source: Office of the Auditor based on information from the Office of Hawaiian Affairs
Chapter 2: OHA Land and Grants Programs Lack Organizational Infrastructure

The office’s 2006–2011 Strategic Plan included a land goal of developing organizational infrastructure. Yet, not only has the program personnel not grown, the program has also been plagued by high staff turnover. During the past three years, OHA’s Land and Property Management Program has had four different managers. As of February 2013, the longest tenure of any program staff member was 13 months. Among the departures were a Land and Property Management director and a land management officer who departed OHA within months of OHA’s 2009 adoption of a strategic plan that shifted the property focus to calling for native Hawaiians to participate in and benefit from responsible Hawai‘i land stewardship. Despite the significant growth in OHA’s real estate portfolio, the overall size of the program’s staff has remained relatively unchanged since December 2007. “As far as staffing levels, maybe land wasn’t a must do,” a former administrator said. We note, however, that OHA has recently expanded its real estate staff by hiring a commercial property manager. OHA also plans to add a commercial property specialist.

We found that trustees have pursued opportunistic real estate purchases without guiding policies and in a manner inconsistent with a methodical approach, as called for in the office’s REVMS. The approach has left OHA with significant legacy land stewardship costs and a real estate portfolio in which income properties do not produce enough to pay for legacy land expenses. This imbalance reduces OHA’s ability to acquire more cultural and programmatic lands.

High-maintenance properties drain OHA resources

Significant stewardship expenses are not offset by revenue from OHA’s real estate portfolio

The office’s executive policy requires trustees to exercise the highest standard of care and loyalty to OHA beneficiaries. This duty is consistent with REVMS, which directs OHA to create financially viable property involvements. The strategy also calls for building a strong financial foundation for all property involvements and notes that sacred lands are to have economic integrity and financial sustainability.

For a land trust’s real property holding to have economic integrity and financial sustainability, the land trust must have a source of funds to meet management expenses. The Land Trust Alliance’s Standards and Practices state that land trusts should determine immediate and long-term financial and management implications and secure dedicated or operating funds needed to manage a property, either before or at transaction closing, or produce a plan to secure and commit funds for this purpose. According to OHA’s chief operating officer, OHA’s commercial properties are to provide financial support for its legacy lands.
Despite this, we found that OHA’s properties incur significant expenses, yet the office does not use revenue from other lands to pay for these costs and is not following best practices for a conservation land trust nor its own stated strategy to ensure financial sustainability. In sum, we found that trustees have not fulfilled their duty to engage in property transactions that are fiscally responsible and financially viable, leaving OHA with significant stewardship expenses. The office’s legacy lands are not self-sustaining. In total, OHA may have spent $7.4 million between FY2006 and FY2012 on management, maintenance, and grants for its owned and leased lands. This includes:

- $5.58 million to non-profit subsidiaries Hiʻilei Aloha LLC and Hiʻipaka LLC for management of Waimea Valley;
- $450,992 for repair, maintenance, studies, and other stewardship expenses for the Pahua Heiau, Waialua Court House, Waimea Valley, Wao Kele o Puna, and Galbraith properties; and
- About $860,000 million paid to the Department of Land and Natural Resources (DLNR) for co-managing Wao Kele o Puna.

We also found the office was complacent in reducing management costs. The board was aware of the fees of up to $228,000 annually for ten years to be paid DLNR for managing Wao Kele o Puna and even questioned why the proposed management fee included $30,000 each year for a vehicle. However, OHA and DLNR failed to complete a comprehensive management plan, which would have allowed OHA to assume management of the property and end the annual co-management payments to DLNR. Ending the DLNR management contract would allow the office to seek support through a foundation.

In addition, without an organizational infrastructure OHA cannot ensure that real estate holdings are financially sustainable. The REVMS provides that important properties be managed by a separate entity and supported by an independent foundation, but OHA has not complied with this strategic requirement. As envisioned by the consultant who helped construct the real estate vision, mission, and strategy, OHA was to establish limited liability corporation ownership and foundation funding for its land holdings. In an April 2007 presentation to the board, the consultant said the limited liability corporation would provide managerial oversight and services for all properties and that a family of foundations would fund acquisitions and legacy land stewardship. Each major property was to have a dedicated foundation for funding.

As of February 2013, OHA had one limited liability corporation that held land, Hiʻipaka LLC, which holds the deed for Waimea Valley. Hiʻipaka LLC is a subsidiary of Hiʻilei Aloha LLC, a non-profit limited liability corporation whose sole member is OHA.
Finally, we found OHA has pursued an opportunistic, acquisition-driven strategy for legacy lands that has resulted in ownership of properties which, while priced attractively, do not produce the income needed to help cover the office’s land management costs. In the case of Wao Kele o Puna, for example, OHA acquired 25,856 acres of lowland native rainforest by contributing $300,000, or $11.60 an acre, of the $3.65 million purchase price. The office estimated the parcel to be worth $9.8 million. The office also contributed only $2,167 an acre, or $3.9 million of the $14 million purchase price, to gain title to the 1,800-acre Waimea Valley. The acquisitions met the REVMS’ call for the acquisition of property for a land base to support the future Hawaiian nation. The purchase of Wao Kele o Puna brought back former ceded land to Hawaiian ownership and OHA preserved the last intact ahupua’a on O’ahu for future generations when it bought Waimea Valley. However, such acquisitions came with significant stewardship costs: up to $228,000 a year for the management of Wao Kele o Puna and $11 million for rock-fall mitigation and other needed improvements at Waimea Valley.

According to OHA’s chief operating officer, commercial properties are supposed to provide financial support for legacy lands, such as Wao Kele o Puna and Waimea Valley. However, OHA’s two commercial/investment transactions took place in 2012, six years after OHA acquired much of its legacy lands. In addition, the income produced by its two recent acquisitions is not slated to pay for legacy and programmatic land costs. The office is projected to earn $3 million during the first three years of its Gentry Pacific Design Center ownership, but this money will be used to build up reserves according to OHA’s acting chief investment officer. Kaka’ako Makai will generate about $1.57 million of revenue in FY2013; however, OHA’s chief financial officer said 10 percent of gross revenues will be used for OHA’s grants program during the first three years, with the remainder earmarked for costs related to developing a master plan or other pre-development costs.

The Board of Trustees’ imbalanced land acquisitions have put a financial strain on OHA, limiting its ability to secure additional legacy and non-income-producing properties. At least two trustees expressed concerns about legacy land costs, and a former Land and Property Management Program manager said OHA cannot take on more legacy land until it “balances” its real estate portfolio. A strategic approach balancing income-producing properties with non-revenue-producing legacy lands could have allowed trustees to better carry out their fiduciary duties by preserving more funding for beneficiary programs.
Trustees’ vote in favor of Gentry acquisition violated OHA investment policy

The Office of Hawaiian Affairs’ Native Hawaiian Trust Fund Investment Policy provides that if a trustee has a personal involvement with any direct investment transaction, or even any perceived conflict of interest, the trustee must disclose the involvement immediately and be recused from both discussions and votes on the transaction.

Contrary to this policy, we found that the board’s decision to purchase the Gentry Pacific Design Center building, a $21.4 million property in Iwilei, hinged on the vote of a trustee who is also a member of the board of directors of the bank that offered the best financing for that acquisition. When a motion authorizing the acquisition was put to a vote on May 17, 2012, the trustee recused herself based on counsel’s determination, on the grounds she was a director of the bank named in the action item. The motion fell one vote short of the five needed to pass. Subsequently, another board member—who told us he was “desperate” to move the deal forward—submitted an action item for the June 7, 2012, board meeting in which the name of the bank was eliminated. Rather than name the specific bank to which the other trustee was a director, the action item now stated that OHA had received “more than one proposals [sic] from local banks to lend OHA 100 percent of the acquisition and improvement cost.” During that June meeting, board counsel advised the trustee/bank director she could now vote on the matter because “none of the banks have been specified and there are two other legitimate offers.” The action item passed, with the bank director/trustee casting the deciding vote, authorizing OHA’s CEO to pursue acquisition of the Design Center. The office’s staff later chose the bank of which the other trustee was a director to finance the acquisition.

In addition to OHA’s Native Hawaiian Trust Fund Investment Policy, the Hawai‘i State Ethics Code (Chapter 84, HRS) states that no employee may take any official action directly affecting a business in which the employee has a substantial financial interest. Employee includes elected state board members, such as the OHA trustees. Financial interest includes a directorship in a corporation, such as a bank director. Official action includes an approval involving the use of discretionary authority, such as voting on a measure involving the use of the Native Hawaiian Trust Fund.

Indeed, the question of whether the Gentry vote violated state ethics law has been brought before the Hawai‘i State Ethics Commission. We defer to the commission on whether the trustee’s vote violated state ethics law. Nevertheless, the trustee’s actions may damage OHA’s reputation and undermine the agency’s credibility with beneficiaries and the public. As OHA prepares to develop its $200 million Kaka‘ako Makai property,
the likelihood of similar conflicts will increase, particularly for trustees involved in banking, real estate, and professional services firms that stand to benefit from the project.

Ineffectual Oversight Continues to Plague Grants Program, Hampering Trust Fund Transparency and Accountability

Our earlier audits found that OHA inadequately monitored grants and failed to ensure that funds disbursed from its grants program were well-spent. Because of its problematic history and the fact that it directly carries out one of OHA’s core responsibilities—improving the conditions of all Hawaiians—we re-examined the agency’s grants program. Despite recent efforts to improve grant oversight, OHA’s administration has not developed procedures and guidelines for its program that satisfy applicable laws and Board of Trustees policies. The lack of formal procedures has led to inadequate and inconsistent grant monitoring that cannot ensure that OHA has the information necessary to determine whether grants are achieving their intended results. Deficient oversight of grant outcomes undermines accountability for improving beneficiary conditions.

Lack of formal policies and procedures has led to inadequate and inconsistent grant monitoring

According to the Comptroller General of the United States’ Domestic Working Group Guide to Opportunities for Improving Grant Accountability, effective grant management increases the likelihood that grants will contribute to agency goals. In addition, organizations awarding grants need good internal control systems to ensure funds are properly used and achieve intended results. Performance measures serve as a basis for determining progress for individual grants and grants programs as a whole. Between FY2010 and FY2012, OHA awarded nearly $38 million in grants and sponsorships intended to improve the conditions and future of native Hawaiians and Hawaiians. Because legislators and the public want assurance that OHA is properly administering funds and complying with the law, it is important that OHA be transparent and accountable both in meeting its mandates and achieving its strategic goals aimed at bettering beneficiary conditions. However, OHA has not established internal controls or performance measures; consequently, grant results are not monitored to ensure achievement of goals and OHA cannot assess the effectiveness and efficiency of its grants. Furthermore, OHA trustees are unable to fulfill their duty to ensure that grants generate their intended activities and outcomes because more often than not, they neither request nor receive information on grant outcomes.

The Transitional Assistance Program has a draft grants operations procedures manual that establishes criteria, and policies and procedures for monitoring grants. The manual has not yet been adopted, but grants staff have begun implementing some of its policies and
procedures. During the period we reviewed, OHA lacked formal policies and procedures for monitoring grants; in the absence of such, staff’s monitoring practices varied by individual and were subject to their individual judgments of what constitutes sufficient monitoring and documentation. This condition was exacerbated by several re-assignments of grant monitoring responsibilities caused by staff turnover during our review period. Consequently, the office could not ensure compliance with contract terms, conditions, reporting requirements, and sufficient documentation of monitoring activities. In addition, grants staff did not conduct on-site monitoring of grant compliance and performance.

**Compliance with general contract terms and conditions is not monitored**

During FY2012, OHA awarded more than $14 million in grants and sponsorships, with the largest grants going to education and housing programs and services. Exhibit 2.2 shows the total awards and number of grants and sponsorships for each program area for FY2008 through FY2012.

Section 10-17, HRS, sets forth OHA’s conditions and qualifications for grants. It mandates that grants shall be made to government agencies or non-profit organizations exempt from federal income tax and shall not be used for entertainment or perquisites. Accordingly, grant contract terms and conditions require grantees to comply with all applicable licensing and operating requirements of state, federal, and county governments, and any applicable accreditation and other standards of quality related to the activities for which the grant was awarded. Contract terms also prohibit grantees from transferring grant funds to other entities without prior written consent from OHA. The agency’s draft grants operations procedures manual further provides that the purposes of grant monitoring include determining whether the terms and conditions of a grant agreement are being met and ensuring that OHA funding is being expended appropriately.

We examined 30 grants covering fiscal years 2010 to 2012 and found that grants staff did not monitor whether grantees maintained their status as an eligible grant recipient. Grants staff only verified that organizations met those requirements during the awards process, then presumed continued compliance with grant terms and conditions governing grantee eligibility. This practice runs counter to the *Guide to Opportunities for Improving Grant Accountability*, which recommends that granting agencies inspect programs and projects after completion to provide assurance that grantees complied with contract terms and conditions not otherwise monitored.
Chapter 2: OHA Land and Grants Programs Lack Organizational Infrastructure

Exhibit 2.2
Grants and Sponsorship Awards, FY2008–FY2012

<table>
<thead>
<tr>
<th>Program</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No.</td>
<td>$ Total</td>
<td>No.</td>
<td>$ Total</td>
<td>No.</td>
<td>$ Total</td>
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<tr>
<td>Education</td>
<td>81</td>
<td>$7,789,222</td>
<td>43</td>
<td>$5,453,018</td>
<td>31</td>
<td>$4,261,206</td>
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<tr>
<td>Housing</td>
<td>1</td>
<td>23,000</td>
<td>2</td>
<td>3,300,000</td>
<td>6</td>
<td>3,379,000</td>
</tr>
<tr>
<td>Economic self-sufficiency/development</td>
<td>16</td>
<td>610,000</td>
<td>21</td>
<td>1,056,578</td>
<td>14</td>
<td>526,267</td>
</tr>
<tr>
<td>Board of Trustees initiative grants</td>
<td>26</td>
<td>6,424,859</td>
<td>-</td>
<td></td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Native rights, land, and culture</td>
<td>16</td>
<td>792,320</td>
<td>28</td>
<td>1,866,993</td>
<td>61</td>
<td>1,561,231</td>
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<tr>
<td>Health</td>
<td>20</td>
<td>626,832</td>
<td>14</td>
<td>454,456</td>
<td>22</td>
<td>609,426</td>
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<tr>
<td>Human services</td>
<td>21</td>
<td>1,250,087</td>
<td>18</td>
<td>1,141,846</td>
<td>28</td>
<td>1,047,236</td>
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<tr>
<td>Culture</td>
<td>-</td>
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<td>-</td>
<td></td>
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<tr>
<td>Governance</td>
<td>166</td>
<td>269,701</td>
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<td>354,456</td>
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<td>Land and water</td>
<td>-</td>
<td></td>
<td>-</td>
<td></td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Family lifestyle</td>
<td>-</td>
<td></td>
<td>-</td>
<td></td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Event grants</td>
<td>49</td>
<td>602,018</td>
<td>-</td>
<td></td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Washington, D.C.</td>
<td>-</td>
<td>-</td>
<td>14</td>
<td>59,100</td>
<td>16</td>
<td>102,000</td>
</tr>
<tr>
<td>Total</td>
<td>396</td>
<td>$18,388,039</td>
<td>246</td>
<td>$13,686,447</td>
<td>231</td>
<td>$11,617,460</td>
</tr>
<tr>
<td>Average award amount</td>
<td>$46,434</td>
<td>$55,636</td>
<td>$50,292</td>
<td>$55,002</td>
<td>$64,421</td>
<td>$53,288</td>
</tr>
</tbody>
</table>

Source: Office of Hawaiian Affairs, FY2008 to FY2011 Grants and Sponsorships Annual Reports and FY2012 Annual Report; Office of the Auditor analysis of OHA grants and sponsorships awards data

We also found that OHA lacked information necessary to determine whether grant funds were expended appropriately because grant reporting terms and conditions generally did not require grantees to provide expenditure details or supporting documentation. Our review showed that grants monitor reviews of $2,745,436 in grantee expenditures were limited to comparisons of actual reported expenditures against approved budgeted amounts for each category. Our examination of monitoring reports showed, and our interviews with grants staff confirmed, that no detailed reviews of the grant fund expenditures or grantee’s financial records were performed to ensure completeness and accuracy, and that grantees did not expend funds for prohibited uses. Instead, grant monitors relied on grantees’ signed certifications as to the completeness and accuracy of expenditure reports.

Grant monitors cannot determine grantee compliance with reporting and other requirements

Contained within OHA grant contracts are special conditions specifying financial, project progress, and deliverables information that must be included in grantee reports as well as deadlines for their submission.
Office operational procedures further provide that grant monitors are responsible for following up with grantees when financial and progress reports are delinquent, incomplete, and inaccurate; identifying problems and initiating corrective actions; and providing technical assistance as needed to address problems and ensure compliance with grant terms and conditions.

We found that grant monitors failed to address missing or unsatisfactory information on project deliverables and document whether and how these issues were resolved. Ten of 30 grant files we examined contained no evidence that grant monitors addressed inadequate progress by grantees and non-compliance with reporting requirements as noted in monitoring reports. Furthermore, for six of the 30 grants reviewed, grantees failed to provide project deliverables and grant monitors neglected to note such non-compliance in their monitoring reports and take appropriate actions to address the issue.

In addition, we found five instances in which grantees were allowed amendments that deviated from grant contract terms and conditions with no evidence of formal approval by OHA. These changes included no-cost extensions and amendments to reporting requirements and payment schedules. In one instance, a grantee extended a $24,334 grant’s period by four months without authorization, but according to the OHA community relations specialist, OHA’s administration later directed the grant monitor to make the final payment and close out the grant. According to to the community relations specialist, the grants staff’s informal email approvals of such amendments were deemed to be sufficient. As a result, for two of the five grant amendments noted, we could not find any evidence of approvals in their grant file documentation. Separately, OHA permitted a recipient of a $47,269 grant to reallocate unexpended grant funds to another non-grant-related project without appropriate approvals. Deficient grantee reports preclude grant monitors from effectively monitoring grants, while undocumented amendments to grant terms increase the risk of improper payments to non-compliant grantees and of waste and misuse of OHA trust funds.

**Monitoring activities are insufficiently documented**

Files for the 30 grants we examined contained incomplete documentation of monitoring activities, which made it difficult to determine the nature and extent of monitoring activities. Fourteen grants files contained information on project deliverables, but were missing at least one period of monitoring reports or similar documentation indicating that grant monitors reviewed grantees’ reports. We also observed that grant files often contained incomplete or no documentation of communications with grantees, particularly documentation to evidence actions taken by grant monitors in response to issues noted when reviewing grantee reports.
Chapter 2: OHA Land and Grants Programs Lack Organizational Infrastructure

The United States General Accounting Office *Standards for Internal Control in the Federal Government* provides that all transactions and other significant events need to be clearly documented, and should be readily available for examination.

A grants staff member acknowledged it was not standard practice for OHA grant monitors to report on their monitoring activities and that requests for payment on contract forms were the only evidence that grantee reports were reviewed; even these were not always found in the grant files reviewed. Staff further confirmed that grant monitors do not consistently record or include copies of their correspondence and other communications with grantees in the grant files. We were told that some communications were contained in e-mail that has since been deleted and were therefore unavailable.

**On-site monitoring of grant compliance and performance is rarely performed**

Section 10-17, HRS, mandates that OHA shall monitor each grant awarded to ensure compliance with Chapter 10, HRS, and with the purposes and intent of the grant; and that OHA shall evaluate each grant annually to determine whether the grant attained its intended results in the manner contemplated. We found that OHA did not fulfill its statutory monitoring responsibilities, as annual or end-of-grant-period evaluations were generally limited to either reviews of final reports prepared by grantees, or regular quarterly or bi-annual monitoring activities. These monitoring activities would yield the information OHA needs to determine whether grants attained their intended results. Grants staff acknowledged that during FY2010 to FY2012, in-depth reviews of grant performance via on-site monitoring were not required and that few site visits were performed. Our audit work confirmed that site visits were completed in 2012 for only three of the 30 grants examined. The Transitional Assistance Program manager said OHA plans to address its deficiencies and begin on-site monitoring.

We also found that OHA is addressing its deficiency in grant monitoring. The office’s draft grants operational procedures manual requires grant monitors to conduct grant evaluations and site visits to provide a more in-depth review of grantees’ programs and projects and to address issues or concerns identified during quarterly monitoring. The draft manual also sets forth criteria and procedures for such monitoring activities. Moreover, OHA has also drafted a program review worksheet that contains additional guidance for conducting site visits.
Grant results are not monitored to ensure achievement of goals

Grant monitoring reports show, and our interviews confirm, that grant monitors generally assess the activities and accomplishments of grant recipients and whether a program/project will be completed by its end-date. However, although measureable results such as the number of native Hawaiian participants and number of workshops conducted were available, grant monitors did not or could not evaluate grantee achievements against planned project outputs and outcomes for 27 of 30 grants reviewed, which were valued at more than $2.5 million. We found that OHA’s monitoring activities lacked quantitative measures of progress and success as there were few or no metrics against which program results could be evaluated, particularly for grants awarded prior to FY2012. Monitoring activities also did not appear to consistently include assessments of whether grantees met their project deliverable requirements, expended grant funds appropriately, or reported such expenditures accurately.

We also found that grant contract terms either lacked criteria or imposed limitations that precluded adequate monitoring activities. As a result, OHA was without the information necessary to determine whether grantee organizations produced desired outcomes with respect to project objectives or the impact of grants on OHA’s strategic goals. For example, OHA did not require all grantees to establish measurable expected outputs and outcomes or to report progress in achieving these performance metrics. For many of the grant contracts reviewed, particularly those for FY2010 and FY2011, the only performance measures OHA incorporated into grant contracts were the number of native Hawaiians and Hawaiians served and/or grantees’ completion of the services or activities described in their contracts. The office demonstrated some improvement with its FY2012 grant contracts, which did include additional performance measures; however, OHA did not establish performance metrics for many of the identified measures. Similarly, we found that grantees did not provide reports to grant monitors on the long-terms results of grants because contract terms and conditions governing project deliverables or reporting requirements did not require the submission of such reports. Exhibit 2.3 shows an example of a FY2012 grant contract where OHA identified several, but established only one performance measure benchmark. This project was meant to increase disposable income, credit standing, and economic opportunities of the Hawaiian community by providing financial education counseling, financial assessments, asset-building micro loans, individual development accounts, and access to working family tax credits.
Exhibit 2.3
Sample of Grant Contract With Only One Performance Measure Benchmark

![PERFORMANCE AND OUTCOME MEASUREMENTS TABLE](image)

Source: Office of Hawaiian Affairs
Only a fraction of grants and sponsorships are evaluated by staff, with few results reported to trustees

We found that OHA’s trustees were largely unaware of whether grants achieved agency-defined goals and how they improved beneficiary conditions. According to the OHA Program Improvement Program manager, administrators and trustees receive information on grant outcomes from grant evaluation reports prepared by the Program Improvement Program, which generally reviews Board of Trustee initiative grants, grants over $100,000, and a sample of grants under $100,000. We found that the Transitional Assistance Program reported to administrators the performance results of just one of the 30 grants examined. Overall, our analysis of grants and sponsorships awarded between FY2010 and FY2012 found that just 28 of 672 grants and sponsorships (4.2 percent), valued at $6.5 million, were evaluated by the Program Improvement Program. When we examined the agendas and minutes for the Board of Trustees’ Committee on Beneficiary Advocacy and Empowerment meetings held between 2010 and 2012, we found that the Program Improvement Program reported on the results of only five of the 28 grants evaluated. The Board of Trustees has a duty to ensure that these funds meet their intended purpose. Further, according to the Guide to Opportunities for Improving Grant Accountability, high-level decision-makers need to know which programs are achieving their goals and objectives in order to make informed decisions about where to allocate resources.

Conclusion

The Office of Hawaiian Affairs acquired its first property when the Kamehameha Schools donated the 1.15 acre Pahua Heiau to the agency in 1988. Since then, OHA’s real estate holdings have grown exponentially in both acreage and value. The office’s real estate holdings would have ranked as Hawai‘i’s 13th-largest landowner by acreage if it was included in a listing of major landowners in 2011. However, OHA trustees have not established a land acquisition and management infrastructure to adequately support this increased activity. Similarly, the agency’s grants program continues to be plagued by ineffectual oversight, the result of a lack of formal policies and procedures to guide consistent and effective grant monitoring. We urge the Board of Trustees to provide these programs with the support and resources that they need.
Chapter 2: OHA Land and Grants Programs Lack Organizational Infrastructure

Recommendations

1. The Office of Hawaiian Affairs Board of Trustees should:
   a. Follow through on its real estate vision, mission, and strategy by ensuring that supporting policies are developed and adopted, including:
      i. A robust real estate investment policy that includes a spending policy, ethics code, general objectives, long-term return goals, asset category definitions, forms of ownership, prohibited investments, and portfolio reporting requirements;
      ii. Asset allocation guidelines outlining an optimal mix of legacy, programmatic, corporate, and investment properties, along with return expectations for each asset class;
      iii. Clearly articulated goals for OHA’s real estate portfolio and individual acquisitions, including whether legacy and programmatic land costs should be supported by corporate and investment property income; and
      iv. A business plan for the Land Management Division that elevates the program to its own line of business with support commensurate to OHA’s level of land ownership responsibilities, including an adequate number of qualified personnel to manage its growing real estate portfolio.
   b. Request information from the Transitional Assistance Program staff on grant outcomes and evidence of program success and evaluate grant performance to ensure grants generate their intended activities, results, and outcomes.

2. The Office of Hawaiian Affairs chief executive officer should take steps to ensure stability within the Land Management Division’s staff.

3. The Land Management Division should:
   a. Implement best practices in its real estate acquisition and management operations; and
   b. Develop, implement, and communicate to the board real estate reports that detail the status of properties and track their historical costs, ongoing stewardship expenses, and forecast liabilities.
4. The Transitional Assistance Program should improve its administration of OHA grants by:

a. Developing, and providing to the Board of Trustees for adoption, a manual that describes criteria, policies, and procedures for monitoring compliance with grant terms and conditions. The manual should include procedures and requirements for:

i. Ensuring grantee reports are reviewed for completeness, accuracy, and adequacy regarding deliverables specified in grant contracts;

ii. Ensuring all instances of non-compliance are properly documented and grantees remedy reporting deficiencies;

iii. On-site reviewing of grantee financial systems;

iv. Randomly reviewing of grantee expenditure reports and supporting documentation;

v. Inspecting programs of completed projects to assure that grantees complied with contract terms and conditions not otherwise monitored; and

vi. Ensuring grant files are complete and accurately reflect monitoring activities.

b. Requiring more specificity in grantees’ expenditure reporting, to provide grant monitors a better understanding of how grant funds are expended;

c. Adopting an information system to track grant status and project deliverables that:

i. Retains copies of e-mails, correspondence, performance reports, and evaluations, and alerts monitoring staff when reports are due;

ii. Can monitor grant staff performance;

iii. Assists grants management staff in tracking delinquent annual and final reports to ensure grant deliverables are received; and

iv. Flags the approval of new awards to grantees that miss a deliverable.
d. Increasing site visits and reviews of financial and progress reports for accuracy, completeness, and alignment with project goals, particularly for new grantees and grantees with problems managing their grants;

e. Ensuring that awards are made only to applicants whose outputs and outcomes are consistent with OHA’s strategic goals;

f. Modifying future grantees’ contract terms and conditions to require grantees to include expected outputs and outcomes in their applications and report progress in achieving those outputs and outcomes; and

g. Increasing reporting of grant outcomes to the Board of Trustees by providing evidence of program success.
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Chapter 3  

To ensure agency accountability over audit recommendations, the 2008 Legislature amended the Auditor’s governing statute to require follow-up reporting on recommendations made in various audit reports. The purpose of this change was to inform the Legislature of recommendations not implemented by audited agencies. Section 23-7.5, Hawai‘i Revised Statutes (HRS), now requires the Auditor to report to the Legislature annually on each audit recommendation more than one-year old that has not been implemented by the audited agency. Accordingly, in this chapter we examine OHA’s implementation of recommendations we made in our 2009 audits relating to OHA’s information technology and investment portfolio.

Legislative Request

The 2008 Legislature intended to provide itself greater oversight over the implementation of audit recommendations. Accordingly, the Legislature modeled Act 36, Session Laws of Hawai‘i 2008, after a 2006 California law that enabled legislators to use agencies’ claims of progress against audit recommendations in their budget discussions. The Hawai‘i Legislature requested the Auditor to report annually, for each unimplemented recommendation: 1) the agency that was audited; 2) the title and number of the report that contained the recommendation; 3) a brief description of the recommendation; 4) the date the report was issued; and 5) the most recent explanation provided by the agency to the Auditor regarding the status of the recommendation.

In addition, Act 36 requires that agencies notified by the Auditor that a recommendation is not considered implemented must submit a written report to the Auditor, the Senate president, and the speaker of the House of Representatives within 30 days of being notified. The report must include an explanation of why the agency did not implement the recommendation and the estimated date when the agency will implement the recommendation.

Objective of the Review

1. Validate claims made by OHA regarding implemental audit recommendations and report on recommendations not yet implemented.

Criteria


The GAO’s criteria were especially useful for our purposes, since the GAO also reports on the status of recommendations that have not been fully implemented. The GAO’s reports are intended to “help congressional and agency leaders determine the actions necessary to implement the open recommendations so that desired improvements to government operations can be achieved.” In particular, the GAO reports on whether:

- Monitoring and follow-up are done by staff members responsible for, and knowledgeable about, the recommendation;

- Each recommendation is followed up on an ongoing basis, with at least semi-annual updates, and an individual recommendation follow-up plan is developed for each assignment; and

- Results intended by each recommendation and the benefits expected from its implementation are defined as a basis for determining the adequacy of implementation.

Scope and Methodology


Similar to our 2009 efforts, our review procedures included interviews with selected administrators, managers, and staff. We examined policies, procedures, and relevant documents and records to assess and evaluate whether OHA’s actions adequately fulfilled our recommendations. Our review efforts were limited to the inquiry, testing, and reporting on implementation of recommendations made in the above-mentioned reports. We did not explore new issues or revisit old ones that did not relate to our original recommendations.
Our review was conducted between October 2012 and March 2013. We followed standard office procedures for conducting audits pursuant to the Office of the Auditor’s Manual of Guides, and generally accepted government auditing standards. Those standards require that we plan and perform our work to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions, based on our objectives. We believe the evidence obtained provides a reasonable basis for our conclusions based on our review objectives.

**Determining progress**

The rate of progress of a recommendation’s implementation depends on the type of recommendation. While some fall fully within the purview of the audited agency and can be addressed relatively quickly, others may deal with complex problems and involve multiple agencies, resulting in a long implementation period. Therefore, ample time should be afforded to agencies implementing recommendations in order for a follow-up system to be useful and relevant. In addition, the GAO has found that action on recommendations usually occurs within the first three years. After that time, few recommendations are implemented.

We therefore decided that active follow-up would be most effective and relevant if conducted three years after publication of an initial audit report. Too short an interval between audit report and follow-up may not give an agency enough time to implement a complex recommendation; too long a period might allow an agency to lose valuable personnel and institutional knowledge needed to conduct an adequate follow-up.

We issued 11 reports in 2009, six of which were reported on for follow-up in our Report No. 12-06, *Report on the Implementation of State Auditor’s 2009 Recommendations*, where we elected to omit recommendations related to the Office of Hawaiian Affairs on the basis that we would include that work in this, our quadrennial audit report of OHA.

**Identifying key recommendations**

The extent of work done to verify implementation depends on the significance of individual recommendations. For instance, GAO notes that while all audit recommendations should be aggressively pursued, some recommendations are so significant that added steps are needed to implement them. The significance of a recommendation depends on its subject matter and the specific situation to which it applies. Significance can be assessed in terms of dollars; however, dollars are only one measure, and not necessarily the most important one. Recommendations to ensure safe operations, for instance, often take precedence since their implementation could prevent the loss of life, substantial bodily injury, or environmental contamination.
In accordance with GAO guidelines, we considered recommendations “closed” for the following reasons:

- The recommendation was effectively implemented;
- An alternative action was taken that achieved the intended results; or
- The recommendation was not implemented despite the use of all feasible strategies.

**Closed:** Recommendation has been addressed and/or implemented.

**Open:** Work on the recommendation has not started, or cannot start because a precursor event has not occurred.

**Open but in progress:** The agency has taken action, but implementation of the recommendation is not complete.

**Open and not likely to be pursued:** The agency has no intention of pursuing implementation of the recommendation.

**Not applicable:** Recommendation is no longer applicable.

**Did not assess:** Did not assess implementation of the recommendation.

Our follow-up effort covered a total of 19 recommendations. Thirteen of those were closed (68 percent), two were open but in progress (11 percent), and four were open and not likely to be pursued (21 percent). This chapter details each recommendation, its status, and actions taken related to the recommendation. Exhibit 3.1 lists the reports we reviewed and the status of our recommendations.

Exhibit 3.1
Reports Reviewed and Recommendation Status

<table>
<thead>
<tr>
<th>Report No.</th>
<th>Report Name</th>
<th>Status of Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>09-08</td>
<td>Management Audit of Information Technology Within the Office of Hawaiian Affairs</td>
<td>Closed: 1; Open: 2; Open but in progress: 0; Open and likely not to be pursued: 0; Not applicable: 0; Did not assess: 0; Total: 3</td>
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<tr>
<td>09-10</td>
<td>Investment Portfolio Review of the Office of Hawaiian Affairs</td>
<td>Closed: 2; Open: 0; Open but in progress: 4; Open and likely not to be pursued: 0; Not applicable: 0; Did not assess: 0; Total: 6</td>
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<tr>
<td></td>
<td>Board Structure and Governance</td>
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<tr>
<td></td>
<td>Monitoring of Investment Performance and Advisors</td>
<td>Closed: 10; Open: 0; Open but in progress: 0; Open and likely not to be pursued: 0; Not applicable: 0; Did not assess: 0; Total: 10</td>
</tr>
<tr>
<td></td>
<td>TOTAL</td>
<td>Closed: 13; Open: 2; Open but in progress: 4; Open and likely not to be pursued: 0; Not applicable: 0; Did not assess: 0; Total: 19</td>
</tr>
</tbody>
</table>

Percent of Total 68%  0%  11%  21%  0%  0%  100%

Source: Office of the Auditor

Summary of Findings

1. The Office of Hawaiian Affairs has taken steps to implement most of the recommendations contained in our 2009 audits.

OHA Has Improved Its Management of Information Technology

Report 09-08, Management Audit of Information Technology Within the Office of Hawaiian Affairs, released in June 2009, was conducted pursuant to Section 10-14.55, Hawai’i Revised Statutes, which requires the Auditor to conduct an audit of OHA at least once every four years. It was our sixth audit of OHA, and the first to focus exclusively on its information technology. Secure Technology Hawaii, Inc., was engaged as a consultant to help us review the management of OHA’s information systems.

Comparison to our 2005 audit, our 2009 report found OHA was more focused on its strategic mission and the Board of Trustees had improved its governance structures and processes. However, these improvements were not consistently reflected in OHA’s management of its information systems, as critical elements of sound information technology governance were missing. While OHA recognized the value of information systems in its day-to-day operations, OHA’s focus was on solving immediate needs, with insufficient consideration for long-range strategic issues, such as Information Technology (IT) risk management and coordination of IT systems. We attributed OHA’s day-to-day focus
to the belief among trustees and the administrator that IT is a “tactical” operational issue to be administered by the agency’s staff. Although the administrator supported the use of technology throughout the organization, he had failed to recognize that the complex nature, critical importance, and increasing risk associated with IT required the attention of a chief information officer (CIO) to provide strategic direction for OHA’s information systems.

Our 2009 audit found major IT components were dispersed throughout OHA without oversight and coordination. At least nine major information systems and assets were managed by nine separate stakeholders. Such diverse and widespread use of information systems reinforced the need for a centralized IT authority to provide leadership. Otherwise, OHA faced increased risk of wasting time and resources, and could not react quickly and effectively to information requirements posed by the organization’s changing needs. The office faced increasing challenges requiring the board and staff to make sound decisions based on secure, accurate, and accessible information. Dedicated leadership of the agency’s information systems was critical for OHA to coordinate its disparate IT resources around a cohesive strategy.

**Status of recommendations**

Report 09-08, *Management Audit of Technology Information Within the Office of Hawaiian Affairs*, made three recommendations to the Office of Hawaiian Affairs. The first directed OHA to create a chief information officer position. We found that the office has designated CIO responsibilities to its chief financial officer, and therefore deem recommendation No. 1 **Closed**. The second and third recommendations dealt with strategic planning for information technology. One directed OHA to create an IT steering committee to help the CIO formulate an IT strategic plan, and the other to implement an IT strategic plan created by the CIO and steering committee. In place of an IT steering committee and a strategic plan for IT, the OHA Information Technology Framework was created. This document provides an overview of OHA’s IT governance framework and provides guidance for OHA to conduct IT business. The office also uses work plans to carry out its high-level goals for IT systems. Because the OHA Board of Trustees has yet to approve the OHA Information Technology Framework, we deem recommendation Nos. 2 and 3 **Open but in progress**.

We released Report 09-10, *Investment Portfolio Review of the Office of Hawaiian Affairs*, in September 2009. We worked with the investment consulting firm Navigant Consulting, Inc., to conduct a portfolio review of OHA’s investments for the period July 1, 2003–June 30, 2008. The review examined OHA’s management and oversight of its investments in the Native Hawaiian Trust Fund and analyzed investment holdings and performance; and relevant processes, policies, and procedures. Our consultant also assessed OHA’s use of and relationships with external investment advisors and consultants.

### Oversight of Investment Management Has Progressed, But Some Concerns Remain

In 2009, we found that OHA needed to improve its investment framework and process to ensure it met its fiduciary responsibilities to beneficiaries. The office had used a manager-of-managers structure in which OHA granted each of its investment advisors full investment discretion over approximately half of the trust’s assets. To satisfy its fiduciary duties related to the trust, the board required policies and procedures to maintain proper oversight of the advisors. However, we found that the board as a whole lacked adequate investment or financial knowledge to properly oversee its trust investments. We determined the board needed to require trustees to attend investment training upon joining the board and periodically thereafter.

<table>
<thead>
<tr>
<th>RECOMMENDATION</th>
<th>PURPOSE</th>
<th>STATUS</th>
<th>COMMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Recommendations to the Office of Hawaiian Affairs</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Create the position of a chief information officer (CIO) to assume the overall governance duties over its information systems, to direct IT policy and strategic planning and to provide oversight to the agency’s varied information assets.</td>
<td>Without guidance from a CIO who understands the technical aspects and business requirements of OHA’s information systems, the agency will continue to react to its technology needs instead of anticipating and planning for them.</td>
<td>Closed</td>
<td>OHA’s chief financial officer/resource management director was given CIO responsibilities and is tasked with overseeing information management and technology.</td>
</tr>
<tr>
<td>2. Form an IT steering committee to support the CIO in formulating an IT strategic plan that identifies, prioritizes, and monitors IT requirements across the agency.</td>
<td>OHA lacks an IT steering committee to assist the CIO in delivering IT strategy and oversee the day-to-day management of information systems and projects.</td>
<td>Open but in progress</td>
<td>OHA has developed an IT governance framework to fulfill the role of a steering committee.</td>
</tr>
<tr>
<td>3. Implement an IT strategic plan as part of the overall strategic planning process.</td>
<td>Although OHA has made improvements to its overall governance structure, elements of sound IT governance are missing.</td>
<td>Open but in progress</td>
<td>OHA has developed an IT governance framework that includes IT strategies.</td>
</tr>
</tbody>
</table>

**Background**

We released Report 09-10, *Investment Portfolio Review of the Office of Hawaiian Affairs*, in September 2009. We worked with the investment consulting firm Navigant Consulting, Inc., to conduct a portfolio review of OHA’s investments for the period July 1, 2003–June 30, 2008. The review examined OHA’s management and oversight of its investments in the Native Hawaiian Trust Fund and analyzed investment holdings and performance; and relevant processes, policies, and procedures. Our consultant also assessed OHA’s use of and relationships with external investment advisors and consultants.

In 2009, we found that OHA needed to improve its investment framework and process to ensure it met its fiduciary responsibilities to beneficiaries. The office had used a manager-of-managers structure in which OHA granted each of its investment advisors full investment discretion over approximately half of the trust’s assets. To satisfy its fiduciary duties related to the trust, the board required policies and procedures to maintain proper oversight of the advisors. However, we found that the board as a whole lacked adequate investment or financial knowledge to properly oversee its trust investments. We determined the board needed to require trustees to attend investment training upon joining the board and periodically thereafter.
Review of the trust’s investment performance illuminated inadequacies in OHA’s investment process and monitoring procedures and their impact on the trust. The trust’s investments had underperformed for most of our review period, failing to meet OHA’s earnings targets in nearly half the quarters and lagging average nationwide peer performance in 18 of 20 quarters reviewed (90 percent). The office had also failed to properly monitor investment performance by not updating its Investment Policy Statement, ensuring accurate and consistent reporting by advisors, or implementing a proper risk management program.

We found in 2009 that since initial procurement of its investment advisors in February 2003, OHA had not evaluated whether its advisory fees—which averaged more than $3 million annually for F2007—were reasonable and competitive. The office also had not implemented procedures crucial to effective oversight of advisors’ activities, such as procedures to monitor investment compliance, valuation, account reconciliations, or proxy voting. Finally, OHA needed to do more to ensure its asset allocation was appropriate, based on OHA’s established goals, risks, and asset ranges, as well as optimally diversified in comparison to its peers.

We recommended the board adopt written policies and procedures regarding investment management and service provider oversight, and formally evaluate its decision to retain the manager-of-managers approach; that the board implement regular mandatory training for trustees on topics such as fiduciary responsibilities and financial and investment matters; and that the board formalize its investment structure and governance policies. We also made several recommendations on improving the monitoring of investment performance and investment advisors’ activities.

Report No. 09-10, *Investment Portfolio Review of the Office of Hawaiian Affairs*, included 16 recommendations to OHA’s Board of Trustees, six of which related to board structure and governance, and ten of which related to monitoring of investment performance and advisors.

**Board structure and governance recommendations**

The first recommendation regarding board structure and governance directed the board to adopt written policies and procedures regarding investment management and service provider oversight. It also directed the board to include a policy on OHA’s website stating that the public can request documentation concerning the trust and OHA. Although OHA’s Investment Policy Statement constitutes written policies and procedures, our current review found no policy on OHA’s website that discusses requesting documentation. The office asserts that the “contact us”
portion of its website fulfills our recommendation. Therefore, we deem recommendation No. 1 **Open and not likely to be pursued.**

Recommendation No. 2 directed the board to annually assess and document its decision to retain its manager-of-managers approach. We note that OHA issued a Request for Information (RFI) on November 12, 2010, to obtain information on alternative investment advisory services and to address Russell Investments’ poor hedge fund performance. Through the RFI, OHA assessed its investment advisors’ firm overview, portfolio construction and risk management, historical performance, services, and fees. The office now assesses its investment advisors’ performance annually through year-end evaluations presented to the board. These evaluations also assess the performance of the investment advisors relative to their peers. The office has also documented a preference for its manager-of-managers approach in its Investment Policy Statement. Therefore, we deem recommendation No. 2 **Closed.**

Recommendation No. 3 addressed training for board members. We asked the board to consider providing yearly mandatory training to trustees on their roles and responsibilities and to record trustees’ attendance in a training log. The OHA Investment Policy Statement says board members must attend at least two investment educational events in Hawai‘i each year and one out-of-state training. We found that one board member failed to attend a single meeting in calendar year 2012 thereby failing to fulfill the training requirement. The office also does not have a training log. Instead, OHA records the attendance of trustees through meeting minutes, which presents a problem concerning training sessions conducted outside of meetings. Although OHA provided documentation for training sessions that board members attended on the mainland in 2012, the documentation appeared only in travel records because there is no training log. Therefore, we deem recommendation No. 3 **Open and not likely to be pursued.**

Recommendation No. 4 directed the board to consider adding the chair of the Asset and Resource Management (ARM) Committee, a trustee-at-large, and the CFO to its Investment Advisory Committee. The Investment Advisory Committee now consists of the chair and vice chair of the ARM Committee and the CFO. The chair of the ARM Committee is also a trustee-at-large. Therefore, we deem recommendation No. 4 **Closed.**

Recommendation No. 5 directed the board to consider having trustees annually certify that they have abided by OHA’s code of ethics and document the evaluation of potential conflicts of interest related to trust fund activities. Our recommendation also directed the board to consider logging beneficiary complaints in a log and to institute a whistleblower
policy that would allow individuals to report illegal or unethical activity anonymously. We found that trustees are required to abide by the ethics policy in OHA’s Investment Policy Statement, but the policy does not require trustees to certify that they abide by the code of ethics. There is also no whistleblower policy. The office asserts that meeting minutes are sufficient to log beneficiary complaints. However, an OHA senior investment analyst confirmed it does not have a policy requiring trustees to certify they have abided by the code of ethics. The office’s senior investment analyst said OHA has considered but not yet added a whistleblower policy to its employee handbook. Together with the fact that the ethics policy still contains many of the shortcomings identified in Report No. 09-10, we deem recommendation No. 5 Open and not likely to be pursued.

Recommendation No. 6 directs the OHA board to consider revising its fiscal reserve policy to include criteria for using the reserve and to define a cap on the reserve. We found the office’s fiscal reserve policy clarifies its existing Native Hawaiian Trust Fund spending policy but does not cap the fund. We deem recommendation No. 6 Open and not likely to be pursued.

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<tr>
<td>1. Adopt written policies and procedures regarding investment management, service provider oversight. In addition, OHA should include a policy on the agency’s website that clearly states the public can request documentation.</td>
<td>OHA’s policies and procedures over its trust fund were inadequate.</td>
<td>Open and not likely to be pursued</td>
<td>OHA has an Investment Policy Statement that was adopted by the board on September 27, 2012. NHTF operational procedures are in draft and there is no policy listed on OHA’s website.</td>
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<td>2. Assess and document its decision to retain the manager-of-manager approach annually.</td>
<td>Under the manager-of-managers structure, the external investment advisors had full investment discretion including hiring and terminating managers, due diligence reviews of managers and allocating resources.</td>
<td>Closed</td>
<td>OHA has documented a preference for its manager-of-managers approach in its Investment Policy Statement. Performance of advisors was assessed through an RFI and year-end evaluations.</td>
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<td>3. At least annually, all board members should be required to receive training on their roles and responsibilities. Training for the board should include: fiduciary responsibilities, accounting, financial and investment matters, and the understanding of quarterly reports provided by the investment advisors.</td>
<td>The OHA board did not possess an adequate level of financial or investment knowledge or experience to properly oversee its trust and investments.</td>
<td>Open and not likely to be pursued</td>
<td>OHA’s Investment Policy Statement notes that training is mandatory for board members; however, not all BOT members met training requirement in 2012. OHA also does not have a training log for board members.</td>
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Monitoring of investment performance and advisors recommendations

Ten recommendations addressed the monitoring of investment performance and advisors. The first and second of these directed the board to consider reviewing OHA’s Investment Policy Statement and to use data to consider why the trust has been outperformed by its peers. We found that OHA annually reviews its Investment Policy Statement, and that the policy was last revised in 2012. The office also receives reports of peer comparisons on a quarterly basis from State Street Investment Analytics. We therefore deem recommendations Nos. 1 and 2 Closed.

Recommendation No. 3 dealt with the performance of OHA’s investment managers. We directed the board to consider reviewing performance of OHA’s investment managers frequently, clarify its investment policy,
and create a written procedure to ensure that investment managers are implementing standardized quarterly reports. Operational procedures for the NHTF now require OHA staff to monitor the performance of investment advisors as well as the monthly reconciliation of portfolio positions and valuations between the custodian and advisors. The office also monitors the performance of its investment managers and compiles their performance in quarterly reports. State Street Investment Analytics provides the board with those quarterly reports as required by OHA's investment policy. The office provided evidence that State Street Investment Analytics provided quarterly reports in June and September of 2012. Therefore, we deem recommendation No. 3 Closed.

Recommendation No. 4 directed the board to approve and implement a risk assessment and risk management policy, including a methodology describing procedures and guidelines for assigning risk rankings. We found that OHA staff has in fact identified risks and completed a risk management evaluation. Also, OHA's NHTF Investment Policy Statement includes a risk management policy requiring OHA staff to conduct an annual qualitative risk assessment. In addition, the Investment Policy Statement and 2011 year-end investment evaluations describe procedures and guidelines for assigning risk. Thus, we deem recommendation No. 4 Closed.

The fifth recommendation dealt with cost savings for investment advisor services. We asked the board to consider soliciting additional investment advisors to identify potential cost savings or to negotiate with the current advisor for a fee reduction. We note that OHA issued an RFI in 2010 to solicit information on alternative investment advisory services and that fees of services were part of the evaluation criteria used to assess investment advisors. Therefore, we deem recommendation No. 5 Closed.

Recommendation No. 6 directed the board to consider developing a valuation policy for its trust. The policy would describe a process by which OHA staff and the ARM committee would review periodic valuation reports provided by advisors to ensure compliance with stated policies. We note that OHA has a valuation policy which states that OHA accepts and adopts its advisors’ valuation policies as its own unless OHA staff find the policies to be unreasonable or imprudent upon review. In addition, OHA's Investment Policy Statement and NHTF operational procedures note that OHA staff are to monitor monthly reconciliations of the portfolio positions and valuations among the custodian and advisors. For this reason, recommendation No. 6 is Closed.

Recommendation No. 7 directed the board to establish written policies and procedures to ensure reconciliations are accurately and properly documented between the custodian and investment advisors. The NHTF
operational procedures state that OHA staff must monitor reconciliations between the custodian and advisors. The procedures also state that staff are to use online tools to monitor and report weekly market values to the CFO at the weekly staff meeting. Staff are also responsible for reviewing monthly reports produced by the advisors and custodians to ensure the accuracy of account reports and resolve any discrepancies. Therefore, we deem recommendation No. 7 **Closed**.

Recommendation No. 8 directed the board to require both Russell and Goldman Sachs to submit a proxy voting report to the investment consultant/analyst on a periodic basis, in addition to creating a Proxy Voting Policy to be adopted by the board. The office was also directed to review proxy reporting information on a periodic basis to ensure investment advisors are voting proxies timely and without conflicts of interest. We found that the office’s Investment Policy Statement now states the board has delegated authority to advisors and managers to vote proxies. In addition, the NHTF draft operational procedures state that OHA staff are to review advisors’ proxy voting policies annually and that advisors are required to provide written certifications of compliance with proxy voting. We were provided copies of advisors’ annual compliance statements and therefore deem recommendation No. 8 **Closed**.

Recommendation No. 9 directed the board to consider requiring the investment consultant to include information in its annual report comparing OHA’s investment performance with a universe of peers and a quarterly analysis of CommonFund data. The board was also directed to review a study of the National Association of College and University Business Officers (NACUBO), information from the Trust Universe Comparison Service (TUCS), or reports of the Council on Foundations. Our review cited this type of data from NACUBO and TUCS. Also, on a quarterly basis, the OHA board receives reports from State Street Investment Analytics that show a peer comparison of portfolio performance. Therefore, we deem recommendation No. 9 **Closed**.

Finally, recommendation No. 10 directed the board to consider requiring its investment advisors to provide enhanced reporting regarding the transition into Private Equity from the US Large Cap target allocation. Based on an investment advisor’s update to the board on capital contributions submitted in March 2012, we deem recommendation No. 10 **Closed**.
### Recommendations to the Board of Trustees of the Office of Hawaiian Affairs

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<td><strong>1.</strong> Consider performing a quarterly analysis of CommonFund, as well as TUCS data or the Council on Foundations to help evaluate the investment performance of the trust against a peer universe and document such analysis.</td>
<td>OHA did not regularly review and update its Investment Policy Statement.</td>
<td>Closed</td>
<td>OHA reviews its Investment Policy Statement annually. On a quarterly basis, the OHA board receives reports from State Street Investment Analytics that show a peer comparison of portfolio performance. The annual report from the investment consultant also shows peer comparison.</td>
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<td><strong>2.</strong> Review the investment policy on an annual basis or more frequently as market conditions and OHA funding requirements dictate.</td>
<td>OHA did not regularly review and update its Investment Policy Statement.</td>
<td>Closed</td>
<td>OHA reviews its Investment Policy Statement annually.</td>
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<td><strong>3.</strong> Consider reviewing the performance of the investment managers more frequently via the online access through ClientLINK, provided after the review period of fiscal years 2004 to 2008.</td>
<td>Investment advisors reports not consistently prepared, lacked peer comparisons, and did not accurately reflect benchmarks. As a result, OHA may not have had accurate performance reports available.</td>
<td>Closed</td>
<td>To monitor investment managers, OHA staff and the consultant must compile quarterly reports which note managers’ performance. State Street Investment Analytics has provided these reports to the board on a quarterly basis.</td>
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<td><strong>4.</strong> Review, approve, and implement the recently developed risk assessment as soon as feasible, along with an approved risk management policy.</td>
<td>Without a risk management policy, OHA was unable to identify, evaluate, or adequately monitor potential risks to the trust and OHA.</td>
<td>Closed</td>
<td>OHA’s NHTF Investment Policy Statement includes a risk management policy which requires OHA staff to conduct an annual qualitative risk assessment.</td>
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<td><strong>5.</strong> Consider soliciting additional investment advisors in order to identify any potential cost savings for comparable services, or at the very least to negotiate with the current advisors for fee reductions.</td>
<td>OHA did not determine the available fee structure for comparable services nor had it completed an analysis of advisory fees being paid by peers.</td>
<td>Closed</td>
<td>OHA issued a RFI in 2010 to solicit information on alternative investment advisory services. Fees for services was one of the areas that were assessed.</td>
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<td><strong>6.</strong> Consider developing a valuation policy for the trust, which could adopt the valuation policy and procedures of its advisors and managers. The valuation policy should describe the process whereby the administrative staff and the ARM Committee shall review periodic valuation reports provided by the advisors.</td>
<td>OHA did not have a valuation policy for illiquid securities and relied on investment advisors to determine the value of such securities.</td>
<td>Closed</td>
<td>OHA’s valuation policy notes that it accepts and adopts its advisor’s valuation policies as its own unless the policies are found to be unreasonable or imprudent during the annual review process.</td>
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## Recommendations to the Board of Trustees of the Office of Hawaiian Affairs

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<td>7. Establish written policies and procedures to ensure reconciliations are accurately and properly documented between the custodian and the investment advisors.</td>
<td>The failure to properly and timely reconcile investment accounts made it difficult for OHA to ensure reported amounts were accurate and to identify and resolve discrepancies.</td>
<td>Closed</td>
<td>The NHTF operational procedures note that OHA staff is responsible for the monitoring of monthly reconciliations of portfolio positions and valuations between custodian and advisors.</td>
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<td>8. Require both Russell and Goldman Sachs to submit a proxy voting report to the investment consultant/analyst on a periodic basis. OHA should review on a periodic basis.</td>
<td>OHA did not appear to review advisor proxy voting policies to assess potential conflicts of interest.</td>
<td>Closed</td>
<td>The NHTF draft operational procedures state that OHA staff is to review the advisors proxy voting policies annually and that the advisors are required to provide written certifications of compliance with proxy voting.</td>
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<td>9. Consider requiring the investment consultant to include a section in the annual report that compares the CommonFund Study as presented by Russell to the applicable trust investment policy. Additionally, consider requiring a quarterly analysis of the CommonFund data to help evaluate the average asset allocation of a peer universe against the trust's strategic asset allocation.</td>
<td>OHA did not compare the investment policy to a peer asset allocation study on a consistent basis. Without this comparison, OHA was unable to determine whether the performance of its trust is in line with its peers.</td>
<td>Closed</td>
<td>Investment consultants' annual reports contain reporting using data from CommonFund, NACUBO, and TUCS. On a quarterly basis, the OHA board receives reports from State Street Investment Analytics showing a peer comparison of portfolio performance.</td>
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<td>10. Consider requiring the investment advisors to provide enhanced reporting regarding the transition into Private Equity from the US Large Cap target allocation.</td>
<td>OHA is unable to track the transition of asset allocation weightings and was unable to monitor performance attribution of the trust.</td>
<td>Closed</td>
<td>Investment advisors update the board on capital contributions on an annual basis.</td>
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Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Office of Hawaiian Affairs’ Board of Trustees and to the Office of Hawaiian Affairs on July 26, 2013. A copy of the transmittal letter to the office is included as Attachment 1. On August 2, 2013, we received a 44-page response from the board chair; it is on file in our office and available for review. On August 6, 2013, we transmitted a letter to the board requesting a revised response of no more than five pages, a copy of which is included as Attachment 2. On August 9, 2013, we received a response from an individual trustee, which is included as Attachment 3. On August 9, 2013, we received a revised response from the board chair, included as Attachment 4.

In her August 9, 2013 response, the board chair thanked auditor staff for their diligence and appreciated the report’s recommendations. Regarding our finding that OHA’s real estate vision, mission, and strategy (REVMS) is not supported by board-adopted land policies, the chair said trustees waited until the Kaka’ako Makai land settlement was approved by the State before approving additional positions to manage OHA’s land holdings. The response does not address our finding that OHA lacked a robust policy to purchase property for investment purposes and misses our broader point that OHA’s lack of a policy framework and other infrastructure to implement REVMS and other best practices is contrary to fulfillment of the board’s role as fiduciary and policymaker, and undermines the board’s ability to ensure that real estate acquisitions are based on a strong financial foundation. Further, OHA’s pursuit of real estate acquisitions without adequate policies increases the risk that acquisitions do not comport with OHA’s land strategy at a time when the office is seeking a larger role as a landowner.

In response to our finding that significant stewardship expenses are not offset by revenue from OHA’s real estate portfolio, the board chair said OHA will at times acquire land with the primary purpose of preservation and protection of “our ‘āina and rights,” and that the goal of financial return and sustainability must not compromise that purpose. Our report acknowledges that Wao Kele o Puna and Waimea Valley acquisitions returned ceded land to Hawaiian ownership and preserved land for future generations. However, we found the office was complacent in reducing management costs. We maintain that OHA investments are bound by fiduciary duties that include a duty of prudence requiring decisions be made in the context of a portfolio as part of an investment strategy, with suitable risk and return objectives. Further, OHA’s REVMS calls for building a strong financial foundation for all property involvements.
and notes that sacred lands are to have economic integrity and financial sustainability. Additionally, as noted in our report, best practices call for land trusts to determine immediate and long-term financial and management implications and secure dedicated or operating funds needed to manage a property, either before or at transaction closing, or produce a plan to secure and commit funds for this purpose. Thus, we maintain that OHA is not following best practices for a conservation land trust nor its own stated strategy to ensure financial sustainability.

Regarding our grant-related findings, the board chair said the office sincerely appreciates the intent of the audit and views the report’s recommendations an opportunity to improve its grants program. The chair added that OHA has identified many of the same concerns we expressed and has been focusing on developing accountability and monitoring measures. The chair said that since July 1, 2012, OHA has taken steps to implement many changes that address the same concerns raised in our report.

The chair disagreed with our finding that the trustees’ vote in favor of Gentry acquisition violated OHA’s Native Hawaiian Trust Fund investment policy, asserting that such a finding is untrue and unsubstantiated. In support, the chair attached an April 11, 2013 letter from the Hawai‘i State Ethics Commission stating that the commission closed its investigation into the trustee’s actions because evidence did not support a conclusion that there was a violation of State ethics code. In a separate response to our draft report, another trustee agreed with us that the trustee vote violated OHA investment policy. However, that trustee misstated that we found the action violated State ethics law; as stated in our report, we defer to the commission to make this determination. Nevertheless, we maintain that the trustee’s action was contrary to OHA’s Native Hawaiian Trust Fund investment policy, which provides that if a trustee has a personal involvement with any direct investment transaction, or even any perceived conflict of interest, the trustee must disclose the involvement immediately and be recused from both discussions and votes on the transaction. The Board chair argued that the trustee involved only voted to authorize acquisition of the property and left details of the acquisition to OHA’s chief executive. While we acknowledge this is true, we maintain that the trustee’s action to vote on an acquisition, despite serving as a director of one of the banks considered to finance that acquisition, constituted a perceived conflict of interest and risked damaging OHA’s reputation and undermining the agency’s credibility with beneficiaries and the public. Accordingly, we stand by our findings.

We made minor technical changes to correct errors of fact.
July 26, 2013

The Honorable Kamanaʻopono Crabbe
Chief Executive Officer
Office of Hawaiian Affairs
711 Kapiʻolani Boulevard, Suite 500
Honolulu, Hawaiʻi 96813

Dear Dr. Crabbe:

Enclosed for your information are three copies, numbered 6 to 8, of our confidential draft report, *Audit of the Office of Hawaiian Affairs and Report on the Implementation of State Auditor's 2009 Recommendations*. We ask that you telephone us by Tuesday, July 30, 2013, on whether or not you intend to comment on our recommendations in Chapter 2. If you wish your comments to be included in the report, please submit them no later than Friday, August 2, 2013.

The Board of Trustees of the Office of Hawaiian Affairs, Governor, and presiding officers of the two houses of the Legislature have also been provided copies of this confidential draft report.

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

Sincerely,

[Signature]

Jan K. Yamane
Acting State Auditor

Enclosures
August 6, 2013

Trustee Colette Y. Machado  
Chairperson  
Board of Trustees  
Office of Hawaiian Affairs  
711 Kapi'olani Boulevard, Suite 500  
Honolulu, Hawai‘i 96813

Dear Trustee Machado:

We have received your comments of August 2, 2013 on our draft report, *Audit of the Office of Hawaiian Affairs and Report on the Implementation of State Auditor’s 2009 Recommendations*. We note that your comments are 44 pages in length, including a 3-page letter, four exhibits totaling 14 pages, and five attachments to the exhibits totaling 27 pages.

It is unfeasible to include such voluminous comments in our report, but we will inform readers that your response is on file at our office. Although our audit standards permit us to summarize your comments, we prefer to include officials’ written comments. Thus, if you would like your written comments to be included in the report, please submit them in a letter no more than five pages long and no later than Friday, August 9, 2013. We ask that you telephone us by Wednesday, August 7, 2013, on whether or not you intend to submit such a letter.

Sincerely,

Jan K. Yamane  
Acting State Auditor
August 8, 2013

Ms. Jan K. Yamane
Acting State Auditor
Office of the Auditor
465 S. King Street, Room 500
Honolulu, HI 96813-2917

Audit of OHA & Report on Implementation of State Auditor’s 2009 Recommendations

Aloha! I am writing to you as an individual Trustee of the Office of Hawaiian Affairs to dispute statements that were made by OHA Chairperson Colette Machado in her August 2, 2013 letter to you regarding your 2013 OHA Audit for the following reasons:

(1) LETTER TO YOU SENT WITHOUT BOARD DISCUSSION

Chair Machado sent her response to you without first discussing the contents of the letter with the Board of Trustees as a whole. This action goes contrary to past practices. Normally, draft responses are first discussed at the board table prior to being sent so that any questions, concerns, or suggested changes can be considered. The Trustees were not given this opportunity.

(2) AUDITOR’S FINDINGS ON GENTRY PURCHASE ARE TRUE

I believe that the State Auditor’s finding that that the Board of Trustees’ vote in favor of the Gentry acquisition violated (1) OHA’s Native Hawaiian Trust Fund Investment Policy on conflict of interest and (2) Hawaii State Ethics Code (Chapter 84, HRS) are true and can be substantiated.

It is a fact that OHA Trustee Haunani Apoliona voted in favor of purchasing the Gentry property, which was financed by Bank of Hawaii, while she also served as a Director on their board.

It is a fact that OHA’s Chief Operating Officer stated that the OHA Administration sought out three quotes and Bank of Hawaii offered, by far, the best loan rate. OHA’s Administration knew this fact before the final authorization vote was taken on June 7, 2012.
Therefore, OHA Trustee Haunani Apoliona was fully aware, as were all members of the Board of Trustees, that Bank of Hawaii was the financial institution that OHA was going to work with for the financing of the Gentry purchase.

An audit should be a tool to help an organization reexamine their operations and set solid benchmarks for improvement. It should not be used to hide embarrassing blemishes.

Thank you for an excellent audit report on the Office of Hawaiian Affairs and for pointing out areas that we can improve on.

Aloha pumehana,

[Signature]

ROWENA AKANA
Trustee-at-Large
August 9, 2013

Ms. Jan K. Yamane
Acting State Auditor
Office of the Auditor
465 S. King Street, Room 500
Honolulu, Hawai‘i 96813-2917

Dear Ms. Yamane:

This responds to the draft of the State Auditor’s 2013 report titled “Audit of the Office of Hawaiian Affairs and Report on the Implementation of State Auditor’s 2009 Recommendations.” The Office of Hawaiian Affairs thanks your staff for its diligent work and appreciates your recommendations.

As requested, we have limited this response, to be included in the audit report, to no more than five (5) pages. We appreciate your office retaining our original response dated August 2, 2013 and trust that you will make it available upon request. We will also post our original response to the draft audit on our website at www.oha.org once your office has officially released its report.

Finding: Trustees’ vote in favor of Gentry acquisition violated OHA investment policy.

OHA strongly disagrees with this finding and requests that it be deleted in its entirety from the Audit Report because it is based on untrue and unsubstantiated information. Further, it ignores key facts as well as the context and intent of the Board of Trustees’ (Board) actions. We are dismayed that the Audit Report ignores the following key facts:

- The State Ethics Commission exonerated and vindicated the OHA Trustee of any violation of the State Ethics Code.
- OHA’s Chief Executive Officer (CEO) was solely responsible for selecting the financing for the Gentry Pacific Design Center (GPDC). Trustees delegated all the financing decisions to the CEO and were never involved in the selection nor did they influence the process.
- The CEO entertained financing proposals from three major banks in Hawai‘i. A letter from one of the banks dated June 22, 2012 indicates that no financial institution had been selected as of that date.

A complaint was brought before the State Ethics Commission based on the Trustee’s vote on the Board’s June 7, 2012 Motion. Trustee S. Haunani Apoliona received a letter from the commission exonerating her from any wrongdoing. The letter is attached to this response. (See Attachment A.) In the letter, Executive Director and General Counsel Leslie H. Kondo wrote, “The commission has determined that the evidence does not support a conclusion that your actions violated the State Ethics Code and, thus, has closed its investigation into this matter.”
Although the Audit Report claims that “we defer to the commission on whether the trustee’s vote violated state ethics law,” it does not “defer” at all. Rather, it goes on to pillory the Trustee by conflating the unfounded “ethics violation” into speculation that the “trustee’s actions may damage OHA’s reputation and undermine the agency’s credibility with beneficiaries and the public.” If the Audit Report really “defers” to the State Ethics Commission, the finding of a violation of policy and state law must be abrogated and entirely deleted from the Audit Report as it is untrue, unsubstantiated by facts, and wrong as a matter of law.

On June 7, 2012, the Board was again asked to approve the acquisition of GDPC by specifically directing the CEO to submit a revised offer and delegating to the CEO responsibility to “seek the best financing available (on terms most favorable to OHA).” There was no mention of any specific financing proposal. The decision on financing was made solely by the CEO without Trustee involvement or further Board direction and therefore, the Audit Report’s claim that “the board later chose the bank of which the other trustee was a director to finance the acquisition” is wrong and unsupported by any facts whatsoever. The Trustees never made that decision.

After the June 7th vote, OHA staff continued to explore financing options from three major banks in Hawai‘i (See “Gentry Pacific Design Center Financing Timeline” which is Attachment A to Exhibit #3 to OHA’s response dated August 2, 2013 and on file with the State Office of the Auditor). In addition, the Bank of Hawai‘i’s June 22, 2012 letter expressing continued interest in the financing of OHA’s acquisition of GPDC demonstrates that no financial institution had been selected as of that date. The letter is attached to this response. (See Attachment B.)

The Audit Report takes an extreme position on the question of whether a Trustee has a “perceived conflict of interest”. We agree that genuine conflicts of interests and the reasonable perception of a conflict must be avoided. In fact, Trustees regularly recuse themselves from votes where there is a reasonable perception of a conflict. Here, however, the Trustee involved voted only to authorize the acquisition of property and delegate the details of the transaction to the CEO. The Audit Report seems to interpret a “perceived conflict of interest” to mean any imagined conflict of interest. This extreme interpretation would make it difficult for the Board in many instances to obtain a quorum and conduct its business—even where no conflict exists. Your prediction noting “the likelihood [that] similar conflicts will increase, particularly for trustees involved in banking, real estate, and professional services firms that stand to benefit from the project” is erroneous, inasmuch as there was no conflict evidenced in this case. As policy makers, OHA Trustees are expected to possess a high level of knowledge and experience. Trustees often bring with them an expansive network of business and community connections, including decision-making authority in other capacities and access to financial resources outside their role as OHA Trustees. OHA’s Trustees and Administration take great exception to the report’s insinuation that the very traits that allow OHA Trustees to be effective policy makers hinder their ability to be effective AND ethical civil servants to our Native Hawaiian beneficiaries. Certainly this case and this vote are examples of a Trustee acting carefully, prudently, and without a doubt, ethically.
Ms. Jan K. Yamane  
August 9, 2013  
Page 3

**OHA’S LAND AND PROPERTY**

The mandate of the Office of Hawaiian Affairs (OHA) is to raise a nation through stewardship of Hawai‘i’s people (lāhui) and environmental resources (‘āina). ‘Āina has always been considered an integral part of Native Hawaiian identity and overall well-being. ‘Āina is instrumental in helping OHA to best address its mission and obligates us to preserve and protect Hawai‘i’s fragile cultural and natural resources while balancing complementary asset resources.

**Finding: OHA’s real estate vision, mission, and strategy is not supported by board-adopted land policies.**

OHA’s Board of Trustees adopted a comprehensive Real Estate Vision, Mission, and Strategy (REVMS) in 2007. The Auditor also points out Trustees adopted an investment policy governing certain real estate investments in 2010. This Hawai‘i Direct Investment Policy (HDIP) was never intended to replace the REVMS, but to supplement it. The HDIP was adopted for the very limited purpose of using OHA’s financial asset portfolio to purchase first a corporate office building to serve as OHA’s headquarters. As such, the board-adopted policy was not abandoned but remains in force.

Until 2012, all of OHA’s land holdings were acquired to help protect lands with cultural significance and biocultural resources. While there had been proposals to settle past-due ceded land revenue claims with the state with land valued at $200 million, OHA could not anticipate whether or when a settlement could be reached. The Auditor notes that while a consultant recommended Land and Property staff be bolstered in 2008, the Trustees prudently decided to wait until it was known which types of land it would receive. It was not until five years later that OHA received lands that require additional staff. Once the Kaka‘ako Makai land settlement was approved by the state, the Trustees quickly approved additional positions to manage its land holdings.

**Finding: Significant stewardship expenses are not offset by revenue from OHA’s real estate portfolio.**

Prior to 2012, OHA acknowledges its land portfolio was skewed to preservation land. Given the importance of ‘āina to our culture and the Native Hawaiian people, there are times when OHA will acquire land where the primary purpose is preservation of our ‘āina and rights; therefore, the goal of financial return and financial sustainability on these lands must be balanced without compromise to this primary purpose. OHA views the Auditor’s finding that “high-maintenance properties drain OHA resources” as an inherent difference of values.

However, given the importance of ‘āina and its connection to Native Hawaiian culture and people, OHA intends to further develop our land policies to integrate cultural and commercial values that best support our lāhui.

With the acquisition of commercial properties in 2012, OHA is in the process of balancing its portfolio. The audit criticizes OHA for a six-year lag time between the acquisition of the legacy lands and the commercial properties, however given the need to find the most prudent...
investments, do the required due diligence, and in the case of Kaka‘ako Makai, shepherd the acquisition through the political process, OHA believes the lag time was reasonable.

**OHA GRANTS PROGRAM**

The audit of the OHA grants program by the State of Hawai‘i Office of the Auditor covers the three-year audit period from July 1, 2009 – June 30, 2012. OHA sincerely appreciates the intent of the audit and views the recommendations contained within its report as an opportunity to improve its grants program.

**Finding: Ineffectual oversight continues to plague grants program, hampering trust fund transparency and accountability.**

On September 10, 2009, OHA’s Board of Trustees approved its 2010-2016 Strategic Plan to include its Mission, Vision, Values, Roles, six Strategic Priorities, and ten Strategic Results while defining its roles as Advocate, Researcher, and Asset Manager. The approval of its Strategic Plan led to the eventual restructuring of the organization as noted in the Auditor’s Report on pages 3-5. This restructure resulted in the formation of the Transitional Assistance Program (TAP), which included four (4) grants specialist devoted to all aspects of the grants process.

Since the restructure, OHA has continued its evaluation of the TAP program, as the Community Grants were redefined to bring it in line with the new Strategic Priorities. The new Strategic Plan demands that results be measurable.

OHA has identified many of the same concerns expressed by the Auditor. As a result, OHA has been focusing on the development of accountability and monitoring measures. Since July 1, 2012, OHA has taken steps to implement many changes that address the same concerns raised in the report. The last two years of grant funding focused on program improvements, quality, effectiveness, transparency, and process efficiency.

Changes implemented over this period included: (a) New solicitation template, (b) New process for evaluating proposals, (c) Implementation of performance-based contract conditions (for income-related contracts), and (d) Creation of Grants Standard Operating Procedures (SOP).

We believe our oversight of the Community Grants program to be effective, but we also recognize there is always room for improvement. We will consider the rest of the recommendations, and adopt them as necessary.

OHA has also recognized the need for increased transparency. In December 2012, our Annual Report was included in Ka Wai Ola o OHA, which has a circulation of 60,000. In addition, it is also available online. The report has a summary of all Community Grants. In May 2013, we published a summary of all Community Grants just after the Trustees approved them.
GENERAL COMMENTS

On page 18, the Audit Report notes OHA spent $5.58 million for management of Waimea Valley. That appears to include money spent after the time period covered by the audit and costs unrelated to Waimea Valley. Our records indicate the cost was approximately $2.9 million.

On page 19, the Audit Report reports OHA spent $11 million for “rock-fall mitigation and other needed improvements to Waimea Valley.” Our records indicate the cost was approximately $3.87 million.

OHA’S IMPLEMENTATION OF STATE AUDITOR’S 2009 RECOMMENDATIONS

Finding: The Office of Hawaiian Affairs has taken steps to implement most of the recommendations contained in our 2009 audits.

The Audit Report properly reflects OHA’s implementation of the State Auditor’s 2009 recommendations. For those recommendations relating to OHA’s Information Technology Framework that remain “open but in progress,” OHA Trustees remain committed to reviewing and approving the framework upon official presentation by Administration. For those recommendations relating to OHA Trustees’ oversight of investment management that remain “open and not likely to be pursued,” OHA Trustees continue to take very seriously all recommendations relating to our fiduciary responsibilities.

CONCLUSION

OHA will continue to work to strengthen the agency for the benefit of all Native Hawaiians, and as such, we are continually looking for ways to improve. Our Land Program continues its commitment to preservation and protection of our ‘āina and rights, while growing our financial returns as we seek self-sufficiency. Our Grants Program is part of a broader effort at OHA to work closely with community-based organizations that improve conditions for Native Hawaiians. We hope that the Office of the Auditor will consider our response, correct errors, and revise the report as suggested.

Sincerely,

Colette Y. Machado, Trustee
Chairperson, Board of Trustees

C: OHA Board of Trustees
OHA Ka Pouhana, Chief Executive Officer

Enclosures:
Attachment A – Hawai‘i State Ethics Commission letter dated April 11, 2013
Attachment B – Bank of Hawai‘i letter dated June 22, 2012
CONFIDENTIAL

Ms. S. Haunani Apoliona
Trustee At-Large
Board of Trustees
Office of Hawaiian Affairs
711 Kapiolani Blvd., Suite 500
Honolulu, Hawaii 96813

Dear Trustee Apoliona:

As you know, Trustee Rowena Akana had raised concerns that your participation in the action taken by the Office of Hawaiian Affairs ("OHA") Board of Trustees ("BOT") at its meeting on June 7, 2012, to proceed with the purchase of the Gentry Pacific Design Center ("GPDC" or "the Property") was a conflict of interests under the State Ethics Code, chapter 84, Hawaii Revised Statutes ("HRS"). The Hawaii State Ethics Commission ("Commission") recently completed its investigation of your actions that served as the basis for Trustee Akana's concerns.

Commission staff interviewed you and others, including BOT private counsel Robert Klein, and reviewed OHA records relevant to the allegations, including the agenda items and minutes from the BOT meetings on May 17, 2012, and June 7, 2012.

Based on staff's investigation, it is the Commission's understanding that the BOT, at its meeting on May 17, 2012, considered authorizing OHA's Chief Executive Officer ("CEO") to submit an offer to purchase the GPDC and to "enter and execute all necessary agreements, instruments, application and other appropriate documents necessary for the acquisition of the Property including documents and agreements relating to financing all or part of the Property acquisition costs . . . ." At this meeting, OHA staff provided the BOT with documents that included information about a proposal by Bank of Hawaii ("BOH") to finance the purchase. Two other lenders had also submitted proposals. There was also the option that OHA purchase the GPDC with its own funds. Based on the information provided at the May 2012 meeting, you and Mr. Klein understood that that the BOH proposal was the most favorable.

During the BOT's consideration of this agenda item and after OHA staff's presentation to the BOT, you disclosed that you were a member of BOH's Board of Directors and stated that you would recuse yourself from participating in the vote.
You apparently understood that, as part of the agenda item, the BOT was being asked to approve the financing for the purchase of the GPDC. You then asked for a determination by Mr. Klein, who was present at the meeting. Mr. Klein agreed that it was appropriate for you to recuse yourself. With your recusal, there were insufficient votes to approve the motion to authorize OHA’s CEO to proceed with the offer to purchase the GPDC.¹

At the subsequent meeting on June 7, 2012, the BOT was again asked to authorize OHA’s CEO to submit an offer to purchase the GPDC, and to specifically delegate to the CEO the responsibility to "seek the best financing available (on terms most favorable to OHA) to support a cash offer to Seller. . . ." OHA staff again provided the BOT with documents relating to this agenda item. The documents, however, did not include any specific references to the BOH proposal. During the BOT’s consideration of the matter, questions were raised about your participation. You then consulted with Mr. Klein as to whether you had a conflict of interests that prohibited your participation. Mr. Klein advised you that, because the matter sought the BOT’s approval to authorize the offer to purchase the GPDC and delegated the financing decisions to OHA staff, you no longer had a conflict because the BOT was not approving BOH’s financing proposal. After receiving that advice, you participated in the BOT’s consideration and action on the agenda item.² The GPDC purchase closed in August 2012.

Between the May and June 2012 BOT meetings, the financing proposals from the three lenders did not essentially change. Thus, the Commission’s investigation addressed the issue of whether or not, at the time of the June meeting, it was clear that financing would be through BOH. Stated differently, the Commission examined whether, notwithstanding the change in OHA staff’s presentation from the May 2012 meeting to the June 2012 meeting and the change in the corresponding motions, it was reasonable to expect that BOH would be selected as the lender.

HRS section 84-14(a), one of the conflicts of interests provisions of the Hawaii State Ethics Code, prohibits a state employee from taking official action if that action directly affects a business in which the employee has a financial interest. "Financial

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¹ Seven of the nine members of the BOT were present at the May 17, 2012, meeting. Four trustees voted in favor of the motion, two abstained, you recused yourself. OHA bylaws required an affirmative vote of five members for the motion to pass.

² All nine members of the BOT participated in the June 7, 2012, meeting. The motion passed with five votes in favor, two opposed, and one abstention.
"Financial interest" is defined to include a directorship in a business. For that reason, you had a financial interest in BOH because of your position as BOH director. At issue, therefore, is whether, by voting at the June 2012 meeting on the recommendation to purchase the GPDC and to delegate financing the purchase to OHA staff, you took action directly affecting BOH.

The Commission's investigation did not reveal facts that would support a conclusion that your actions at the June 2012 meeting directly affected BOH. It appears that, as of the June 2012 meeting, there was no decision as to how OHA intended to finance the purchase of the GPDC. It also appears that, after the June 2012 meeting, OHA staff continued exploring financing options, one of which was through BOH. However, it does not appear that the agenda item at the June 2012 meeting, in which you participated, sufficiently related to BOH. From the information obtained, the possibility that BOH may be selected by OHA's CEO to finance the purchase of the GPDC, even assuming that financing through BOH was one of only a small number of likely options, appears to be insufficient to constitute a violation of the State Ethics Code's conflicts of interests provision. The Commission has determined that the evidence does not support a conclusion that your actions violated the State Ethics Code and, thus, has closed its investigation with no further action.

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3 HRS section 84-14(a) reads, in relevant part:

§84-14 Conflicts of Interests. (a) No employee shall take any official action directly affecting:

(1) A business or other undertaking in which he has a substantial financial interest.

HRS section 84-3 reads, in relevant part:

§84-3 Definitions.

"Financial interest" means an interest held by an individual, the individual's spouse, or dependent children which is:

(6) A directorship or officership in a business.

4 Staff also understands that BOH directors are compensated for their service.
The Commission notes that the conflicts of interests law prohibits a state employee (including a member of a state board, commission or committee) from taking any discretionary action directly affecting a business in which the state employee has a financial interest. Discretionary action includes more than voting on a matter. It also may include participating in discussions, making recommendations or suggestions, and any other action that involves the use of discretionary authority. Whenever a board member has a conflict of interests on an agenda item, absent unusual circumstances, the Commission generally recommends that the board member leave the room before the matter is discussed in order to avoid issues arising under the conflicts of interests law.

The Commission further notes that at both the May 2012 and June 2012 meetings, you sought advice from BOT’s legal counsel as to whether you needed to recuse yourself. On both occasions, you acted according to the advice of counsel. The Commission, by law, is the agency charged with administering the State Ethics Code. Although, in this case, BOT’s legal counsel appears to have construed the statute consistent with the Commission’s interpretation, there may be circumstances where, for whatever reason, the advice may be inconsistent with the Commission’s position. For that reason, the Commission recommends that, in the future, conflicts of interests questions be addressed to the Commission in order to avoid any confusion.

Thank you for your cooperation during the Commission’s review of this matter.

Very truly yours,

[Signature]

Leslie H. Kondo
Executive Director and
General Counsel

LHK/NCN/af

END OF ATTACHMENT "A"
June 22, 2012

Ms. Connie Cheng  
Chief Investment Officer  
Office of Hawaiian Affairs  
711 Kapiolani Blvd.  
Honolulu, Hawaii 96813

Subject: Gentry Design Center Property

Dear Connie,

In connection with OHA's contemplated purchase of the property known as the Gentry Design Center and our financing proposals dated April 19, 2012, we wanted to advise of Bank of Hawaii's continued interest in providing financing for the property for OHA. We have completed a substantial amount of due diligence normally required in order to issue a formal loan commitment, and reviewed our proposals with the appropriate authorities within our organization. We continue to view this potential transaction favorably and are hope to be involved in your financing.

Please feel free to contact me at 694-8847, if you have any questions or concerns, or if we can be of further assistance. Thank you.

Sincerely,

[Signature]

Tony Mizuno  
Senior Vice President & Manager  
Commercial Real Estate Division