



STATE OF HAWAII
OFFICE OF HAWAIIAN AFFAIRS
560 N. NIMITZ HWY., SUITE 200
HONOLULU, HAWAII 96817

December 20, 2019

Representative Scott Saiki
House Speaker
Hawai'i State Capitol, Room 431
415 South Beretania Street
Honolulu, Hawai'i 96813

Senator Ronald Kouchi
Senate President
Hawai'i State Capitol, Room 409
415 South Beretania Street
Honolulu, Hawai'i 96813

Re: Senate Concurrent Resolution No. 70 and Senate Resolution No. 48 (SCR 70/SR48)

Aloha 'olua mai,

SCR70/SR48: Requesting the Office of Hawaiian Affairs to conduct an independent fiscal audit of all Limited Liability Corporations created or controlled by the Office to report the findings and recommendations of the audit to the Legislature no later than 20 days prior to the convening of the regular session of 2020.

The Office of Hawaiian Affairs (OHA) testimony during the 2019 session noted the following: 1) *[OHA] Is subject to an Audit by the State Auditor every four years¹; 2) Is subject to a State Review every five years; 3) Annually contracts with an independent audit firm to conduct a financial audit of OHA²; and 4) contracted with an independent audit firm to conduct a review of OHA disbursements. Limited Liability Companies³ (LLCs) created by OHA engage, contract, and pay for their own independent audits. LLC audit reports are provided to OHA for inclusion in OHA's basic financial statements and footnotes. OHA's independent auditor relies on the LLC auditor's opinion. OHA's audited basic financial statements, including footnotes and LLC information, are published annually on its website.⁴ **Independent financial audits of all LLCs created by OHA are already conducted.***

¹ Section 10-14.55, Hawai'i Revised Statutes, "Audit and report."

² The "clean" audit opinion "based on our [independent OHA auditors] and the report of the other [independent LLC auditors]" as of June 30, 2017, may be found on OHA's website <https://19of32x2y133s8o4xza0gf14-wpengine.netdna-ssl.com/wp-content/uploads/OHA-2017-FS-Final.pdf>.

³ Chapter 428 – Uniform Limited Liability Company Act

⁴ The Financial Statements and Report of Independent Certified Public Accountants of the Office of Hawaiian Affairs (OHA) are for the fiscal year ended June 30. The reports are prepared by OHA's Resource Management Line of Business. OHA is responsible for the accuracy of this information, its completeness and fairness, including all disclosures. The report includes the independent auditors' report, management's discussion and analysis (MD&A), basic financial statements and notes to the financial statements. <https://www.oha.org/about/aboutfinancial-statements/>

To comply with our obligations under SCR70/SR48, enclosed are the most recent audit reports for the OHA and LLCs as further described below.

OHA. The OHA is currently undergoing its annual financial audit for the fiscal year ended June 30, 2019. Independently engaged and contracted audits for the LLC's, for the year ended December 2018 were completed in August 2019 and related audit and financial information have been furnished to the OHA's independent auditor for inclusion in the OHA's fiscal year 2019 audited financial statements, under the business-type activities. The OHA expects completion of the OHA audit fieldwork, and issuance of the fiscal year 2019 Financial Statements with Independent Auditor's Report in February 2020. Therefore, enclosed is the Office of Hawaiian Affairs's Financial Statements with Independent Auditor's Report for the Year Ended June 30, 2018—the most recently available. The OHA's audit reports are also available on the OHA website at <https://www.oha.org/financials>

LLCs. Independent audit reports for LLCs are published on its website at: <http://www.hiilei.org/Ke-Kumu-Oihana/Reports/Annual-Audits>. However, for your convenience, we've provided hard, bound copies of the following reports that were provided to the OHA by the LLCs: 1) Hi'ilei Aloha LLC and Sub-Entities; 2) Hi'ipaka LLC, a sub-entity of Hi'ilei aloha LLC; and 3) Ho'okōpaipai LLC.

Please do not hesitate to contact me at 594-1973 or sylviah@oha.org, or have your staff contact Interim Chief Financial Officer, Gloria Li at 594-1955 or glorial@oha.org, should there be any questions regarding this correspondence or its attachments.

'O wau iho nō me ka 'oia'i'o,



Sylvia M. Hussey, Ed.D.
Ka Pouhana, Chief Executive Officer

SH:sh

Attachments

cc: Trustee Colette Machado, Chair, Board of Trustees

**OFFICE OF HAWAIIAN AFFAIRS
STATE OF HAWAI'I**

**FINANCIAL STATEMENTS WITH
INDEPENDENT AUDITOR'S REPORT**

Year Ended June 30, 2018



**OFFICE OF HAWAIIAN AFFAIRS
STATE OF HAWAI'I**

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Office of Hawaiian Affairs, State of Hawai‘i
LETTER FROM KA POUHANA/CHIEF EXECUTIVE OFFICER - UNAUDITED
June 30, 2018

To the Board of Trustees of the Office of Hawaiian Affairs

It is my pleasure to present to you, the Financial Statements and Report of Independent Certified Public Accountants of the Office of Hawaiian Affairs (OHA) for the fiscal year ended June 30, 2018. This report has been prepared by the Resource Management Line of Business. Responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures, rests with OHA. I believe the information, as presented, is fairly stated in all material aspects; that it is presented in a manner designed to fairly set forth the financial position and results of operations of OHA as measured by the financial activity of its various funds; and that all the information necessary to enable the reader to gain the maximum understanding of OHA’s financial affairs has been included.

The report includes the independent auditor’s report, management’s discussion and analysis, basic financial statements and notes to the financial statements.

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

THE REPORTING ENTITY

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

GASB Statement No. 14, *The Financial Reporting Entity*, establishes standards for defining and reporting on the financial reporting entity. The financial reporting entity consists of OHA as the primary government, as well as other organizations classified as component units. Based on GASB Statement No. 14, Ho‘okele Pono LLC and Hi‘ilei Aloha LLC and its subsidiaries, have been classified as component units under proprietary funds. As a result, the financial results of Ho‘okele Pono LLC and Hi‘ilei Aloha LLC and its subsidiaries through December 31, 2017 have been included as business-type activities in the government-wide financial statements of OHA for the year ended June 30, 2018.

Office of Hawaiian Affairs, State of Hawai'i
LETTER FROM KA POUHANA/CHIEF EXECUTIVE OFFICER - UNAUDITED
June 30, 2018

DIVISIONS

A division is a combination of resources and activities designed to achieve an objective or objectives. OHA prepares biennial budgets and records expenditures separately for each of its divisions.

The title and objective of each division are listed below:

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

PURPOSE OF THE REPORT AND DEFINITIONS

The purpose of the financial audit was to enable the independent auditor to form an opinion on the financial statements of the Office of Hawaiian Affairs as of June 30, 2018, and for the year then ended. The auditor's report represents the conclusion of the independent auditor regarding the fairness of the presentations, in conformity with accounting principles generally accepted in the United States of America, set forth in the financial statements and is used to communicate such conclusion to interested parties.

Office of Hawaiian Affairs, State of Hawai‘i
LETTER FROM KA POUHANA/CHIEF EXECUTIVE OFFICER - UNAUDITED
June 30, 2018

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

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

EMPOWERING HAWAIIANS

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

HO‘OKAHUA WAIWAI

Economic Self-Sufficiency

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

‘ĀINA

Land & Water

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

MO‘OMEHEU

Culture

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

MAULI OLA

Health

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

EA

Governance

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

HO‘ONA‘AUAO

Education

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

Office of Hawaiian Affairs, State of Hawai'i
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June 30, 2018

In addition, we continued to fulfill our promise to the State of Hawaii's Department of Hawaiian Home Lands, providing \$3 million annually over 30 years to pay the debt service on its infrastructure improvement – an example of how Hawaiian-focused agencies can, and must, work hand-in-hand to leverage assets toward a common goal. This is just part of the approximately \$9 million in grants OHA awarded in fiscal year 2018 to improve, among other things, the health, education, housing, and economic conditions of Native Hawaiians.

FACTORS AFFECTING FINANCIAL CONDITION

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

Sources of Funding

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

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

State of the Local Economy

Hawai'i's year over year Gross Domestic Product (GDP) increased by 3% in 2018 and is forecasted to grow by 3.5% in 2019. The Department of Business, Economic Development & Tourism (DBEDT) reports GDP for 2018 at the highest level in Hawaii's history (\$91.1 billion) with an estimated \$94 billion in 2019. Visitor arrivals in 2018 increased to 9.9 million visitors in comparison to 2017, 9.4 million visitors with visitor spending increasing to \$18.3 million. Hawai'i's unemployment rate fell to 2.3% at the end of 2018, down 0.1% a year earlier and is still below the national unemployment rate of 4%. Local price inflation in 2018 increased by 2%. The Economic Research Organization at the University of Hawai'i (UHERO) forecasted in the third quarter of 2018, 35,100 construction jobs for 2018, increasing in 2019 to 35,500 a 1.2% improvement. Total commitments to build in 2018 rose 22.8% to \$5.3 billion, however is projected to decline to \$5.1 billion in 2019. The decline represents a stabilization from a strong 2018; construction activity will maintain its current level through the end of the decade. The 2018 elections resulted in democrats maintaining control of the Legislature. Seven new members entered the House, two former state lawmakers, and one member returned after being appointed at the end of the last session. The Senate added four new members, including one former House member. Gov. David Ige, U.S. Senator Mazie Hirono, and U.S. Representative Tulsi Gabbard won their re-election bids and returned for another term.

Office of Hawaiian Affairs, State of Hawai'i
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June 30, 2018

State of the National Economy

The economy expanded in 2018 as the Federal Reserve Bank raised the overnight interest rate four times. At the end of 2018 the rate was set at 2.25-2.5% with two rate hikes anticipated in 2019. In 2018, we saw a change in the Federal Reserve (Fed) leadership with Jerome Powell replacing the previous Fed President Janet Yellen. Fed policy remained neutral, as their focus turns to reducing their balance sheet. Last year, the U.S. tax code was revised for consumers and businesses. Short-term implications were consumers receiving increased take-home pay and businesses increasing earnings. The long-term implications remain to be seen. Inflation has remained at the Fed's target around 2%. The capital markets experienced greater volatility due to uncertainties in the Fed's abilities to use their tools to achieve their mandate of stable prices and full employment. Concerns over an economic slowdown loom over 2019 as 2018 ended the longest stock market rally in U.S. history with the S&P 500 returning a 4.38% loss. The U.S. budget deficit rose to \$779 billion with the national debt approaching \$22 trillion at the end of 2018. Overseas, Europe continued to work out their post-Brexit future and Asia remained uncertain as China and the U.S. worked on a trade deal.

OHA's Investments

OHA's investment portfolio reported an 8.43% gain in fiscal year 2018, outperforming its strategic benchmark by 0.43%, on a net-of-fees basis. OHA's Global Equities portfolio contributed a gain of 10.85%, underperforming its benchmark by 0.29%. OHA's Private Equity investments portfolio posted a 9.41% internal rate of return. The 4th quarter of 2018 saw the worst quarterly return and its performance will be reflected in the fiscal year 2019 performance. The five-year return on the portfolio has been 6.87% and 6.16% for seven years.

CLOSING COMMENTS

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

Respectfully submitted,

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

INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information as well as the budgetary comparison for the general fund of the Office of Hawaiian Affairs (OHA), State of Hawai'i, as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise OHA's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of Hi'ilei Aloha LLC, which represent 99.6 percent, 99.9 percent, and 98 percent, respectively, of the assets, net position, and revenues of the business-type activities. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Hi'ilei Aloha LLC, is based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control

relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinions

In our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of OHA, as of June 30, 2018, and the respective changes in financial position and, where applicable, cash flows thereof and the respective budgetary comparison of the general fund, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Adoption of New Accounting Principle

As discussed in Note Q to the financial statements, OHA adopted new accounting guidance, GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 13 through 21 and the schedules of OHA's proportionate share of the net pension liability, contributions (pension), changes in the net OPEB liability and related ratios, and contributions (OPEB) on pages 68 to 74 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 25, 2019 on our consideration of OHA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of OHA's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the OHA's internal control over financial reporting and compliance.

N&K CPAs, Inc.

Honolulu, Hawaii
March 25, 2019

Office of Hawaiian Affairs, State of Hawai'i
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2018

As management of OHA, we offer the following narrative overview and analysis to readers of our financial statements. While the financial statements and notes present only the financial activities for the year ended June 30, 2018, management discussion and analysis will address both this year and the year ended June 30, 2017.

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

FINANCIAL HIGHLIGHTS

Government-wide Financial Statements Highlights

Statement of Net Position - The assets and deferred outflows of resources of OHA exceeded its liabilities and deferred inflows of resources as of June 30, 2018, by \$586,459,833 (presented as "total net position"). Of this amount, \$340,321,269 is reported as "unrestricted", while \$25,326,992 is reported as "restricted-federal funds" and \$220,811,572 is reported as "invested in capital assets, net of related debt."

The assets of OHA exceeded its liabilities as of June 30, 2017 by \$600,726,145 (presented as "total net position"). Of this amount, \$355,005,176 is reported as "unrestricted", while \$25,498,353 is reported as "restricted-federal funds" and \$220,222,616 is reported as "invested in capital assets, net of related debt."

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

Statement of Activities - OHA's total net position, increased by \$17,163,712 (a 2.86% increase) in 2018. This was primarily due to increased revenue from interest and investment earnings in the amount of approximately \$33.09 million.

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

Governmental Funds Financial Statements Highlights

Governmental Funds - Fund Balances - In 2018, OHA's governmental funds reported an ending fund balance of \$420,483,602. Of this total amount, \$465,589, or 0.11% is classified as nonspendable for inventory, prepaid items and security deposits. Restricted fund balance totaled \$25,227,434 or 6.00%, broken down as follows: 95.04% for Native Hawaiian Revolving Loan Fund program of which \$3,402,511 relates to the long-term portion of outstanding loans, and 4.96% restricted for other federal programs administered by OHA. \$29,516,390 or 7.02% is classified as committed, based on the Board of Trustees' resolution to commit these funds towards the debt service of DHHL-issued revenue bonds. Assigned fund balance comprises 86.87% or \$365,274,189 of fund balance, broken down as follows: \$13,396,369 or 3.67% has been encumbered, \$144,190 or 0.04% represents the non-current portion of outstanding loans and \$351,733,630 or 96.29% is available for future expenditures.

Office of Hawaiian Affairs, State of Hawai'i
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2018

Overview of the Financial Statements

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

Government-wide Financial Statements

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

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

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

Office of Hawaiian Affairs, State of Hawai'i
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2018

It also includes the results of Business-Type Activities, Ho'okele Pono LLC and Hi'ilei Aloha LLC and its wholly-owned subsidiaries, through its separate year end, December 31, 2017. Ho'okele Pono LLC and Hi'ilei Aloha LLC have been included as blended component units due to the fact that OHA is the sole corporate member of each entity.

Governmental Funds Financial Statements

A “*fund*” is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. OHA, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The governmental funds financial statements focus on individual parts of OHA, reporting OHA's operations in more detail than the government-wide statements. All of the funds of OHA are considered “*governmental funds*” as opposed to proprietary (operate more like those of commercial enterprises) and fiduciary funds (used to account for resources held for the benefit of parties outside OHA).

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, the governmental funds financial statements focus on near-term inflows and outflows of expendable resources. They also focus on the balances of available resources at the end of the year. Such information may be useful in evaluating the government's near-term financing requirements. This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of OHA's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of OHA.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and the governmental activities. These reconciliations are included on pages 25 and 27 of this report.

OHA has two types of governmental funds that are presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures, and changes in fund balances. OHA's two types of governmental funds are General Fund and Special Revenue Funds. The Special Revenue Funds are the PLTF, Federal Grants Fund, and Other Fund.

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MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2018

The business type activities of blended component units, Ho'okele Pono LLC and Hi'ilei Aloha LLC and its wholly-owned subsidiaries, have been classified as proprietary funds. Like the government-wide financial statements, the proprietary fund statements report long-term (noncurrent) and short-term (current) financial information. The Statement of Cash Flows for the proprietary funds presents changes in cash and cash equivalents, resulting from operating, noncapital financing, capital and related financing, and investing activities. OHA's proprietary funds are classified as business-type activities in the government-wide financial statements on pages 21 and 22.

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

The governmental funds financial statements are followed by a budgetary comparison statement, which compares the general fund's original budget, final budget, and actual amounts prepared on a budgetary basis. A reconciliation between the actual general fund revenues and expenditures compared to the general fund revenues and expenditures prepared for budgetary purposes is included in Note C to the financial statements. The *Statement of Revenues and Expenditures - Budget and Actual (Budgetary Basis), General Fund* can be found on page 28.

Notes to Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and the governmental funds financial statements. The notes to the financial statements can be found immediately following the *Proprietary Funds - Statement of Cash Flows*.

Office of Hawaiian Affairs, State of Hawai'i
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2018

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Statement of Net Position

Summarized financial information of OHA's *Statement of Net Position* as of June 30, 2018 and 2017 is as follows:

	2018	2017
ASSETS		
Capital assets	\$ 249,052,159	\$ 250,931,473
Other assets	<u>431,502,434</u>	<u>411,571,926</u>
Total assets	\$ <u>680,554,593</u>	\$ <u>662,503,399</u>
DEFERRED OUTFLOWS OF RESOURCES		
Deferred outflows of resources related to pensions	7,089,131	10,362,562
Deferred outflows of resources related to OPEB	<u>1,881,695</u>	<u>--</u>
Total deferred outflows of resources	\$ <u>8,970,826</u>	\$ <u>10,362,562</u>
LIABILITIES		
Other liabilities	\$ 7,557,810	\$ 6,524,573
Long-term liabilities	<u>95,048,640</u>	<u>65,039,339</u>
Total liabilities	\$ <u>102,606,450</u>	\$ <u>71,563,912</u>
DEFERRED INFLOWS OF RESOURCES		
Deferred inflows of resources related to pensions	420,848	575,904
Deferred inflows of resources related to OPEB	<u>38,288</u>	<u>--</u>
Total deferred inflows of resources	\$ <u>459,136</u>	\$ <u>575,904</u>
NET POSITION		
Invested in capital assets, net of related debt	220,811,572	220,222,616
Restricted	25,326,992	25,498,353
Unrestricted	<u>340,321,269</u>	<u>355,005,176</u>
Total net position	\$ <u>586,459,833</u>	\$ <u>600,726,145</u>

The 2017 amounts noted above do not reflect the restatement adjustment resulting from the implementation of GASB 75 as detailed in Note Q to the financial statements.

As noted earlier, net position may serve over time as a useful indicator of a government's financial position. OHA's net position totaled \$586,459,833 as of June 30, 2018, compared to \$600,726,145 as of June 30, 2017, representing a decrease of 2.37% or \$14,266,312.

Office of Hawaiian Affairs, State of Hawai'i
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2018

Unrestricted funds represent the largest portion of OHA's net position (58.03% and 59.10% at June 30, 2018 and 2017, respectively) and are comprised of resources that may be used to meet OHA's ongoing obligations to beneficiaries and creditors. This also includes internally imposed assignments of resources.

Statement of Activities

Summarized financial information of OHA's *Statement of Activities* for the years ended June 30, 2018 and 2017 is as follows:

	2018	2017
REVENUES		
Program revenues:		
Charges for services	\$ 13,301,050	\$ 12,500,418
Operating grants	769,960	730,421
General revenues:		
State allotments, net of lapsed appropriations	3,037,879	2,990,908
Public land trust revenue	15,100,000	15,100,000
Donations and other	375,294	515,639
Restricted donation	--	119,687
Interest and investment earnings	33,085,232	39,560,405
Non-imposed employee fringe benefits	554,408	235,135
Total revenues	66,223,823	71,752,613
EXPENSES		
Current divisions:		
Board of trustees	2,888,608	2,766,255
Support services	18,903,267	19,554,828
Beneficiary advocacy	19,130,071	14,911,396
Unallocated depreciation	2,227,170	2,412,043
Ho'okele Pono LLC	235,097	314,077
Hi'ilei Aloha LLC	5,495,298	5,214,852
Total expenses	48,879,511	45,173,451
NET TRANSFERS (TO) / FROM OTHER FUNDS	(180,600)	(31,085)
Change in net position	\$ 17,163,712	\$ 26,548,077

Office of Hawaiian Affairs, State of Hawai'i
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2018

OHA's change in net position decreased by \$9,384,365 during the year. Key elements of this decrease compared to the prior are as follows:

General revenues interest and investment earnings decreased by \$6,475,173 from the prior year primarily due to decline market conditions in the third and fourth quarters of fiscal year 2018.

Changes in net position were further attributed to increase in expenses in fiscal year 2018 by \$3,706,060. This change was primarily due to increase in beneficiary advocacy expenses by \$4,218,675, resulting largely from increased grant expense for the year.

\$201,466 of the \$3,706,060 increase is attributed to the operations of OHA's proprietary funds Hi'ilei Aloha LLC and subsidiaries. The increase in costs incurred are directly related to increased operations which have yielded an increase of revenues of \$688,762. With assistance from OHA, Hi'ilei Aloha LLC and subsidiaries continues progress toward self-sustainability.

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

GOVERNMENTAL FUNDS FINANCIAL ANALYSIS

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

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

At the close of 2018, OHA's governmental funds reported an ending fund balance of \$420,483,602. Fund balance was segregated in to the following categories: Nonspendable, Restricted, Committed, Assigned and Unassigned.

Nonspendable fund balance totaled \$465,589 or 0.11% due to amounts related to inventory, prepaid items and security deposits.

Restricted fund balance totaled \$25,227,434 or 6.00%, and is comprised of the following: \$23,976,076 or 95.04% for the Native Hawaiian Revolving Loan Fund program of which \$3,402,511 relates to the long-term portion of outstanding loans, and \$1,251,358 or 4.96% restricted for other federal programs administered by OHA.

Committed fund balance totaled \$29,516,390 or 7.02% based on the Board of Trustees' resolution to commit these funds towards the debt service of DHHL-issued revenue bonds.

Office of Hawaiian Affairs, State of Hawai'i
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2018

Assigned fund balance totaled \$365,274,189 or 86.87% of fund balance and is comprised of the following: \$13,396,369 or 3.67% has been encumbered, \$144,190 or 0.04% represents the non-current portion of outstanding loans and \$351,733,630 or 96.29% is available for future expenditures.

At the close of 2017, OHA's governmental funds reported an ending fund balance of \$401,480,597. Fund balance was segregated in to the following categories: Nonspendable, Restricted, Committed, Assigned and Unassigned.

Nonspendable fund balance totaled \$310,424 or 0.08% due to amounts related to inventory, prepaid expenses and security deposits.

Restricted fund balance totaled \$25,378,666 or 6.32%, and is comprised of the following: \$23,922,356 or 94.26% for the Native Hawaiian Revolving Loan Fund program of which \$3,701,101 relates to the long-term portion of outstanding loans, and \$1,456,310 or 5.74% restricted for other federal programs administered by OHA.

Committed fund balance totaled \$37,809,788 or 9.42% based on the Board of Trustees' resolution to commit these funds towards the debt service of DHHL-issued revenue bonds.

Assigned fund balance totaled \$337,981,719 or 84.18% of fund balance and is comprised of the following: \$14,695,035 or 4.35% has been encumbered, \$434,999 or 0.13% represents the non-current portion of outstanding loans and \$322,851,685 or 95.52% is available for future expenditures.

OHA's governmental funds experienced an increase of \$19,003,005 in fund balance during 2018.

PROPRIETARY FUNDS FINANCIAL ANALYSIS

Proprietary funds' net position totaled \$18,106,167 at the end of 2018, compared to \$17,906,087 at the end of 2017, representing an increase of 1.12% or \$200,080.

Invested in capital assets, net of related debt represents the largest portion of proprietary funds' net position at \$15,082,250 or 83.30% and is primarily comprised of capital assets of Hi'ilei Aloha LLC and its wholly-owned subsidiaries.

Office of Hawaiian Affairs, State of Hawai'i
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2018

CAPITAL ASSETS AND LONG-TERM LIABILITIES

OHA's investment in capital assets, net of depreciation, amounted to \$249,052,159 and \$250,931,473, as of June 30, 2018 and 2017, respectively. Capital assets include land, building, leasehold improvements, equipment and software development.

	2018	2017
Land	\$ 226,965,802	\$ 226,965,802
Buildings and improvements	33,000,571	32,659,840
Furniture, fixtures and equipment	7,146,867	6,865,130
Accumulated depreciation	<u>(18,061,081)</u>	<u>(15,559,299)</u>
Totals	<u>\$ 249,052,159</u>	<u>\$ 250,931,473</u>

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

OHA's long-term liabilities include notes payable, lines of credit, accrued vacation, and capital lease obligation. Total liabilities also increased due to recognition of the net Other Post-Employment Benefits (OPEB) liability, approximately \$33.3 million. Additional information about OHA's long-term liabilities can be found in Notes L and M to the financial statements.

REQUEST FOR INFORMATION

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

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

Office of Hawaiian Affairs, State of Hawai'i
STATEMENT OF NET POSITION
June 30, 2018

	Governmental Activities	Business-Type Activities	Total
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES			
Petty cash	\$ 784	\$ --	\$ 784
Cash:			
Held in State Treasury	5,355,851	--	5,355,851
Held in bank	11,798,983	2,936,049	14,735,032
Held by investment managers	4,685,289	--	4,685,289
Restricted cash	197,096	97,046	294,142
Accounts receivable, net	1,716,281	313,458	2,029,739
Interest and dividends receivable	83,425	--	83,425
Inventory, prepaid items and other assets	902,694	264,022	1,166,716
Notes receivable, net:			
Due within one year	1,775,892	--	1,775,892
Due after one year	3,546,701	--	3,546,701
Investments	397,828,863	--	397,828,863
Capital assets - net	<u>233,969,909</u>	<u>15,082,250</u>	<u>249,052,159</u>
Total assets	<u>661,861,768</u>	<u>18,692,825</u>	<u>680,554,593</u>
Deferred outflows of resources related to pensions	7,089,131	--	7,089,131
Deferred outflows of resources related to OPEB	<u>1,881,695</u>	<u>--</u>	<u>1,881,695</u>
Total deferred outflows of resources	<u>8,970,826</u>	<u>--</u>	<u>8,970,826</u>
Total assets and deferred outflows of resources	<u>\$ 670,832,594</u>	<u>\$ 18,692,825</u>	<u>\$ 689,525,419</u>
LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION			
Accounts payable and accrued liabilities	\$ 6,638,755	\$ 586,658	\$ 7,225,413
Due to State of Hawaii	332,397	--	332,397
Long-term liabilities:			
Due within one year	3,355,744	--	3,355,744
Due after one year	26,475,206	--	26,475,206
Other liabilities due in more than one year:			
Net pension liability	31,892,391	--	31,892,391
Net OPEB liability	<u>33,325,299</u>	<u>--</u>	<u>33,325,299</u>
Total liabilities	<u>102,019,792</u>	<u>586,658</u>	<u>102,606,450</u>
Deferred inflows of resources related to pensions	420,848	--	420,848
Deferred inflows of resources related to OPEB	<u>38,288</u>	<u>--</u>	<u>38,288</u>
Total deferred inflows of resources	<u>459,136</u>	<u>--</u>	<u>459,136</u>
Net Position:			
Invested in capital assets, net of related debt	205,729,322	15,082,250	220,811,572
Restricted	25,229,946	97,046	25,326,992
Unrestricted	<u>337,394,398</u>	<u>2,926,871</u>	<u>340,321,269</u>
Total net position	<u>568,353,666</u>	<u>18,106,167</u>	<u>586,459,833</u>
Total liabilities, deferred inflows of resources, and net position	<u>\$ 670,832,594</u>	<u>\$ 18,692,825</u>	<u>\$ 689,525,419</u>

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i
STATEMENT OF ACTIVITIES
Year Ended June 30, 2018

Programs	Expenses	Program Revenues		Net (Expenses) Revenue and Changes in Net Position		
		Charges for Services	Operating Grants and Contributions	Governmental Activities	Business-Type Activities	Total
	\$ 2,888,608	\$ --	\$ --	\$ (2,888,608)	\$ --	\$ (2,888,608)
	18,903,267	7,589,975	--	(11,313,292)	--	(11,313,292)
	19,130,071	--	769,960	(18,360,111)	--	(18,360,111)
	<u>2,227,170</u>	<u>--</u>	<u>--</u>	<u>(2,227,170)</u>	<u>--</u>	<u>(2,227,170)</u>
activities	<u>43,149,116</u>	<u>7,589,975</u>	<u>769,960</u>	<u>(34,789,181)</u>	<u>--</u>	<u>(34,789,181)</u>
	235,097	115,323	--	--	(119,774)	(119,774)
	<u>5,495,298</u>	<u>5,595,752</u>	<u>--</u>	<u>--</u>	<u>100,454</u>	<u>100,454</u>
activities	<u>5,730,395</u>	<u>5,711,075</u>	<u>--</u>	<u>--</u>	<u>(19,320)</u>	<u>(19,320)</u>
side	\$ <u>48,879,511</u>	\$ <u>13,301,050</u>	\$ <u>769,960</u>	\$ <u>(34,789,181)</u>	\$ <u>(19,320)</u>	\$ <u>(34,808,501)</u>
lapsed appropriations				\$ 3,037,879	\$ --	\$ 3,037,879
				15,100,000	--	15,100,000
				375,294	--	375,294
earnings				33,085,232	--	33,085,232
fringe benefits				<u>554,408</u>	<u>--</u>	<u>554,408</u>
ies				52,152,813	--	52,152,813
				<u>(400,000)</u>	<u>219,400</u>	<u>(180,600)</u>
ies and transfers				<u>51,752,813</u>	<u>219,400</u>	<u>51,972,213</u>
on				16,963,632	200,080	17,163,712
s previously stated				582,820,058	17,906,087	600,726,145
ment				<u>(31,430,024)</u>	<u>--</u>	<u>(31,430,024)</u>
s restated				551,390,034	17,906,087	569,296,121
				\$ <u>568,353,666</u>	\$ <u>18,106,167</u>	\$ <u>586,459,833</u>

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i
GOVERNMENTAL FUNDS - BALANCE SHEET
June 30, 2018

	<u>General Fund</u>	<u>Public Land Trust</u>	<u>Federal Grants</u>	<u>Other</u>	<u>Total</u>
	\$ --	\$ 784	\$ --	\$ --	\$ 784
Inventory	971,845	4,384,006	--	--	5,355,851
Accounts payable	--	8,398,768	3,346,592	53,623	11,798,983
Accounts receivable	--	758,856	3,926,433	--	4,685,289
Prepaid expenses	--	--	197,096	--	197,096
Net assets	--	1,679,085	34,177	3,019	1,716,281
Accounts receivable	--	3,151	80,274	--	83,425
Investments and other assets	--	463,077	2,512	--	465,589
	--	307,636	1,468,256	--	1,775,892
	--	144,190	3,402,511	--	3,546,701
	<u>--</u>	<u>384,679,887</u>	<u>13,148,976</u>	<u>--</u>	<u>397,828,863</u>
	<u>\$ 971,845</u>	<u>\$ 400,819,440</u>	<u>\$ 25,606,827</u>	<u>\$ 56,642</u>	<u>\$ 427,454,754</u>

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i
GOVERNMENTAL FUNDS - BALANCE SHEET (Continued)
June 30, 2018

	<u>General Fund</u>	<u>Public Land Trust</u>	<u>Federal Grants</u>	<u>Other</u>	<u>Total</u>
UNDEVELOPED BALANCE					
and accrued liabilities	\$ 573,021	\$ 5,978,052	\$ 76,881	\$ 10,801	\$ 6,638,755
and	<u>--</u>	<u>32,397</u>	<u>300,000</u>	<u>--</u>	<u>332,397</u>
es	<u>573,021</u>	<u>6,010,449</u>	<u>376,881</u>	<u>10,801</u>	<u>6,971,152</u>
items and security	--	463,077	2,512	--	465,589
acy	--	--	1,251,358	--	1,251,358
an programs	--	--	20,573,565	--	20,573,565
of notes receivable	--	--	3,402,511	--	3,402,511
venue bonds	--	29,516,390	--	--	29,516,390
	--	535,299	--	--	535,299
	32,088	7,869,872	--	--	7,901,960
acy	366,736	4,546,533	--	45,841	4,959,110
of notes receivable	--	144,190	--	--	144,190
	<u>--</u>	<u>351,733,630</u>	<u>--</u>	<u>--</u>	<u>351,733,630</u>
balances	\$ <u>398,824</u>	\$ <u>394,808,991</u>	\$ <u>25,229,946</u>	\$ <u>45,841</u>	\$ <u>420,483,602</u>
es and fund balances	\$ <u>971,845</u>	\$ <u>400,819,440</u>	\$ <u>25,606,827</u>	\$ <u>56,642</u>	\$ <u>427,454,754</u>

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i
RECONCILIATION OF FUND BALANCES OF GOVERNMENTAL FUNDS TO
NET POSITION OF GOVERNMENTAL ACTIVITIES
June 30, 2018

Total fund balances - governmental funds		\$ 420,483,602
Amounts reported for governmental activities in the statement of net position are different because:		
Capital assets used in governmental funds are not financial resources, and therefore, are not reported in the funds.		233,969,909
Other assets used in governmental activities are not current financial resources and therefore are not reported in the funds.		437,105
Long-term liabilities are not due and payable in the current period and therefore are not reported in the funds.		
Compensated absences	(1,590,363)	
Capital lease obligations	(180,515)	
Net pension liability	(31,892,391)	
Net OPEB liability	(33,325,299)	
Deferred outflows of resources related to the net pension liability	7,089,131	
Deferred inflows of resources related to the net pension liability	(420,848)	
Deferred outflows of resources related to the net OPEB liability	1,881,695	
Deferred inflows of resources related to the net OPEB liability	(38,288)	
Notes payable	(19,734,367)	
Lines of credit	<u>(8,325,705)</u>	<u>(86,536,950)</u>
Net position of governmental activities		\$ <u><u>568,353,666</u></u>

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i
GENERAL FUNDS - STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
Year Ended June 30, 2018

	<u>General Fund</u>	<u>Public Land Trust</u>	<u>Federal Grants</u>	<u>Other</u>	<u>Total</u>
Revenue	\$ --	\$ 15,100,000	\$ --	\$ --	\$ 15,100,000
Revenue	--	--	394,108	--	394,108
of lapses	3,037,879	--	--	--	3,037,879
s	--	9,225,554	--	57,802	9,283,356
ent earnings	--	33,084,542	375,852	690	33,461,084
	--	332,283	43,011	--	375,294
benefits	<u>554,408</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>554,408</u>
es	<u>3,592,287</u>	<u>57,742,379</u>	<u>812,971</u>	<u>58,492</u>	<u>62,206,129</u>
	149,801	2,738,807	--	--	2,888,608
	2,094,169	16,390,758	(420)	(135,877)	18,348,630
y	<u>1,261,313</u>	<u>16,906,647</u>	<u>962,111</u>	<u>--</u>	<u>19,130,071</u>
ditures	<u>3,505,283</u>	<u>36,036,212</u>	<u>961,691</u>	<u>(135,877)</u>	<u>40,367,309</u>
(RES) SOURCES:					
	--	(2,435,815)	--	--	(2,435,815)
er funds	<u>--</u>	<u>(200,000)</u>	<u>--</u>	<u>(200,000)</u>	<u>(400,000)</u>
in fund balances	<u>87,004</u>	<u>19,070,352</u>	<u>(148,720)</u>	<u>(5,631)</u>	<u>19,003,005</u>
	<u>311,820</u>	<u>375,738,639</u>	<u>25,378,666</u>	<u>51,472</u>	<u>401,480,597</u>
	<u>\$ 398,824</u>	<u>\$ 394,808,991</u>	<u>\$ 25,229,946</u>	<u>\$ 45,841</u>	<u>\$ 420,483,602</u>

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i
RECONCILIATION OF NET CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS
TO CHANGE IN NET POSITION OF GOVERNMENTAL ACTIVITIES
Year Ended June 30, 2018

Net change in fund balances - total governmental funds		\$ 19,003,005
Amounts reported for governmental activities in the statement of activities are different because:		
Governmental funds report capital outlays as expenditures, however, in the statement of activities, the cost of those assets are depreciated over their estimated useful lives as depreciation expense. This is the amount by which depreciation exceeded capital outlay in the current period.		
Expenditures for capital assets	202,681	
Current year depreciation, amortization and other changes	<u>(2,227,170)</u>	(2,024,489)
Borrowings provide current financial resources to governmental funds; however, issuing debt increases long-term liabilities in the statement of net position. In the current period this is the amount of assets financed through capital leases.		
		(14,238)
Repayment of long-term debt is reported as an expenditure in governmental funds, but the repayment reduces long-term liabilities in the statement of net position. In the current year this is the principal payment on notes payable and capital leases.		
		2,482,508
Some items reported in the statement of activities do not involve current financial resources and therefore are not reported as revenues or expenditures in governmental funds. These activities are as follows:		
Decreases in other assets	(160,639)	
Decreases in compensated absences	70,402	
Decrease in net pension liability	777,326	
Decrease in deferred outflows of resources related to pension liability	(3,273,431)	
Decrease in deferred inflows of resources related to pension liability	155,056	
Increase in net OPEB liability	(371,903)	
Increase in deferred outflows of resources related to net OPEB liability	358,323	
Increase in deferred inflows of resources related to net OPEB liability	<u>(38,288)</u>	<u>(2,483,154)</u>
Change in net position of governmental activities		\$ <u>16,963,632</u>

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i
OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL (BUDGETARY BASIS), GENERAL FUND
Year Ended June 30, 2018

	Budgeted Amounts		Actual (Budgetary Basis)	Variance
	Original	Final		Favorable (Unfavorable)
ns, net of lapses	\$ <u>3,037,879</u>	\$ <u>3,037,879</u>	\$ <u>3,037,879</u>	\$ <u> --</u>
	93,855	93,855	93,855	--
	1,607,262	1,607,262	1,607,262	--
acy	<u>1,336,762</u>	<u>1,336,762</u>	<u>1,336,762</u>	<u> --</u>
	<u>3,037,879</u>	<u>3,037,879</u>	<u>3,037,879</u>	<u> --</u>
REVENUES UNDER EXPENDITURES	\$ <u> --</u>	\$ <u> --</u>	\$ <u> --</u>	\$ <u> --</u>

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i
PROPRIETARY FUNDS - STATEMENT OF NET POSITION
June 30, 2018

	<u>December 31, 2017</u>		
	<u>Ho'okele Pono LLC</u>	<u>Hi'ilei Aloha LLC</u>	<u>Total</u>
ASSETS			
Cash and cash equivalents	\$ 4,240	\$ 2,931,809	\$ 2,936,049
Restricted cash	--	97,046	97,046
Accounts receivable, net	66,134	247,324	313,458
Inventory, prepaid items and other assets	856	263,166	264,022
Capital assets - net	<u>--</u>	<u>15,082,250</u>	<u>15,082,250</u>
Total assets	\$ <u>71,230</u>	\$ <u>18,621,595</u>	\$ <u>18,692,825</u>
LIABILITIES AND NET POSITION			
Liabilities			
Accounts payable and accrued liabilities	\$ <u>48,769</u>	\$ <u>537,889</u>	\$ <u>586,658</u>
Net position			
Invested in capital assets	--	15,082,250	15,082,250
Restricted - property acquisition	--	97,046	97,046
Unrestricted	<u>22,461</u>	<u>2,904,410</u>	<u>2,926,871</u>
Total net position	<u>22,461</u>	<u>18,083,706</u>	<u>18,106,167</u>
Total liabilities and net position	\$ <u>71,230</u>	\$ <u>18,621,595</u>	\$ <u>18,692,825</u>

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i
PROPRIETARY FUNDS - STATEMENT OF REVENUES, EXPENSES,
AND CHANGES IN NET POSITION
Year Ended June 30, 2018

	<u>December 31, 2017</u>		
	<u>Ho'okele Pono LLC</u>	<u>Hi'ilei Aloha LLC</u>	<u>Total</u>
OPERATING REVENUES			
Sales - gift store and other	\$ --	\$ 2,171,221	\$ 2,171,221
Cost of sales	<u>--</u>	<u>(2,307,154)</u>	<u>(2,307,154)</u>
Gross margin	--	(135,933)	(135,933)
Admission and tours	--	4,344,144	4,344,144
Other revenue	--	1,409,299	1,409,299
Cooperative agreement - Federal government	100,613	--	100,613
Conference registration fees	<u>14,710</u>	<u>--</u>	<u>14,710</u>
Total operating revenues	115,323	5,617,510	5,732,833
EXPENSES			
Program services	196,062	3,987,003	4,183,065
Management and general	60,793	1,490,995	1,551,788
Fundraising	<u>--</u>	<u>17,300</u>	<u>17,300</u>
Total operating expenses	<u>256,855</u>	<u>5,495,298</u>	<u>5,752,153</u>
Operating income (loss)	(141,532)	122,212	(19,320)
NONOPERATING REVENUES AND EXPENSES			
Net transfers from other funds	<u>56,600</u>	<u>162,800</u>	<u>219,400</u>
	<u>56,600</u>	<u>162,800</u>	<u>219,400</u>
Change in net position	<u>(84,932)</u>	<u>285,012</u>	<u>200,080</u>
NET POSITION			
Beginning of year	<u>107,393</u>	<u>17,798,694</u>	<u>17,906,087</u>
End of year	\$ <u>22,461</u>	\$ <u>18,083,706</u>	\$ <u>18,106,167</u>

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i
PROPRIETARY FUNDS - STATEMENT OF CASH FLOWS
Year Ended June 30, 2018

	December 31, 2017		
	Ho'okele Pono LLC	Hi'ilei Aloha LLC	Total
Cash flows from operating activities			
Receipts from customers, grantors and funders	\$ 80,918	\$ 7,912,261	\$ 7,993,179
Payments to suppliers, vendors and service providers	(101,805)	(3,802,285)	(3,904,090)
Payments to employees for salaries and benefits	<u>(145,758)</u>	<u>(3,652,645)</u>	<u>(3,798,403)</u>
Net cash provided by (used in) operating activities	<u>(166,645)</u>	<u>457,331</u>	<u>290,686</u>
Cash flows from noncapital financing activities			
Cash grants from OHA and Hi'ilei Aloha LLC	50,000	--	50,000
Advances from Hi'ilei Aloha LLC	34,942	--	34,942
Grants from OHA	<u>--</u>	<u>162,800</u>	<u>162,800</u>
Net cash provided by noncapital financing activities	<u>84,942</u>	<u>162,800</u>	<u>247,742</u>
Cash flows from capital and related financing activities			
Acquisitions of property and equipment	<u>--</u>	<u>(470,806)</u>	<u>(470,806)</u>
Net cash used in capital and related financing activities	<u>--</u>	<u>(470,806)</u>	<u>(470,806)</u>
Cash flows from investing activities			
Advances to Ho'okipaipai LLC	<u>--</u>	<u>(34,942)</u>	<u>(34,942)</u>
Net cash used in investing activities	<u>--</u>	<u>(34,942)</u>	<u>(34,942)</u>
Net increase (decrease) in cash and cash equivalents	(81,703)	114,383	32,680
Cash and cash equivalents - January 1, 2017	<u>85,943</u>	<u>2,914,472</u>	<u>3,000,415</u>
Cash and cash equivalents - December 31, 2017	\$ <u>4,240</u>	\$ <u>3,028,855</u>	\$ <u>3,033,095</u>
Cash and cash equivalents consist of:			
Cash	\$ 4,240	\$ 2,931,809	\$ 2,936,049
Restricted cash	<u>--</u>	<u>97,046</u>	<u>97,046</u>
	\$ <u>4,240</u>	\$ <u>3,028,855</u>	\$ <u>3,033,095</u>

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i
PROPRIETARY FUNDS - STATEMENT OF CASH FLOWS (Continued)
Year Ended June 30, 2018

	December 31, 2017		Total
	Ho'okele Pono LLC	Hi'ilei Aloha LLC	
Reconciliaion of operating loss to net cash used in operating activities			
Operating loss	\$ (141,532)	\$ 122,212	\$ (19,320)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:			
Expenses paid by Hi'ilei Aloha LLC and OHA	6,600	--	6,600
Depreciation	--	317,664	317,664
Loss on disposal of equipment	--	7,967	7,967
Change in:			
Accounts receivable, net	(34,405)	9,016	(25,389)
Inventory, prepaid items and other assets	94	(52,051)	(51,957)
Accounts payable and accrued liabilities	<u>2,598</u>	<u>52,523</u>	<u>55,121</u>
Net cash used in operating activities	\$ <u>(166,645)</u>	\$ <u>457,331</u>	\$ <u>290,686</u>
Schedule of noncash financing activities			
Grants from Hi'ilei Aloha LLC and OHA - payment of expenses	\$ 6,600	\$ --	\$ 6,600

See accompanying notes to the basic financial statements.

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE A - FINANCIAL REPORTING ENTITY

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

As of June 30, 2018, OHA's blended components units are comprised of Hi'ilei Aloha LLC and Ho'okele Pono LLC, Hawai'i limited liability companies (collectively, the Companies) which were formed by OHA in September 2007 and May 2010, respectively. OHA is the sole corporate member of the Companies. The results of the Companies as of and for the year ended December 31, 2017, their fiscal year ends, have been included in the basic financial statements. For the period January 1, 2018 through June 30, 2018, the Companies have not entered into any significant or unusual transactions.

Ho'okele Pono LLC and its wholly-owned subsidiaries, Ho'okipaipai LLC and Hi'ilei Aloha LLC and its wholly-owned subsidiaries, Hi'ipaka LLC, Hi'ipoi LLC and Hi'ikualona LLC are exempt from federal income tax under Sections 501(a) and 501(c)(3) of the Internal Revenue Code. In August 2017, Articles of Termination were processed for Hi'ipoi LLC. Hi'ikualono LLC has been inactive since formation.

NOTE B - SIGNIFICANT ACCOUNTING POLICIES

- (1) ***Basis of Presentation*** - OHA's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).
- (2) ***Governmental Funds Financial Statements*** - The governmental funds financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, OHA considers revenues to be available if they are collected within 60 days of the end of the current fiscal year. Principal revenue sources susceptible to accrual include Federal grants, public land trust revenue, and interest and dividends on investments.

Expenditures are generally recorded when a liability is incurred as under accrual accounting. Modifications to the accrual basis of accounting include the employees' vested annual leave, workers' compensation, net pension liability, net other postemployment benefits (OPEB) liability and capital lease obligations which are recorded as expenditures when utilized or paid. The amount of accumulated annual leave unpaid, accrued workers' compensation, net pension liability, net OPEB liability and capital lease obligations as of June 30, 2018 have been reported only in the government-wide financial statements.

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

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

OHA reports the following funds as major:

General Fund - The general fund of OHA is part of the State of Hawai'i General Fund. OHA's general fund financial statements reflect only OHA's appropriations and obligations. The general fund is used to account for all financial resources except those required to be accounted for in another fund, and includes the operating budget of general funds appropriated by the Hawai'i State Legislature.

Public Land Trust Fund (PLTF) - Reflects the income and expenditures from the Public Land Trust as defined in Chapter 10, Hawai'i Revised Statutes, as well as the proceeds and income of the Native Hawaiian Rights Fund. Expenditures reflect those from the OHA Board of Trustee appropriations of the Public Land Trust Funds.

Federal Grants Fund - Reflects the interest income earned from the Native Hawaiian Revolving Loan Fund (NHRLF) and the funds earned under other federal grants. Expenditures reflect necessary costs to administer the NHRLF and other federal grants.

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

OHA reports the following funds as major:

Hi'ilei Aloha LLC - Reflects the revenues and expenditures related to the preservation and perpetuation of cultural and natural resources which are primarily generated from managing admissions to Waimea Valley on Oahu and the activities and events held there.

Ho'okele Pono LLC - Reflects the revenues and expenditures related to community economic development activity in the State of Hawaii which are primarily related to the operation of the Hawaii Procurement Technical Assistance Center. Although this fund does not meet the major fund criteria, management believes this fund is important to financial statement users and has elected to report it as a major fund.

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

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

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

- (6) **Inventory and Prepaid Items** - All inventories are stated at the lower of cost (first-in, first-out method) or market. Inventories of governmental funds are recorded as expenditures when consumed rather than when purchased. Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.
- (7) **Capital Assets** - Capital assets include tangible and intangible assets acquired with estimated useful lives greater than one year. Capital assets acquired for general organization purposes are recorded as expenditures in the governmental funds financial statements. Donated fixed assets are recorded at estimated fair value at the time received on the government-wide and proprietary fund financial statements.

Depreciation and amortization expense is recorded in the government-wide financial statements. Buildings, equipment, furniture and fixtures are depreciated on the straight-line method over their estimated useful lives. There is no depreciation recorded for land. The estimated useful lives of capital assets are as follows:

Buildings	30 Years
Leasehold improvements	Shorter of lease term or useful life
Furniture, fixtures, and equipment	5 Years

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

- (8) ***Deferred Outflows of Resources and Deferred Inflows of Resources*** - Deferred outflows (inflows) of resources represent a consumption of (benefit to) net position that applies to a future period. The deferred outflow of resources related to pensions and other postemployment benefits (OPEB) resulted from differences between expected and actual experiences, changes in assumptions, the net difference between projected and actual earnings on pension plan investments, changes in proportion which will be amortized over five years, and OHA's contributions to the pension and OPEB plans subsequent to the measurement date of the actuarial valuations for the plans which will be recognized as reductions of the net pension and net OPEB liabilities in the subsequent fiscal year. The deferred inflow of resources related to pensions and OPEB resulted from differences between expected and actual experiences and changes in proportion of the pension plan which will be amortized over five years.
- (9) ***Compensated Absences and Compensatory Pay*** - OHA accrues all vacation and compensatory pay at current salary rates; including additional amounts for certain salary-related expenses associated with the payment of compensated absences, in accordance with GASB Codification Section C60, Compensated Absences. The balance at June 30, 2018 includes fringe benefits computed at the rate of 7.65% of accrued vacation and compensatory pay. Accrued vacation is reported as an expense when earned in the government-wide and proprietary fund financial statements, but not reported as an expenditure in the governmental funds financial statements, as current financial resources are not used.
- (10) ***Risk Management*** - OHA is exposed to various risks of loss from torts, theft of or damage to assets, errors and omissions, and employee injuries and illnesses.
- (11) ***Governmental Funds - Fund Balance*** - GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB 54) provides guidance on the reporting of stabilization arrangements and changes the classifications and definitions to the following:

Nonspendable Fund Balance

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

Restricted Fund Balance

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

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

Committed Fund Balance

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

Assigned Fund Balance

Includes amounts that are constrained as to use by the entity's intent to be used for specific purposes, but are neither "restricted" nor "committed". Intent should be expressed by (a) the governing body itself or (b) a body or official to which the governing body has delegated such authority to assign amounts to be used for specific reasons. These constraints are more easily modified and/or removed. Generally all funding of any fund, other than the General Fund are "assigned." Public Land Trust as presented on OHA's Governmental Funds - Balance Sheet includes trust fund corpus for which no specific purpose has been defined. Draws from this line item are made annually pursuant to biennium budget approved by the Board of Trustees.

Unassigned Fund Balance

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

Stabilization Arrangements

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

OHA's Fiscal Reserve is comprised of lapsed fiscal year funding for its Public Land Trust budget. The Public Land Trust fiscal year budget is subject to Trustee approval prior to the start of each fiscal year. Use of Fiscal Reserve funding is subject to Board of Trustee approval and may be used to cover any current year funding shortfalls. As of June 30, 2018, OHA had approximately \$5.7 million in its Fiscal Reserve and is reported as Assigned Public Land Trust fund balance.

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

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

Encumbrances as of June 30, 2018 consist of the following:

General Fund	\$ 398,824
Public Land Trust Fund	12,951,704
Federal Grants Fund	1,251,358
Other Funds	<u>45,841</u>
	<u>\$ 14,647,727</u>

- (13) **Use of Estimates** - The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from estimates.
- (14) **Notes Receivable** - Notes receivable consist of notes made to Native Hawaiian-owned businesses and individuals. Management provides an allowance for doubtful accounts equal to the estimated amounts deemed uncollectible by management which it considers outstanding for more than 90 days. Management also provides a general allowance for its notes receivable. The composition of notes receivable as of June 30, 2018 are as follows:

Native Hawaiian and Hawaiian persons	99.8%
Agencies	<u>0.2%</u>
	<u>100.0%</u>

- (15) **Pensions** - For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Employees' Retirement System (ERS) and additions to/deductions from the ERS's fiduciary net position have been determined on the same basis as they are reported by the ERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with benefit terms. Investments are reported at their fair value.
- (16) **Postemployment Benefits Other Than Pensions** - For purposes of measuring the net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of the Hawaii Employer-Union Health Benefits Trust Fund (EUTF) and additions to/deductions from EUTF's fiduciary net position have been determined on the same basis as they are reported by EUTF. For this purpose, EUTF recognizes benefit payments when due and payable in accordance with the benefit terms. Investments are reported at fair value, except for investments in commingled and money market funds, which are reported at net asset value (NAV). The NAV is based on the fair value of the underlying assets held by the respective fund less its liabilities.

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

- (17) **Recent Accounting Pronouncements** - The Governmental Accounting Standards Board (GASB) issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. The Statement replaces GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. The Statement will require the liability of employers for defined benefit OPEB to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service, less the amount of the OPEB plan's fiduciary net position. The requirements of this Statement are effective for fiscal years beginning after June 15, 2017. Management has adopted the applicable requirements of the new standard as presented in OHA's financial statements.

The GASB issued Statement No. 83, *Certain Asset Retirement Obligations*. This Statement addresses accounting and financial reporting for certain asset retirement obligations ("AROs"). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this Statement. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Management has not yet determined the effect this Statement will have on OHA's financial statements.

The GASB issued Statement No. 84, *Fiduciary Activities*. This Statement establishes specific criteria for identifying activities that should be reported as fiduciary activities and clarifies whether and how business-type activities should report their fiduciary activities. The requirements of this Statement are effective for reporting periods beginning after December 15, 2018. Management has not yet determined the effect this Statement will have on OHA's financial statements.

The GASB issued Statement No. 85, *Omnibus 2017*. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits [OPEB]). The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Management has adopted the applicable requirements of this new standard as presented in OHA's financial statements.

The GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*. This Statement improves consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources - resources other than the proceeds of refunding debt - are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance. The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Management has determined that this Statement does not have a material impact on OHA's financial statements.

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

The GASB issued Statement No. 87, *Leases*. This Statement requires the recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources. The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Management has not yet determined the effect this Statement will have on OHA's financial statements.

The GASB issued Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*. This Statement defines debt for purposes of disclosure in notes to financial statements and establishes additional financial statement note disclosure requirements related to debt obligations of governments, including direct borrowings (for example, a government entering into a loan agreement with a lender) and direct placements (for example, a government issuing a debt security directly to an investor). Direct borrowings and direct placements have terms negotiated directly with the investor or lender and are not offered for public sale. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Management has not yet determined the effect this Statement will have on OHA's financial statements.

The GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*. This Statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund. The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Changes adopted to conform to the provisions of this Statement should be applied prospectively. Management has not yet determined the effect this Statement will have on OHA's financial statements.

The GASB issued Statement No. 90, *Majority Equity Interest - an amendment of GASB Statement No. 14 and No. 61*. The primary objectives of this Statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and improve the relevance of financial statement information for certain component units. The requirements of this Statement are effective for reporting periods beginning after December 15, 2018. OHA has not yet determined the effect this Statement will have on its financial statements.

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE C - BIENNIAL BUDGET

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

The Budget - In the fall of each odd-numbered fiscal year, OHA's Administration drafts the program and budget recommendations that will be the basis for OHA's biennium budget request. Once approved by OHA's Board of Trustees, the general funds budget is submitted directly to the State Legislature prior to its convening. The Budget is generally constructed around OHA's operations (offices) and programs (divisions) and state programmatic objectives, expected outcomes, and financial requirements. The budget also shows the proportion of funding requested from general funds to be appropriated by the Legislature and from trust funds appropriated by OHA's Board of Trustees.

Legislative Review - Once the budget is submitted to the State Legislature, the review process follows that which is applied to the executive branch, with the budget being reviewed by House Finance Committee, Senate Ways and Means Committee, and the respective subject matter committees in the House and Senate. The State Legislature may request provisos and may require financial analysis and evaluation of those programs funded with general funds, but has no discretion over trust fund allocations.

Program Execution - Except as limited by policy decisions of OHA's Board of Trustees, provisions of the State Legislature, and other provisions of law, OHA's Administration is responsible for the proper management of the programs. Appropriation changes and transfers can be authorized by OHA's Board of Trustees; those impacting general funds are reported to the State Legislature.

The budget is adopted for the general fund and is prepared on a basis other than GAAP. The actual results of operations are presented on the budgetary basis in the statement of revenues and expenditures - budget and actual to provide a meaningful comparison of actual results to the legislative budget.

The major differences between the budgetary basis and GAAP basis are that (1) encumbrances are recorded as the equivalent of expenditures under the budgetary basis; and (2) revenue is recognized when received under the budgetary basis.

Adjustments necessary to reconcile the results of operations for the year ended June 30, 2018 from the budgetary basis to GAAP basis are as follows:

	Amount
Deficiency of revenues under expenditures - actual (budgetary basis)	\$ --
Reserve for encumbrances at June 30, 2018	398,824
Prior year reserve for encumbrances	252,898
Accrued payables and payroll	(178,473)
Expenditures for liquidation of prior-year encumbrances	(386,245)
Revenues over expenditures - actual (GAAP basis)	\$ 87,004

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NOTE D - APPROPRIATIONS

OHA is authorized to transfer appropriation amounts and staffing positions between programs for operating purposes, provided that a report of all transfers are made to the State Legislature prior to convening of the next legislative session. Act 131, Sessions Laws of Hawai'i (SLH) 2017 authorized a total of \$3,037,879 in general funds.

NOTE E - CASH

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

OHA's cash included in State pooled funds is fully collateralized with securities held by third-party agents in the State's name, as required by the HRS, Section 38-8. As of June 30, 2018, OHA's cash held in the State Treasury totaled \$5,355,851. OHA holds cash in banking institutions held outside of the State Treasury to maximize investment returns in accordance with HRS Section 10-5.

As of December 31, 2017, Hi'ilei Aloha LLC had a cash and restricted cash balance of \$3,028,855. Hi'ilei Aloha LLC and its wholly-owned subsidiaries, Hi'ipaka LLC and Hi'ipoi LLC maintain separate legal entity cash accounts with a financial institution in the State of Hawai'i. Balances are insured up to \$250,000 per account holder by the FDIC. Balances may at times, however, exceed the FDIC's insurance limits. As of August 2017, Articles of Termination were processed for Hi'ipoi LLC.

As of December 31, 2017, Ho'okele Pono LLC did not have bank balances that exceed FDIC insurance limits. Balances may at times, however, exceed the FDIC's insurance limits.

NOTE F - INVENTORY, PREPAID ITEMS AND OTHER ASSETS

As of June 30, 2018, OHA's governmental funds had prepaid items totaling \$465,589. As of December 31, 2017, Hi'ilei Aloha LLC and Ho'okele Pono LLC, had inventory of \$123,040, and \$-0-, respectively, and prepaid items totaling \$140,126 and \$856, respectively.

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NOTE G - NOTES RECEIVABLE

At June 30, 2018, notes receivable bear interest from 4% to 6.25%, mature on various dates through August 2021, and consists of the following:

	Amount
Notes receivable (of which \$236,618 is guaranteed by the Department of Hawaiian Home Lands (DHHL))	\$ 257,902
Native Hawaiian Revolving Loan Fund	6,401,523
Other	<u>1,283,723</u>
Total	7,943,148
Less allowance for doubtful accounts	<u>(2,620,555)</u>
Notes receivable, net	5,322,593
Amounts due within one year	<u>(1,775,892)</u>
Amounts due after one year	<u>\$ 3,546,701</u>

NOTE H - INVESTMENTS

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

OHA's investment policy allows for investments in U.S. large cap, U.S. small cap equities, international equities, core fixed income, high yield, real estate, absolute return, private equity, and private debt securities. Investments as of June 30, 2018 and their maturities were as follows:

Investment type	Fund	Reported Value	Investment maturities (in years)	
			Less than one	One through five
U.S. treasuries	NHRLF	11,713,544	5,293,108	6,420,436
U.S. agencies	NHRLF	<u>1,435,432</u>	<u>1,042,283</u>	<u>393,149</u>
Subtotal - NHRLF		<u>13,148,976</u>	<u>6,335,391</u>	<u>6,813,585</u>
Mutual funds	NHTF	\$ 200,172,908		
Commingled funds	NHTF	59,446,468		
Alternative investments				
Private equity	NHTF	79,695,102		
Hedge funds	NHTF	<u>45,365,409</u>		
Subtotal - NHTF		384,679,887		
Total investments		<u>\$ 397,828,863</u>	<u>\$ --</u>	<u>\$ --</u>

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE H - INVESTMENTS (Continued)

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

In addition, OHA has a separate investment policy for the NHRLF, which is restricted to investments in government backed securities (fixed securities) which strive for higher rates of return with the potential for greater principal stability than longer term fixed income investments.

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

- (1) **Foreign Currency Risk** - To diversify the NHTF portfolio against market fluctuations, OHA's investment policy allows for investments in foreign countries. As of June 30, 2018, OHA's foreign currency risks are as follows:

<u>Investment Type</u>	<u>Currency</u>	<u>Value (US Dollar)</u>
Private equity funds	Euro	\$ 3,649,596

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

<u>Type of Investment</u>	<u>Maximum Maturity</u>
U.S. treasuries	5 Years
U.S. agencies	5 Years

The duration of the investment portfolio, under normal market conditions, range between plus or minus 50% of the investment policy benchmark.

- (3) **Credit Risk** - Pursuant to 45 C.P.R. 1336.72(a), "any portion of the revolving loan fund that is not required for expenditure must be invested in obligations of the United States or in obligations guaranteed or insured by the United States." At June 30, 2018, credit rates for all securities of government agencies were rated at least Aa (Moody's) or AA (Standard & Poor's).

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE H - INVESTMENTS (Continued)

- (4) **Concentration of Credit Risk** - The NHRLF investment policy states that except for U.S. treasury securities and U.S. government sponsored agency obligations, fixed income securities will be limited to not more than 5% of the total portfolio, at the time of purchase, in any one issue. OHA is in compliance with this policy.
- (5) **Fair Value Measurements** - The framework for measuring fair value provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1) and the lowest priority to unobservable inputs (level 3). Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The three levels of the fair value hierarchy are described as follows:

Level 1 - Inputs to the valuation methodology are quoted prices (unadjusted) in active markets for identical assets or liabilities that OHA can access at the time of measurement date.

Level 2 - Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly, such as:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specific (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 - Inputs that are unobservable for the asset or liability.

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

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

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NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE H - INVESTMENTS (Continued)

The following table sets forth by level, within the fair value hierarchy, assets measured at fair value on a recurring basis as of June 30, 2018.

	Fund	Level 1	Level 2	Level 3	Total
Mutual funds					
Blended	NHTF	\$ 93,533,482	\$ --	\$ --	\$ 93,533,482
Bond funds	NHTF	58,661,506	--	--	58,661,506
Value	NHTF	16,988,737	--	--	16,988,737
Diversified emerging markets	NHTF	11,895,680	--	--	11,895,680
Real estate	NHTF	10,718,578	--	--	10,718,578
Growth	NHTF	8,374,925	--	--	8,374,925
Total mutual funds		200,172,908	--	--	200,172,908
U.S. treasuries	NHRLF	--	11,713,544	--	11,713,544
U.S. agencies	NHRLF	--	1,435,432	--	1,435,432
Total investments at fair value		<u>200,172,908</u>	<u>13,148,976</u>	<u>--</u>	<u>213,321,884</u>
Investments held at NAV					
Commingled funds					59,446,468
Alternative investments					
Private market funds					79,695,102
Hedge funds					45,365,409
Total investments at NAV					<u>184,506,979</u>
Total investments					\$ <u>397,828,863</u>

The preceding measurements described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. The market volatility of equity-based investments is expected to substantially impact the value of such investments at any given time. It is likely that OHA's investments have fluctuated since June 30, 2018.

	Fair Value	Unfunded Commitments	Redemption Frequency	Required Redemption Notice
Investments measured at NAV				
Commingled funds				
Domestic equity	\$ 26,894,239	None	Monthly/Quarterly	Various up to trade date
International equity	9,561,499	None	Monthly/Quarterly	Various up to trade date
Domestic core fixed income	22,990,730	None	Monthly/Quarterly	Various up to trade date
Alternative investments				
Private market funds	79,695,102	30,774,918	Monthly/Quarterly	Various up to trade date
Hedge funds	<u>45,365,409</u>	None	Monthly/Quarterly	Various up to trade date
Total investments measured at NAV	\$ <u>184,506,979</u>			
Invested securities lending collateral				
Money market fund	\$ <u>761,036</u>			Same as trade date

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE H - INVESTMENTS (Continued)

- **Domestic equity** - State Street Equity 500 Index Fund - primary objective is to replicate as closely as possible, before expenses, the performance of the Standard & Poor's 500 Index (the "S&P 500" or sometimes referred to in context as the "Index"). This Index is commonly used to represent the broad U.S. equity market.
- **International equity** - State Street Global Equity ex-U.S. Index Fund - primary objective is to provide investment results, before fees and expenses, correspond generally to the total return performance of a broad-based index of world (ex-U.S.) equity markets over the long term.
- **Domestic core fixed income** - State Street Aggregate Bond Index Fund - primary objective is to provide investment results that, before fees and expenses, correspond generally to the price and yield performance of an index that tracks the U.S. dollar denominated investment grade bond market over the long term.
- **Private market funds** - The private market portfolio seeks to enhance total return through investments/partnerships which may have limited liquidity and/or utilize leverage. The types of investments may consist of leveraged buy-outs, venture capital, secondary transactions, private debt (mezzanine, convertible, secured loans), recapitalization, distressed (debt and/or equity), and acquisitions. Staff and investment consultant will conduct diligence on each fund and the CEO must approve commitments into funds. Each commitment is made as a limited partner. The funds are generally illiquid for five to ten years.
- **Hedge funds** - The hedge fund portfolio seeks to provide a consistently positive return source above the risk free rate that has a low volatility and low correlation to other asset classes. The portfolio is diversified by strategies which may include but are not limited to macro, relative value, opportunistic, distressed, market neutral, and quantitative strategies.
- **Money market funds** - State Street Institutional U.S. Government Money Market Fund - primary objective is to maximize current income, to the extent consistent with the preservation of capital and liquidity and the maintenance of a stable \$1.00 per share net asset value ("NAV").

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE I - CAPITAL ASSETS

OHA's capital assets of governmental activities during the year ended June 30, 2018 was as follows:

	Balance July 1, 2017	Additions	Deductions	Balance June 30, 2018
Capital assets not depreciated:				
Land	\$ 213,961,981	\$ --	\$ --	\$ 213,961,981
Capital assets being depreciated:				
Buildings	23,708,949	--	--	23,708,949
Leasehold improvements	6,140,781	46,579	--	6,187,360
Furniture, fixtures and equipment	5,832,744	156,102	(13,455)	5,975,391
Total capital assets being depreciated	35,682,474	202,681	(13,455)	35,871,700
Less accumulated depreciation	<u>(13,650,057)</u>	<u>(2,227,170)</u>	<u>13,455</u>	<u>(15,863,772)</u>
Capital assets being depreciated, net	<u>22,032,417</u>	<u>(2,024,489)</u>	<u>--</u>	<u>20,007,928</u>
Governmental activities capital assets, net	\$ <u>235,994,398</u>	\$ <u>(2,024,489)</u>	\$ <u>--</u>	\$ <u>233,969,909</u>

Hi'ilei Aloha LLC's capital assets activities during the year ended December 31, 2017 are as follows:

	Balance January 1, 2017	Additions	Deductions	Balance December 31, 2017
Capital assets not depreciated:				
Land	\$ 13,003,821	\$ --	\$ --	\$ 13,003,821
Capital assets being depreciated:				
Buildings and improvements	2,810,110	294,152	--	3,104,262
Furniture, fixtures and equipment	863,659	100,639	(37,564)	926,734
Vehicles	168,727	76,015	--	244,742
Total capital assets being depreciated	3,842,496	470,806	(37,564)	4,275,738
Less accumulated depreciation	<u>(1,909,242)</u>	<u>(317,664)</u>	<u>29,597</u>	<u>(2,197,309)</u>
Total capital assets being depreciated	<u>1,933,254</u>	<u>153,142</u>	<u>(7,967)</u>	<u>2,078,429</u>
Capital assets, net	\$ <u>14,937,075</u>	\$ <u>153,142</u>	\$ <u>(7,967)</u>	\$ <u>15,082,250</u>

NOTE J - CAPITAL LEASES

OHA leases photocopiers and mail postage meter machines for all offices. Capital leases are recorded as assets and liabilities and amortized over the term of the lease agreement by use of the straight line method. The amortization of assets recorded under capital leases is included with depreciation expenses. As of June 30, 2018, assets recorded under capital lease included in furniture, fixtures and equipment is \$452,676 and related amortization is \$301,523.

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE J - CAPITAL LEASES (Continued)

Annual debt service requirements to maturity for the capital leases are as follows:

Fiscal Year Ending June 30,	Principal	Interest
2019	\$ 48,898	\$ 4,340
2020	50,110	3,128
2021	51,322	1,917
2022	27,360	705
2023	2,825	66
	\$ 180,515	\$ 10,156

NOTE K - OPERATING LEASES

OHA leases office space and equipment under various noncancelable operating leases through June 2020. Future minimum payments under all leases as of June 30, 2018 are approximately \$159,400 in 2019 and \$69,300 in 2020.

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

Rent expense (including taxes and common area maintenance) under all operating leases totaled approximately \$219,000 for the year ended June 30, 2018.

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

Future minimum payment obligations under all leases as of December 31, 2017 are approximately \$63,700 in 2018 and \$54,400 in 2019.

Rent expense under operating leases totaled approximately \$100,000 for the year ended December 31, 2017. Hi'ilei Aloha LLC sub-leases a portion of its office space to Ho'okele Pono LLC under an agreement that renews annually. Rent revenue and related expenses of \$21,758 for the year ended December 31, 2017, are eliminated in the government-wide adjustments.

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE K - OPERATING LEASES (Continued)

Portions of Kaka'ako Makai, land included in capital assets, and Na Lama Kukui, building included in capital assets, are currently leased under operating lease arrangements that expire through 2042 and 2022, respectively. For the year ended June 30, 2018, rental revenue from Kaka'ako Makai and Na Lama Kukui amounted to approximately \$4,316,000 and \$3,190,000 respectively, and are recorded in the PLTF as charges for services.

As of June 30, 2018, approximate minimum future lease rentals under non-cancellable operating leases are as follows:

<u>Fiscal Year Ending June 30,</u>	<u>Amount</u>
2019	\$ 4,714,700
2020	4,131,300
2021	3,344,400
2022	2,236,800
2023	1,401,300
2024 - 2035	9,324,600
2036 - 2043	<u>4,672,700</u>
	<u>\$ 29,825,800</u>

NOTE L - LONG-TERM LIABILITIES

On August 14, 2012, OHA entered into a \$21,370,000 long term note payable with a bank, to finance the purchase of Na Lama Kukui. The interest rate is fixed at 3.35%. The note is due in full on September 1, 2022 and is collateralized by a mortgage lien on the property, assignment of OHA's right, title and interest as landlord in and to any rents under tenant leases and rental agreements on Na Lama Kukui and security interest in all furniture, fixtures, and equipment. On July 26, 2013 the agreement was modified to increase the interest rate to 3.6% and include certain financial covenants. At June 30, 2018, OHA was in compliance with those covenants.

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

<u>Fiscal Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	\$ 596,444	\$ 701,149	\$ 1,297,593
2020	618,274	679,319	1,297,593
2021	640,903	656,691	1,297,594
2022	664,360	633,234	1,297,594
2023	<u>17,214,386</u>	<u>154,543</u>	<u>17,368,929</u>
	<u>\$ 19,734,367</u>	<u>\$ 2,824,936</u>	<u>\$ 22,559,303</u>

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE L - LONG-TERM LIABILITIES (Continued)

On June 28, 2013 OHA entered into a \$6,758,000 line of credit to finance the renovation of Na Lama Kukui, which is due in full on June 28, 2023. On January 28, 2015, OHA entered into a \$5,000,000 line of credit to finance OHA's governance planning initiative and other projects, which is due in full on February 3, 2024. OHA had drawn a total of \$8,325,705 between the lines of credit as of June 30, 2018. The interest rates are contingent upon certain elections by OHA. The lines of credit are collateralized by all investment property and financial assets held in certain investment accounts. There were no principal payments made for the year ended June 30, 2018. The lines of credit are also subject to certain financial covenants. At June 30, 2018, OHA was in compliance with those covenants. Future principal and interest payments are as follows:

<u>Fiscal Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	\$ 1,614,666	\$ 210,051	\$ 1,824,717
2020	1,614,666	221,100	1,835,766
2021	1,614,666	172,443	1,787,109
2022	1,614,666	123,771	1,738,437
2023	1,614,666	55,227	1,669,893
2024	<u>252,375</u>	<u>4,151</u>	<u>256,526</u>
	<u>\$ 8,325,705</u>	<u>\$ 786,743</u>	<u>\$ 9,112,448</u>

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

Changes in long-term liabilities for the year ended June 30, 2018 were as follows:

	<u>Balance</u>			<u>Balance</u>	<u>Amount due</u>	<u>Amount due</u>
	<u>July 1, 2017</u>	<u>Additions</u>	<u>Deductions</u>	<u>June 30, 2018</u>	<u>within one year</u>	<u>after one year</u>
Compensated absences	\$ 1,660,765	\$ 792,290	\$ (862,692)	\$ 1,590,363	\$ 1,095,736	\$ 494,627
Capital lease obligation	212,971	14,238	(46,694)	180,515	48,898	131,617
Notes payable	20,300,386	--	(566,019)	19,734,367	596,444	19,137,923
Lines of credit	<u>10,195,500</u>	<u>--</u>	<u>(1,869,795)</u>	<u>8,325,705</u>	<u>1,614,666</u>	<u>6,711,039</u>
Total	<u>\$ 32,369,622</u>	<u>\$ 806,528</u>	<u>\$ (3,345,200)</u>	<u>\$ 29,830,950</u>	<u>\$ 3,355,744</u>	<u>\$ 26,475,206</u>

NOTE M - EMPLOYEE BENEFITS

- (1) **Defined Benefit Pension Plans** - Generally, all full-time employees of the State are required to be members of the Employees' Retirement System of the State of Hawai'i (ERS), a cost-sharing multiple-employer defined benefit pension plan that administers the State's pension benefits program. The employees of Hi'ilei Aloha LLC and Ho'okele Pono LLC are excluded from the ERS plans. Benefits, eligibility, and contribution requirements are governed by HRS Chapter 88 and can be amended through legislation. The ERS issues publicly available annual financial reports that can be obtained at ERS's website: <http://ers.ehawaii.gov/>.

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE M - EMPLOYEE BENEFITS (Continued)

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

Each retiree's original retirement allowance is increased on each July 1 beginning the calendar year after retirement. Retirees first hired as members prior to July 1, 2012 receive a 2.5% increase each year of their original retirement allowance without a ceiling. Retirees first hired as members after June 30, 2012 receive a 1.5% increase each year of their original retirement allowance without a ceiling. The annual increase is not compounded.

The following summarizes the provisions relevant to the largest employee groups of the respective membership class. Retirement benefits for certain groups, such as police officers, firefighters, some investigators, sewer workers, judges, and elected officials, vary from general employees.

Noncontributory Class

Retirement Benefits

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

Disability Benefits

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

Death Benefits

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

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE M - EMPLOYEE BENEFITS (Continued)

Ordinary death benefits are available to employees who were active at time of death with at least ten years of credited service. The surviving spouse/reciprocal beneficiary (until remarriage/reentry into a new reciprocal beneficiary relationship) and dependent children (up to age 18) receive a benefit equal to a percentage of the member's accrued maximum allowance unreduced for age or, if the member was eligible for retirement at the time of death, the surviving spouse/reciprocal beneficiary receives 100% joint and survivor lifetime pension and the dependent children receive a percentage of the member's accrued maximum allowance unreduced for age.

Contributory Class for Employees Hired prior to July 1, 2012

Retirement Benefits

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

Police officers and firefighters' retirement benefits are determined using the benefit multiplier of 2.5% for qualified service, up to a maximum of 80% of average final compensation. Police officers and firefighters with five years of credited service are eligible to retire at age 55. Police officers and firefighters with 25 years of credited service are eligible to retire at any age, provided the last five years is service credited in these occupations.

Disability Benefits

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

Death Benefits

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

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

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE M - EMPLOYEE BENEFITS (Continued)

Contributory Class for Employees Hired After June 30, 2012

Retirement Benefits

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

Police officers and firefighters' retirement benefits are determined using the benefit multiplier of 2.25% for qualified service, up to a maximum of 80% of average final compensation. Police officers and firefighters with ten years of credited service are eligible to retire at age 60. Police officers and firefighters with 25 years of credited service are eligible to retire at 55, provided the last five years is service credited in these occupations.

Disability and Death Benefits

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

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

Hybrid Class for Employees Hired Prior to July 1, 2012

Retirement Benefits

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

Disability Benefits

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

Death Benefits

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

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE M - EMPLOYEE BENEFITS (Continued)

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

Hybrid Class for Employees Hired After June 30, 2012

Retirement Benefits

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

Disability and Death Benefits

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

Contributions

Contributions are established by HRS Chapter 88 and may be amended through legislation. The employer rate is set by statute based on the recommendations of the ERS actuary resulting from an experience study conducted every five years. Since July 1, 2005, the employer contribution rate is a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liabilities. The contribution rates for fiscal year 2018 were 25.00% for police and firefighters and 17.00% for all other employees. Contributions to the pension plan from OHA were approximately \$1,694,800 for the year ended June 30, 2018.

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

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NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE M - EMPLOYEE BENEFITS (Continued)

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

At June 30, 2018, OHA reported a liability of \$31,892,391 for its proportionate share of net pension liability. The net pension liability was measured as of June 30, 2017, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. OHA's proportion of the net pension liability was based on a projection of OHA's long-term share of contributions to the pension plan relative to projected contributions of all participants, actuarially determined. At June 30, 2017, OHA's proportion was 0.41% which was a decrease of 0.01% from its proportion measured as of June 30, 2016.

There were no changes between the measurement date, June 30, 2017, and the reporting date, June 30, 2018, that are expected to have a significant effect on the proportionate share of the net pension liability.

For the year ended June 30, 2018, OHA recognized pension expense of \$2,341,048. At June 30, 2018, OHA reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ 514,174	\$ (344,554)
Changes in assumptions	4,752,295	--
Net difference between projected and actual earnings on pension plan investments	(5,311)	--
Changes in proportion and differences between OHA contributions and proportionate share of contributions	133,197	(76,294)
OHA's contributions subsequent to the measurement date	<u>1,694,776</u>	<u>--</u>
	<u>\$ 7,089,131</u>	<u>\$ (420,848)</u>

The \$1,694,776 reported as deferred outflows of resources related to pensions resulting from OHA contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2019.

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE M - EMPLOYEE BENEFITS (Continued)

Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Fiscal Year Ending June 30,	Amount
2019	\$ (1,173,197)
2020	(1,746,187)
2021	(1,468,428)
2022	(574,730)
2023	(10,965)
	\$ (4,973,507)

Actuarial Assumptions

The total pension liability in the June 30, 2017 actuarial valuation was determined using the following actuarial assumptions adopted by the Board of Trustees of the Employees' Retirement System of the State of Hawai'i, on December 12, 2016, based on the most recent experience study dated July 5, 2016:

Inflation	2.50%	
Payroll growth rate	3.50%	
Investment rate of return	7.00% compounded annually including inflation	

There were no changes to ad hoc postemployment benefits including cost of living allowances.

Post-retirement mortality rates are based on the 2016 Public Retirees of Hawaii mortality table with adjustments based on generational projections of the BB projection table for 2016 and full generational projections in future years. Pre-retirement mortality rates are based on multiples of the RP-2014 mortality table based on the occupation of the member.

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

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NOTES TO FINANCIAL STATEMENTS
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NOTE M - EMPLOYEE BENEFITS (Continued)

The target allocation and best estimates of geometric real rates of return for each major asset class are summarized in the following table:

<u>Strategic Allocation (Risk-Based Classes)</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Broad growth	63.0%	5.80%
Principal protection	7.0%	0.02%
Real return	10.0%	3.60%
Crisis risk offset	<u>20.0%</u>	3.10%
Total investments	<u>100.0%</u>	

Discount Rate

The discount rate used to measure the net pension liability was 7.00%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that contributions from the State will be made at statutorily required rates, actuarially determined. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all period of projected benefit payments to determine the total pension liability.

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

The following presents OHA's proportionate share of the net pension liability calculated using the discount rate of 7.00%, as well as what OHA's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.00%) or 1-percentage point higher (8.00%) than the current rate:

	<u>1 percent decrease (6.00%)</u>	<u>Current discount rate (7.00%)</u>	<u>1 percent increase (8.00%)</u>
OHA's proportionate share of the net pension liability	\$ 40,804,589	\$ 31,892,391	\$ 23,786,984

Pension Plan Fiduciary Net Position

The pension plan's fiduciary net position is determined on the same basis used by the pension plan. The ERS financial statements are prepared using the accrual basis of accounting under which expenses are recorded when the liability is incurred, and revenues are recorded in the accounting period in which they are earned and become

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE M - EMPLOYEE BENEFITS (Continued)

measurable. Employer and member contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. Investment purchases and sales are recorded as of their trade date. Administrative expenses are financed exclusively with investment income.

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

Payables to the Pension Plan

At June 30, 2018, the amount payable to the ERS was \$131,748.

(2) ***Postemployment Health Care and Life Insurance Benefits***

Plan Description

The State provides certain health care and life insurance benefits to all qualified employees. Pursuant to Act 88, SLH 2001, the State contributes to the EUTF, an agent multiple-employer defined benefit plan that replaced the Hawaii Public Employees Health Fund effective July 1, 2003. The EUTF was established to provide single delivery system of health benefits for state and county workers, retirees, and their dependents.

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

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

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

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
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NOTE M - EMPLOYEE BENEFITS (Continued)

Members Covered by Benefit Terms

At July 1, 2017, the State's plan members covered by benefit terms consisted of the following:

Inactive plan members or beneficiaries currently receiving benefits	35,374
Inactive plan members entitled to but not yet receiving benefits	8,124
Active plan members	<u>50,101</u>
 Total plan members	 <u>93,599</u>

Contributions

Contributions are governed by HRS Chapter 87A and may be amended through legislation. Contributions to the EUTF from OHA were \$1,881,695 for the year ended June 30, 2018. OHA is required to make all contributions for members.

OPEB Liabilities, OPEB Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB

Measurement of the actuarial valuation of the OPEB liability, OPEB expense, and deferred outflows of resources and deferred inflows of resources related to OPEB is made for the State as a whole and is not separately computed for the individual state departments and agencies such as the OHA. The State allocates the OPEB liability, OPEB expense, and deferred outflows of resources and deferred inflows of resources related to OPEB to the various departments and agencies based upon a systematic methodology. Additional disclosures and required supplementary information stipulated by Statement No. 75 pertaining to the State's net OPEB liability, OPEB expense, and deferred outflows of resources and deferred inflows of resources related to OPEB can be found in the State's CAFR.

At June 30, 2018, OHA reported a net OPEB liability of \$33,325,299. The net OPEB liability was measured as of July 1, 2017, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of that date.

At June 30, 2018, OHA's proportionate share of the State's net OPEB liability was 0.36%.

There were no changes between the measurement date, July 1, 2017, and the reporting date, June 30, 2018, that are expected to have a significant effect on OHA's proportionate share of the State's net OPEB liability.

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
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NOTE M - EMPLOYEE BENEFITS (Continued)

For the year ended June 30, 2018, OHA recognized OPEB expense of \$51,868. At June 30, 2018, OHA reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
OHA's contributions subsequent to the measurement date	\$ 1,881,695	\$ --
Net difference between projected and actual earnings on OPEB plan investments	--	(38,288)
	\$ 1,881,695	\$ (38,288)

The \$1,881,695 reported as deferred outflows of resources related to OPEB resulting from OHA's contribution subsequent to the measurement date will be recognized as a reduction of the net OPEB liability in the year ending June 30, 2019. The net difference between projected and actual earnings on OPEB plan investments will be recognized in OPEB expense as follows:

Fiscal Year Ending June 30,	Amount
2019	\$ (9,572)
2020	(9,572)
2021	(9,572)
2022	(9,572)
	\$ (38,288)

Actuarial Assumptions

The total OPEB liability in the July 1, 2017 actuarial valuation was determined using the following actuarial assumptions adopted by the Board of Trustees of the EUTF, on January 8, 2018, based on the experience study covering the five year period ended June 30, 2015:

Inflation	2.50%
Payroll growth rate	3.50% to 7.00%, including inflation
Investment rate of return	7.00%

Healthcare cost trend rates:

PPO*	Initial rates of 6.60%, 6.60%, and 9.00%; declining to a rate of 4.86% after 14 years
HMO*	Initial rate of 9.00%; declining to a rate of 4.86% after 14 years

Office of Hawaiian Affairs, State of Hawai'i
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NOTE M - EMPLOYEE BENEFITS (Continued)

Part B & Base Monthly Contribution (BMC)	Initial rates of 2.00% and 5.00%; declining to a rate of 4.70% after 14 years
Dental	3.50%
Vision	2.50%
Life insurance	0.00%

* Blended rates for medical and prescription drug.

Mortality rates are based on system-specific mortality tables utilizing scale BB to project generational morality improvement.

The long-term expected rate of return on OPEB plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of OPEB plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

The target allocation and best estimates of arithmetic real rates of return for each asset class are summarized in the following table:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-term Expected Real Rate of Return</u>
U.S. equity	19.00%	5.50%
International equity	19.00%	7.00%
U.S. microcap	7.00%	7.00%
Private equity	10.00%	9.25%
REITs	6.00%	5.85%
Core real estate	10.00%	3.80%
Global options	7.00%	5.50%
Core bonds	3.00%	0.55%
Long treasuries	7.00%	1.90%
Trend following	7.00%	1.75%
TIPS	5.00%	0.50%
	<u>100.00%</u>	

Single Discount Rate

The discount rate used to measure the net OPEB liability was 7.00%, based on the expected rate of return on OPEB plan investments of 7.00% and the municipal bond rate of 3.56% (based on the daily rate closet to but not later than the measurement date of the Fidelity "20-year Municipal GO AA index"). Beginning with the fiscal year

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June 30, 2018

NOTE M - EMPLOYEE BENEFITS (Continued)

2019 contribution, the State's funding policy is to pay the recommended actuarially determined contribution, which is based on layered, closed amortization periods. Based on those assumptions, the OPEB plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive plan members. Therefore, the long-term expected rate of return on OPEB plan investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

OPEB Plan Fiduciary Net Position

The OPEB plan's fiduciary net position has been determined on the same basis used by the OPEB plan. The EUTF's financial statements are prepared using the accrual basis of accounting under which revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the timing of the cash flows. Employer contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. Investment purchases and sales are recorded on a trade-date basis. Administrative expenses are financed exclusively with investment income.

There were no significant changes after the report measurement date. Detailed information about the OPEB plan's fiduciary net position is available in the separately issued EUTF financial report. EUTF's complete financial statements are available at <http://eutf.hawaii.gov>.

Changes in OHA's Proportionate Share of the State's Net OPEB Liability

The following table represents a schedule of changes in OHA's proportionate share of the State's net OPEB liability. The ending balances are as of the measurement date, July 1, 2017.

	<u>Total OPEB Liability</u>	<u>Plan Fiduciary Net Position</u>	<u>Net OPEB Liability</u>
Balance at June 30, 2017	\$ 34,683,659	\$ 1,730,263	\$ 32,953,396
Changes for the fiscal year:			
Service cost	510,265	--	510,265
Interest on the total OPEB liability	1,549,389	--	1,549,389
Contributions - employer	--	1,523,372	(1,523,372)
Net investment income	--	152,522	(152,522)
Benefit payments	(766,044)	(766,044)	--
Administrative expense	--	(391)	391
Other	--	12,248	(12,248)
Net changes	<u>1,293,610</u>	<u>921,707</u>	<u>371,903</u>
Balance at June 30, 2018	\$ <u>35,977,269</u>	\$ <u>2,651,970</u>	\$ <u>33,325,299</u>

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE M - EMPLOYEE BENEFITS (Continued)

Sensitivity of OHA's Proportionate Share of the State's Net OPEB Liability to Changes in the Discount Rate and Healthcare Cost Trend Rates

The following table represents OHA's proportionate share of the State's net OPEB liability calculated using the discount rate of 7.00%, as well as what OHA's net OPEB liability would be if it were calculated using a discount rate that is one percentage point lower (6.00%) or one percentage point higher (8.00%) than the current discount rate:

	1% Decrease (6.00%)	Discount Rate (7.00%)	1% Increase (8.00%)
Net OPEB Liability	\$ <u>39,113,322</u>	\$ <u>33,325,299</u>	\$ <u>28,641,586</u>

The following table represents OHA's proportionate share of the State's net OPEB liability calculated using the assumed healthcare cost trend rate, as well as what OHA's net OPEB liability would be if it were calculated using a trend rate that is one percentage point lower or one percentage point higher than the current healthcare cost trend rate:

	1% Decrease	Healthcare Cost Trend Rates	1% Increase
Net OPEB Liability	\$ <u>28,371,902</u>	\$ <u>33,325,299</u>	\$ <u>39,577,043</u>

- (3) ***Deferred Compensation*** - The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, which is available to all State employees (excluding part-time, temporary, and casual/seasonal), permits employees to defer a portion of their compensation until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but does have the duty of due care that would be required of an ordinary prudent investor. Accordingly, the assets and liabilities of the State's deferred compensation plan are not reported in the State's nor OHA's financial statements.

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

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NOTES TO FINANCIAL STATEMENTS
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NOTE M - EMPLOYEE BENEFITS (Continued)

- (5) ***Hi'ilei Aloha LLC and Ho'okele Pono LLC Retirement Plan*** - Hi'ilei Aloha LLC and Ho'okele Pono LLC offer 401(k) profit sharing plans. Employees become eligible upon six (6) months of employment and may contribute to the plan to the extent allowed by law. Hi'ilei Aloha LLC and Ho'okele Pono LLC match employees' contributions up to a specified percentage of salary. For the year ended December 31, 2017, contribution expense amounted to \$68,570 and \$3,557 for Hi'ilei Aloha LLC and Ho'okele Pono LLC, respectively.
- (6) ***Sick Leave*** - Accumulated sick leave amounted to approximately \$3,228,000 as of June 30, 2018. Sick leave accumulates at the rate of 14 hours for each month of service, as defined, without limit. Sick pay can be taken only in the event of illness and is not convertible to pay upon termination of employment. Employees who retire or leave government service in good standing with sixty or more unused sick days are entitled to additional service credit in the ERS. Accordingly, no liability for sick leave is recorded in the accompanying basic financial statements.

NOTE N - NON-IMPOSED EMPLOYEE FRINGE BENEFITS

Payroll fringe benefit costs for employees of OHA funded by state appropriations (general fund) are assumed by the State and are not charged to OHA's operating funds. These costs, totaling \$554,409 for the year ended June 30, 2018, have been reported as revenues and expenditures of OHA's general fund.

NOTE O - RISK MANAGEMENT AND CONTINGENT LIABILITIES

- (1) ***Workers' Compensation and Other Self-Insurance Liabilities*** - As a state agency, OHA participates in the state's risk management program. The State maintains certain insurance coverage to satisfy bond indenture agreements, cover liability and property exposures as well as for other purposes, but is substantially self-insured for many perils. The State records a liability for risk financing and insurance related losses, including incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies. In addition to the state coverage, OHA purchases public officials and employment practices liability insurance, bankers' professional liability insurance, property coverage and general and excess liability coverage for property owned or required by lease agreements entered into.

The State is self-insured for workers' compensation. Accordingly, OHA is liable for workers' compensation claims filed by its employees to the extent not otherwise covered by insurance. Liabilities for workers' compensation claims are established if information indicates that it is probable that liabilities have been incurred and the amount of those claims can be reasonably estimated. Beginning in fiscal year 2013 OHA began purchasing a third party workers' compensation policy, but was still liable for outstanding claims related to periods in which OHA was self-insured. As of June 30, 2018, there are no outstanding claims for which OHA is liable.

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NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE O - RISK MANAGEMENT AND CONTINGENT LIABILITIES (Continued)

- (2) **Quiet Title Litigation** - Under HRS 669-3(e), OHA is required to be joined as a defendant in any action to quiet title to an interest in kuleana if an owner of an inheritable interest in the kuleana died intestate or partially intestate and without any heirs or other takers. OHA typically responds in these actions by answering the complaint, seeking discovery and information, reviewing the evidence to determine whether OHA has an escheat interest in the kuleana, and participating in the litigation as necessary. As of June 30, 2018, OHA is currently evaluating its potential interest in 10 quiet title actions. OHA continues to monitor this action for any potential escheated interest.
- (3) **Litigation** - OHA is a party to legal proceedings and claims that arise in the ordinary course of business. Although occasional adverse decisions (or settlements) may occur, OHA believes that the final disposition of such matters will not have a material adverse effect on the financial position or changes in the financial position of OHA.

NOTE P - RELATED PARTY TRANSACTIONS

OHA receives a portion of ceded land revenues from various state agencies. In June 2006, Act 178 was passed which laid the foundation for a quarterly guaranteed ceded land revenue stream of \$3,775,000, totaling \$15,100,000 per year. The total received during the year ended June 30, 2018 was \$15,132,397 of which \$15,100,000 was included as public land trust revenue in the PLTF. The remaining \$32,397 was included as due to the State of Hawai'i in the PLTF.

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

During 2017, OHA made payments of \$400,000 to Hi'ilei Aloha LLC and Ho'okele Pono LLC. These payments were reported as transfers in the fund financial statements. The resulting net transfer out of \$180,600 on the statement of activities is due to the difference in reporting period for the proprietary funds noted in Note A.

In December 2008, OHA and DHHL mutually agreed to a collaborative financing arrangement to provide funds for DHHL's use in the planning, design and construction of infrastructure for homesteads for native Hawaiians on properties owned and controlled by DHHL, in fulfillment of OHA's mission to better the conditions of Native Hawaiians. OHA's obligation under the agreement was to pay DHHL an annual fee not to exceed \$3,000,000 for 30 years.

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NOTES TO FINANCIAL STATEMENTS
June 30, 2018

NOTE P - RELATED PARTY TRANSACTIONS (Continued)

In August 2017, DHHL notified OHA about the refinancing of its debt service bonds. OHA's contractual obligation remains at \$3,000,000 annually, however, the maturity is shortened by approximately 7 years. As a result of refinancing, funds held in an account for insurance requirements were released and applied to lower OHA's payment for the year ended June 30, 2018. OHA remitted \$1,987,220 to DHHL and amounts have been presented as beneficiary advocacy expenditures in the PLTF; governmental funds - statement of revenues, expenditures, and changes in fund balances. As of June 30, 2018, OHA has committed \$29,516,390 of its fund balances for future payments to DHHL.

NOTE Q - ADOPTION OF NEW ACCOUNTING PRINCIPLE

OHA has adopted the applicable requirements of GASB 75. The cumulative effect of applying the requirements of GASB 75 resulting in a reduction to beginning net position by \$31,430,024 as of June 30, 2017, which is summarized as follows:

	Amount
Net position at June 30, 2017, as previously reported	\$ 582,820,058
Cumulative effect of applying GASB 75:	
Net OPEB liability at June 30, 2017	(32,953,396)
Deferred outflows of resources - employer contributions paid during the fiscal year ended June 30, 2017	1,523,372
Net position at June 30, 2017, as restated	\$ 551,390,034

OHA management concluded that it was not practical to determine the amounts of all applicable deferred inflows of resources and deferred outflows of resources related to OPEB as of June 30, 2017. Accordingly, as permitted under the provisions of GASB 75, the restatement of beginning balances as of June 30, 2017 only includes deferred outflows of resources for OPEB contributions by OHA made subsequent to the measurement date of the beginning net OPEB liability (June 30, 2016) but before June 30, 2017.

Office of Hawaiian Affairs, State of Hawai'i
SCHEDULE OF OHA'S PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
Last Ten Fiscal Years

Measurement Period Ended	Proportion of the Net Pension Liability	Proportionate Share of the Net Pension Liability	Covered Payroll	Proportionate Share of the Net Pension Liability as a %age of Covered Payroll	Plan Fiduciary Net Position as a %age of the Total Pension Liability
June 30, 2018	0.41%	\$ 31,892,391	\$ 9,008,205	354.04%	54.80%
June 30, 2017	0.42%	\$ 32,669,717	\$ 10,027,875	325.79%	51.28%
June 30, 2016	0.43%	\$ 21,773,504	\$ 10,033,406	217.01%	62.42%
June 30, 2015	0.42%	\$ 20,332,122	\$ 9,966,952	204.00%	63.92%
June 30, 2014	0.43%	\$ 22,136,982	\$ 9,270,781	238.78%	57.96%

Note: GASB 67 was implemented in 2014. This schedule is being built prospectively. Ultimately, ten years of data will be presented.

Office of Hawaiian Affairs, State of Hawai'i
SCHEDULE OF CONTRIBUTIONS (PENSION)
Last Ten Years *

Year Ended	Statutorily Required Contribution	Contributions in Relation to Statutorily Required Contributions	Contribution Deficiency (Excess)	Covered Payroll	Contributions as a %age of Covered Payroll
June 30, 2018	\$ 1,694,776	\$ 1,621,477	\$ 73,299	\$ 9,008,205	18.81%
June 30, 2017	\$ 1,633,906	\$ 1,633,906	\$ --	\$ 10,027,875	16.29%
June 30, 2016	\$ 1,705,768	\$ 1,634,903	\$ 70,865	\$ 10,033,406	17.00%
June 30, 2015	\$ 1,644,547	\$ 1,644,547	\$ --	\$ 9,966,952	16.50%
June 30, 2014	\$ 1,483,325	\$ 1,483,325	\$ --	\$ 9,270,781	16.00%

* GASB 67 was implemented in 2014. This schedule is being built prospectively. Ultimately, ten years of data will be presented.

Office of Hawaiian Affairs, State of Hawai'i
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
REQUIRED BY GASB STATEMENT NO. 68
Year Ended June 30, 2018

There were no changes of assumptions or other inputs that significantly affected the measurement of the total pension liability since the measurement period June 30, 2016.

Amounts reported in the schedule of the proportionate share of the net pension liability as of the measurement period ended June 30, 2016 (fiscal year ended June 30, 2017) were significantly impacted by the following changes of actuarial assumptions:

- The investment return assumption decreased from 7.65% to 7.00%
- Mortality assumptions were modified to assume longer life expectancies as well as to reflect continuous mortality improvement

Prior to the measurement period ended June 30, 2016 (fiscal year ended June 30, 2017), there were no other factors, including the use of different assumptions that significantly affect trends reported in these schedules.

Office of Hawaiian Affairs, State of Hawai'i
SCHEDULE OF CHANGES IN NET OPEB LIABILITY AND RELATED RATIOS
Year Ended June 30, 2018*

Total OPEB liability	
Service cost	\$ 510,265
Interest on the total OPEB liability	1,549,389
Benefit payments	<u>(766,044)</u>
Net change in total OPEB liability	1,293,610
Total OPEB liability - Beginning	<u>34,683,659</u>
Total OPEB liability - Ending	\$ <u>35,977,269</u>
Plan fiduciary net position	
Contributions - employer	\$ 1,523,372
Net investment income	152,522
Benefit payments	(766,044)
Administrative expense	(391)
Other	<u>12,248</u>
Net change in plan fiduciary net position	921,707
Plan fiduciary net position - Beginning	<u>1,730,263</u>
Plan fiduciary net position - Ending	\$ <u>2,651,970</u>
Net OPEB liability	\$ <u>33,325,299</u>
Plan fiduciary net position as a percentage of the total OPEB liability	7.37%
Covered-employee payroll	\$ 9,008,205
Net OPEB Liability as a Percentage of Covered-employee Payroll	369.94%

* The schedule is intended to present information for ten years for each respective fiscal year. Additional years will be built prospectively as information becomes available.

Office of Hawaiian Affairs, State of Hawai'i
SCHEDULE OF CONTRIBUTIONS (OPEB)
Last Ten Years*

Year Ended	Actuarially Determined Contribution (ADC)	Contributions in Relation to the ADC	Contribution Deficiency (Excess)	Covered Payroll	Contributions as a %age of Covered Payroll
June 30, 2018	\$ 2,123,100	\$ 1,881,695	\$ 241,405	\$ 9,008,205	23.57%
June 30, 2017	\$ 1,523,372	\$ 1,523,372	\$ --	\$ 10,027,875	15.19%

* The data is presented for the years for which information is available.

Office of Hawaiian Affairs, State of Hawai‘i
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
REQUIRED BY GASB STATEMENT NO. 75
Year Ended June 30, 2018

NOTE A - SIGNIFICANT METHODS AND ASSUMPTIONS

An actuarial valuation of OHA’s liability associated with other postemployment benefits other than pension provided through the EUTF is performed as of July 1 of each odd-numbered year (e.g. July 1, 2015). This actuarial valuation serves as the basis for developing the annual required contributions (“ARC”) for the two fiscal years which begin one year after the actuarial valuation date. For example, the ARC for the fiscal years ended June 30, 2018 and 2017 were developed from the actuarial valuation as of July 1, 2015. Beginning July 1, 2017, the EUTF will be completing an actuarial valuation on an annual basis.

The following summarizes the significant methods and assumptions used to determine the actuarially determined contribution for the fiscal year ended June 30, 2018:

Actuarial valuation date	July 1, 2015
Actuarial cost method	Entry Age Normal
Amortization method	Level percent, closed
Equivalent single amortization period	19.9
Asset valuation method	Market
Inflation rate	3.00%
Investment rate of return	7.00%
Payroll growth	3.50%
Healthcare cost trend rates	
PPO	Initial rate of 9%, declining to a rate of 5% after 8 years
HMO	Initial rate of 7%, declining to a rate of 5% after 8 years
Part B	Initial rate of 3% for the first two years, 5% thereafter
Dental	4.00%
Vision	3.00%
Life Insurance	0.00%

The actuarial valuation as of July 1, 2009, which was used to develop the ARC for fiscal year 2011 and 2012, included a reduction to the discount rate used from the prior valuation. The discount rate changed from a blended discount rate of 7% - 8% to 7%. This resulted in an overall increase to the actuarially determined OPEB liability and the ARC.

There were no other factors that significantly affected trends in the amounts reported in the schedule of changes in the net OPEB liability and related ratios or the schedule of contributions (OPEB).

Hi'ilei Aloha LLC and Sub-Entities

(Nonprofit Organizations)

**A component unit for financial reporting purposes of the
Office of Hawaiian Affairs**

Consolidated Financial Statements

December 31, 2018 and 2017

Hi'ilei Aloha LLC and Sub-Entities
(Nonprofit Organizations)
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Independent Auditor's Report

To the Member and Managers
Hi'ilei Aloha LLC and Sub-Entities

Report on the Financial Statements

I have audited the accompanying consolidated financial statements of Hi'ilei Aloha LLC and its sub-entities (all nonprofit organizations), a component unit of the Office of Hawaiian Affairs, State of Hawai'i, which comprise the consolidated statements of net position as of December 31, 2018 and 2017, and the related consolidated statements of revenues, expenses, and changes in net position, and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

My responsibility is to express an opinion on these consolidated financial statements based on my audits. I conducted my audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Hi'ilei Aloha LLC and its sub-entities as of December 31, 2018 and 2017, and the changes in their financial position and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter – Omission of Management's Discussion and Analysis

Management has omitted management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. My opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, I have also issued my report dated August 30, 2019 on my consideration of Hi'ilei Aloha LLC and its sub-entities's internal control over financial reporting and on my tests of their compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Hi'ilei Aloha LLC and its sub-entities's internal control over financial reporting and compliance.



Honolulu, Hawai'i
August 30, 2019

Hi'ilei Aloha LLC and Sub-Entities
(Nonprofit Organizations)
Consolidated Statements of Net Position
December 31, 2018 and 2017

Assets	2018	2017
Current Assets		
Cash	\$ 3,228,745	\$ 2,931,809
Accounts receivable, net of allowance for doubtful accounts of \$15,000 in 2018 and \$2,825 in 2017	383,552	212,382
Receivable - Ho'okipaipai LLC	61,931	34,942
Inventories	132,425	123,040
Prepaid expenses	187,060	130,132
Total current assets	3,993,713	3,432,305
Cash Restricted for Property Acquisition	15,025	97,046
Capital Assets		
Buildings and improvements	3,445,360	3,104,262
Furniture, fixtures and equipment	923,806	926,734
Vehicles	227,402	244,742
	4,596,568	4,275,738
Less accumulated depreciation	(2,489,934)	(2,197,309)
	2,106,634	2,078,429
Land	13,072,711	13,003,821
Total capital assets	15,179,345	15,082,250
Other Assets - lease security deposit	10,394	9,994
Total assets	\$ 19,198,477	\$ 18,621,595
Liabilities and Net Position		
Current Liabilities		
Accounts payable	\$ 148,216	\$ 168,852
Accrued liabilities	309,510	329,051
Deferred revenue	89,587	39,986
Total current liabilities	547,313	537,889
Net Position		
Unrestricted	3,456,794	2,904,410
Restricted - property acquisition	15,025	97,046
Net investment in capital assets	15,179,345	15,082,250
Total net position	18,651,164	18,083,706
Total liabilities and net position	\$ 19,198,477	\$ 18,621,595

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

Hi'ilei Aloha LLC and Sub-Entities
(Nonprofit Organizations)
Consolidated Statements of Revenues, Expenses, and Changes in Net Position
Years Ended December 31, 2018 and 2017

	2018	2017
Operating revenue and support		
Sales		
Gift store and food service	\$ 2,324,790	\$ 2,171,221
Cost of sales, including gift store and food service departmental expenses	<u>(2,450,832)</u>	<u>(2,307,154)</u>
Gross margin (loss)	(126,042)	(135,933)
Admissions and tours	4,671,269	4,344,144
Shuttle service	272,563	240,932
Special events and other	189,116	58,906
Less bad debt expense	<u>(23,726)</u>	<u>(2,254)</u>
Total net sales	<u>4,983,180</u>	<u>4,505,795</u>
Capacity building consulting and training services	552,026	479,684
Parking, rental and other	368,000	403,120
Audio visual production	21,583	97,907
Grants and donations	149,112	81,069
Flood insurance recoveries, net of losses incurred	<u>34,286</u>	<u>49,935</u>
Other revenue and support	<u>1,125,007</u>	<u>1,111,715</u>
Total operating revenue and support	<u>6,108,187</u>	<u>5,617,510</u>
Operating expenses		
Program Services - Hi'ipaka LLC		
Cultural	854,415	831,476
Botanical	1,401,788	1,249,379
Preservation and stewardship	1,320,104	1,279,688
Program Services - Hi'ilei LLC: capacity building	<u>787,577</u>	<u>626,460</u>
	4,363,884	3,987,003
Management and general	1,866,143	1,490,995
Fundraising	<u>18,502</u>	<u>17,300</u>
Total operating expenses	<u>6,248,529</u>	<u>5,495,298</u>
Operating income (loss)	(140,342)	122,212
Nonoperating activity		
Grants from member - Office of Hawaiian Affairs	<u>707,800</u>	<u>162,800</u>
Change in net position	567,458	285,012
Net position		
Beginning of year	<u>18,083,706</u>	<u>17,798,694</u>
End of year	<u>\$ 18,651,164</u>	<u>\$ 18,083,706</u>

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

Hi'ilei Aloha LLC and Sub-Entities
(Nonprofit Organizations)
Consolidated Statements of Cash Flows
Years Ended December 31, 2018 and 2017

	2018	2017
Cash flows from operating activities		
Receipts from customers, grantors and funders	\$ 8,361,233	\$ 7,862,326
Payments to suppliers, vendors and service providers	(4,423,828)	(3,893,934)
Payments to employees for salaries and benefits	(4,006,460)	(3,652,645)
Insurance recoveries - flood damage	34,286	141,584
Net cash provided by (used in) operating activities	<u>(34,769)</u>	<u>457,331</u>
Cash flows from capital and related financing activities		
Acquisitions of property and equipment	<u>(465,258)</u>	<u>(470,806)</u>
Net cash used in capital and related financing activities	<u>(465,258)</u>	<u>(470,806)</u>
Cash flows from noncapital financing activities		
Grants from the Office of Hawaiian Affairs	<u>700,000</u>	<u>162,800</u>
Cash provided by noncapital financing activities	<u>700,000</u>	<u>162,800</u>
Cash flows from investing activities		
Advances to Ho'okipaipai LLC	(55,000)	(34,942)
Repayments of advances to Ho'okipaipai LLC	69,942	-
Net cash provided by (used in) noncapital financing activities	<u>14,942</u>	<u>(34,942)</u>
Increase in cash	214,915	114,383
Cash and cash equivalents		
Beginning of year	<u>3,028,855</u>	<u>2,914,472</u>
End of year	<u>\$ 3,243,770</u>	<u>\$ 3,028,855</u>
Cash and cash equivalents consist of:		
Cash	\$ 3,228,745	\$ 2,931,809
Restricted cash	15,025	97,046
	<u>\$ 3,243,770</u>	<u>\$ 3,028,855</u>
Reconciliation of operating income (loss) to net cash used in operating activities		
Operating income (loss)	\$ (140,342)	\$ 122,212
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities		
Depreciation of property and equipment	369,209	317,664
Loss (gain) on disposal of equipment	(1,046)	7,967
Donated advertising services	7,800	-
Change in:		
Receivables	(213,101)	9,016
Inventories	(9,385)	(6,033)
Prepaid expenses	(56,928)	(46,018)
Lease security deposit	(400)	-
Accounts payable	(20,636)	42,080
Accrued liabilities	(19,541)	31,862
Deferred revenue	49,601	(21,419)
Net cash provided by (used in) operating activities	<u>\$ (34,769)</u>	<u>\$ 457,331</u>
Schedule of Noncash Investing and Financing Activities		
Grant from the Office of Hawaiian Affairs		
Donated advertising services	\$ 7,800	\$ -

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

Hi'ilei Aloha LLC and Sub-Entities (Nonprofit Organizations) Notes to Consolidated Financial Statements December 31, 2018 and 2017

1. Organization and Summary of Significant Accounting Policies

Hi'ilei Aloha LLC (Company or Hi'ilei) was established on October 1, 2007, for the study, protection, development, enhancement and promotion of Hawaiian culture, resources, values, customs and practices, and for related purposes. The Company is a limited liability company with the Office of Hawaiian Affairs (OHA) as its sole member. The Company's governing body consists of three "Managers" who are senior management officials of OHA. In 2019, OHA approved amending the Company's Operating Agreement to state that the Managers shall not be OHA employees.

In December 2007, the Company created Hi'ipaka LLC, a Hawai'i limited liability company, as a sub-entity whose mission is to preserve and perpetuate the human, cultural and natural resources of Waimea Valley, O'ahu for future generations through education and stewardship. In January 2008, the Company created Hi'ipoi LLC, a Hawai'i limited liability company, as a sub-entity whose primary purpose is to foster cultural, educational, and business opportunities related to taro farming and the production of poi and taro products, primarily in West Kauai. Hi'ipoi was dissolved in 2017. In May 2010, the Company created Hi'ikualono LLC, a Hawai'i limited liability company, as a sub-entity whose primary purpose is to preserve Hawaiian culture and natural resources through land stewardship activities; this entity has been inactive since formation. In 2019, OHA approved a plan to dissolve Hi'ikualono LLC.

Revenues are generated primarily from sales of admission to Waimea Valley and the activities and events (hikes, education programs, tours, gift and food service sales, etc.) held there. Revenues are also generated by providing capacity building services under contracts and grants. Hi'ilei also receives grants from OHA.

Based on its relationship with OHA, the Company is considered to be a component unit of OHA for financial reporting purposes.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, Hi'ipaka LLC (Hi'ipaka), and, through its dissolution, Hi'ipoi LLC (Hi'ipoi)(collectively the Companies). All significant inter-company transactions and balances have been eliminated.

Basis of Accounting

The consolidated financial statements of the Companies have been prepared on the accrual basis of accounting consistent with enterprise fund accounting and accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB).

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Hi'ilei Aloha LLC and Sub-Entities

(Nonprofit Organizations)

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Cash and Cash Equivalents

The Companies consider all highly liquid debt investments with original maturities of three months or less when purchased to be cash equivalents.

Concentrations of Credit Risk

The Companies maintain separate legal entity cash accounts with a financial institution in the State of Hawai'i. Balances are insured up to \$250,000 per account holder by the Federal Deposit Insurance Corporation (FDIC). Hi'ipaka's bank account balances were in excess of \$250,000 at December 31, 2018 and 2017 and amounted to \$3,060,975 and \$2,790,798, respectively.

Receivables

Accounts receivable are stated at the amount management expects to collect from outstanding balances. The carrying amount of accounts receivable is reduced by an allowance for doubtful accounts that reflects management's best estimate of the amounts that will not be collected based upon prior experience, a review of delinquent accounts, and management's assessment of the credit worthiness of its customers. Management considers accounts past due when they are outstanding beyond 60 days with no payment. Interest is generally not charged on past due accounts. Balances that are still outstanding after management has used reasonable collection efforts are written-off through a charge to the allowance account and a credit to accounts receivable. The Companies' allowance for doubtful accounts was \$15,000 and \$2,825 at December 31, 2018 and 2017, respectively, and was established based on a review of specific delinquent accounts.

Inventories

Inventories consist of items held for sale in Hi'ipaka's gift stores and snack shop. Inventories are stated at the lower of cost (first-in, first-out method) or net realizable value.

Capital Assets

Property is stated at cost if purchased. Property transferred to the Company from OHA as part of the Company's formation is stated at OHA's carrying basis. Property purchased with a cost in excess of \$1,000 and a useful life exceeding one year is capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of such assets (5 to 7 years for furniture, fixtures, equipment and vehicles, 5 to 7 years for leasehold improvements, and 10 to 30 years for building and improvements). Expenditures for maintenance, repairs, restoration, and minor renewals are charged to expense; expenditures for betterments are capitalized. Property retired or otherwise disposed of is removed from the appropriate asset and related accumulated depreciation accounts. Gains and losses from the disposition of assets are reflected in current operations.

Impairment Review

Long-lived assets such as property and equipment are reviewed for impairment when events or circumstances indicate that their carrying value may not be recoverable. Estimated undiscounted future cash flows are used to determine if an asset is impaired, in which case the asset's carrying value would be reduced to fair value. No impairment charges have been recorded.

Revenue Recognition

Hi'ipaka's admission and tours revenues are recognized based on the date of admission to Waimea Valley. Hi'ipaka's gift and food service sales are recognized at the time of sale as sales returns are inconsequential. Revenue from special events and venue rentals are recognized when the event

Hi'ilei Aloha LLC and Sub-Entities

(Nonprofit Organizations)

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

occurs. Capacity building consulting and training services provided by Hi'ilei are recognized as costs are incurred or upon final completion of the contracted service. Revenues are recognized net of all discounts and allowances, including bad debts if any. Contributions are recognized as support in the period in which eligibility requirements imposed by the donor have been met, which is generally when received. Amounts received prior to revenue recognition are recorded as deferred revenue.

Expenses

The costs of conducting programs and other services have been summarized on a functional basis in the statements of revenues, expenses, and changes in net position. Hi'ipaka's program service expenses consist of cultural, botanical and the preservation and stewardship of Waimea Valley. Cultural expenses include various programs and educational activities. Botanical expenses include all activities related to the flora and fauna of the Valley. Preservation and stewardship expenses include all activities pertaining to maintaining, restoring and improving the physical infrastructure and safety of the Valley. Hi'ipaka also incurs costs related to its gift stores, restaurant and snack shop, which serve to support its programmatic initiatives and enhance the visitor experience. These costs include cost of goods sold, salaries and other departmental expenses. Hi'ilei's program service expenses include costs associated with community capacity building. Management and general expenses represent those costs associated with oversight, business management, general recordkeeping, budgeting, advertising and other related administrative activities. Fundraising represents costs associated with obtaining grants and donations. Certain costs have been allocated between programs and supporting services based on various methodologies, including relative personnel costs or other estimates.

When an expense is incurred for purposes for which both restricted and unrestricted resources are available to pay the expenses, resources are generally applied proportionate to the benefit realized. For instances in which such a determination is not feasible or if there are cost compliance issues, unrestricted resources are applied first.

Operating and Nonoperating Revenues and Expenses

Operating revenues and expenses result from the activities described above. Nonoperating activities relate to grants and other amounts paid by OHA to the Company and its sub-entities; and OHA's grants to its sub-entity Ho'okele Pono LLC and Ho'okele Pono's sub-entity Ho'okīpaipai LLC, which may pass through the Company to the sub-entities as an administrative accommodation. These grants are recognized when received or paid. Donations received that are restricted for capital asset acquisition are reflected as capital contributions and reported separately from operating and nonoperating activity.

Advertising Costs

The cost of advertising production is expensed the first time the advertising takes place. Total advertising expense amounted to \$378,716 and \$295,419 in 2018 and 2017, respectively.

General Excise Tax

General excise tax collected from customers is reflected in revenues. General excise taxes paid to the State of Hawai'i is reflected in cost of sales and other expenses.

Hi'ilei Aloha LLC and Sub-Entities
(Nonprofit Organizations)
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Income Taxes

The Company and Hi'ipaka have both received determination letters from the Internal Revenue Service (IRS) that their stated purposes are tax-exempt under Section 501(c)(3) of the Internal Revenue Code. Accordingly, the Company and Hi'ipaka are exempt from federal income taxes, except on unrelated business income. The Company and Hi'ipaka each file form 990 with the IRS.

The Companies adhere to generally accepted accounting principles (GAAP) pertaining to uncertain tax positions. Those principles call for uncertain tax positions to be recognized in the financial statements only if those positions are more likely than not to be sustained upon regulatory examination. Management is not aware of any uncertain tax positions taken on previously filed tax returns. Such tax returns are generally open for examination by the IRS until the statute of limitations (three years) expires.

Reclassifications

Reclassifications have been made to certain amounts presented in the 2017 financial statements to conform with the 2018 presentation. These reclassifications did not affect the change in net position as previously reported.

Subsequent Events

Management has reviewed and considered whether events occurring after year end should be reflected or disclosed in these financial statements. The date through which this review was conducted was August 30, 2019, the date the financial statements were available to be issued.

2. Retirement Plan

The Companies maintain a 401(k) profit sharing plan. Employees become eligible upon six months of employment and may contribute to the plan to the extent allowed by law. Under the plan, the Companies match employees' contributions up to 4% of salary. Contribution expense amounted to \$67,850 and \$68,570 for the years ended December 31, 2018 and 2017.

3. Restricted Assets and Lease Agreement

In 2016, Hi'ipaka commenced a process to acquire a real estate parcel adjacent to its Waimea Valley property. This process culminated in 2019 with the acquisition of the property. Donations from the community of \$119,687, net of fundraising expenses, were raised for this purpose in 2016. State and City grants were also received in 2019 to help fund the acquisition. An unrelated third party nonprofit organization held title to the property pending completion of the transaction. The Company had entered into a lease agreement with the title holder, with monthly payments of \$2,000 beginning February 2017 (\$22,000 paid in 2017, and \$12,000 paid in 2018). Donated funds restricted for this transaction have been reflected as restricted net position in the statements of net position.

Hi'ilei Aloha LLC and Sub-Entities
(Nonprofit Organizations)
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

4. Capital Assets

Capital asset activity for the years ended December 31, 2018 and 2017 was as follows:

	Balance January 1, 2018	Additions	Deductions	Balance December 31, 2018
Capital assets not depreciated:				
Land	\$ 13,003,821	\$ 68,890	\$ -	\$ 13,072,711
Total capital assets not depreciated	13,003,821	68,890	-	13,072,711
Capital assets being depreciated				
Buildings and improvements	3,104,262	341,098	-	3,445,360
Furniture, fixtures and equipment	926,734	38,385	(41,313)	923,806
Vehicles	244,742	48,257	(65,597)	227,402
Total capital assets being depreciated	4,275,738	427,740	(106,910)	4,596,568
Less accumulated depreciation	(2,197,309)	(369,209)	76,584	(2,489,934)
Capital assets being depreciated, net	2,078,429	58,531	(30,326)	2,106,634
Total capital assets, net	\$ 15,082,250	\$ 127,421	\$ (30,326)	\$ 15,179,345
	Balance January 1, 2017	Additions	Deductions	Balance December 31, 2017
Capital assets not depreciated:				
Land	\$ 13,003,821	\$ -	\$ -	\$ 13,003,821
Total capital assets not depreciated	13,003,821	-	-	13,003,821
Capital assets being depreciated				
Buildings and improvements	2,810,110	294,152	-	3,104,262
Furniture, fixtures and equipment	863,659	100,639	(37,564)	926,734
Vehicles	168,727	76,015	-	244,742
Total capital assets being depreciated	3,842,496	470,806	(37,564)	4,275,738
Less accumulated depreciation	(1,909,242)	(317,664)	29,597	(2,197,309)
Capital assets being depreciated, net	1,933,254	153,142	(7,967)	2,078,429
Total capital assets, net	\$ 14,937,075	\$ 153,142	\$ (7,967)	\$ 15,082,250

Depreciation expense amounted to \$369,209 and \$317,664 in 2018 and 2017, respectively.

In connection with the initial acquisition of Waimea Valley by OHA for purposes of preserving and protecting the Valley and its historical and archaeological sites and artifacts, a conservation easement covering the Valley was granted to the City and County of Honolulu and the State of Hawai'i. The purpose of the easement is to protect and preserve the Conservation Values (as defined in the easement) of the property, through the rights of inspection, monitoring and similar enforcement actions.

Hi'ilei Aloha LLC and Sub-Entities
(Nonprofit Organizations)
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

In 2017, Hi'ipaka sustained damage from flooding, including the loss of equipment, and water and mud damage to property dwellings. Hi'ipaka received insurance proceeds of \$141,584 to remediate the water and mud damage. Repairs were largely performed by Hi'ipaka personnel. Total cost of repair (excluding in-house labor costs) and loss on damaged equipment amounted to \$91,649. The net gain recorded for accounting purposes of \$49,935 was utilized to replace damaged equipment and partially cover in-house labor costs of repair. In 2018, Hi'ipaka received additional insurance proceeds of \$34,286 for business interruption coverage.

5. Transactions with Member and Sub-Entities

The Company's member, OHA, provides grants to the Company and its sub-entities. Such grants amounted to \$707,800 in 2018 and \$162,800 in 2017. OHA also provides grants to its sub-entity Ho'okele Pono LLC and Ho'okele Pono's sub-entity Ho'okipaipai LLC. Certain of these grants may pass through the Company to the sub-entities as an administrative accommodation.

In 2015, Hi'ipaka and OHA executed an agreement whereby Hi'ipaka sub-leases property located in Hale'iwa, Hawai'i from OHA. The agreement expires March 2033 but can be cancelled by OHA at any time, or by either party upon the failure to successfully re-negotiate payment terms at defined dates. The agreement calls for Hi'ipaka to pay annual lease rent to OHA during OHA's fiscal years ended June 30, 2016, 2017 and 2018 of \$7,514, \$7,739 and \$7,971, respectively, with rent to be renegotiated thereafter. The Company made payments aggregating \$19,468 in 2017 under this lease agreement. No payments were made in 2018. As part of this agreement, Hi'ipaka is responsible for providing building management services, including operating and maintenance costs. OHA has agreed to compensate Hi'ipaka \$62,400 for these services for the period July 1, 2015 to June 30, 2017, \$41,200 for the period July 1, 2017 to June 30, 2018, and \$41,200 for the period July 1, 2018 to June 30, 2019. Funding beyond June 30, 2019 shall be negotiated at a future date. Payments received from OHA under this agreement amounted to \$46,800 in 2017 and zero in 2018.

The Company provides management and administrative services to Ho'okele Pono and Ho'okipaipai. Fees charged for these services amounted to \$40,634 in 2018 and \$34,553 in 2017. The Company also provided working capital advances to Ho'okipaipai of \$55,000 in 2018 and \$34,942 in 2017, of which \$69,942 was repaid in 2018.

6. Lease Commitments

The Company leases office space under a lease agreement that expires in October 2019, with an option to extend to October 2021. The lease agreement provides that the Company shall pay base rent, plus a proportionate share of building operating expenses and general excise tax. Minimum base rent payable in 2019 is \$54,447.

Rental expense, including building operating expenses and general excise tax, totaled \$108,747 and \$100,383 for the years ended December 31, 2018 and 2017.

Hi'ilei Aloha LLC and Sub-Entities
(Nonprofit Organizations)
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

The Company sub-leases certain of its office space to Ho'okipaipai LLC under an agreement that renews annually so long as Ho'okipaipai continues to operate its Procurement Technical Assistance Center (PTAC). This agreement is expected to terminate September 30, 2019. Rent paid by Ho'okipaipai under this agreement amounted to \$21,984 in 2018 and \$21,758 in 2017, respectively.

Hi'ipaka sub-leased part of the Hale'iwa property discussed in Note 5 to an unrelated third party tenant. The agreement, as amended in June 2017, expired June 2018. Rental income was \$5,458 in 2018 and \$8,514 in 2017.

7. Limited Liability Companies

Since the Companies are limited liability companies, no member, manager, agent, or employee of the Companies shall be personally liable for debts, obligations, or liabilities of the Companies whether arising in contract, tort, or otherwise for the acts or omissions of any other member, director, manager, agent, or employee of the Companies, unless the individual has signed a specific personal guarantee. The duration of the Companies is perpetual.

Hi'ilei Aloha LLC and Sub-Entities
(Nonprofit Organizations)
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

8. Condensed Financial Statements

The following condensed financial information summarizes the individual entities comprising the Company's consolidated financial position, results of operations and cash flows as of and for the years ended December 31, 2018 and 2017:

Condensed Statements of Net Position

	2018		
	Hi'ilei	Hi'ipaka	Total
Assets			
Current assets	\$ 327,784	\$ 3,665,929	\$ 3,993,713
Cash restricted for property acquisition	-	15,025	15,025
Capital assets, net	28,659	15,150,686	15,179,345
Other assets - lease security deposit	10,394	-	10,394
Total assets	<u>\$ 366,837</u>	<u>\$ 18,831,640</u>	<u>\$ 19,198,477</u>
Liabilities and Net Position			
Current and total liabilities	\$ 84,253	\$ 463,060	\$ 547,313
Net position			
Unrestricted	253,925	3,202,869	3,456,794
Restricted - property acquisition	-	15,025	15,025
Net investment in capital assets	28,659	15,150,686	15,179,345
Total net position	<u>282,584</u>	<u>18,368,580</u>	<u>18,651,164</u>
Total liabilities and net position	<u>\$ 366,837</u>	<u>\$ 18,831,640</u>	<u>\$ 19,198,477</u>
2017			
	Hi'ilei	Hi'ipaka	Total
Assets			
Current assets	\$ 297,763	\$ 3,134,542	\$ 3,432,305
Cash restricted for property acquisition	-	97,046	97,046
Capital assets, net	57,373	15,024,877	15,082,250
Other assets - lease security deposit	9,994	-	9,994
Total assets	<u>\$ 365,130</u>	<u>\$ 18,256,465</u>	<u>\$ 18,621,595</u>
Liabilities and Net Position			
Current and total liabilities	\$ 127,093	\$ 410,796	\$ 537,889
Net position			
Unrestricted	180,664	2,723,746	2,904,410
Restricted - property acquisition	-	97,046	97,046
Net investment in capital assets	57,373	15,024,877	15,082,250
Total net position	<u>238,037</u>	<u>17,845,669</u>	<u>18,083,706</u>
Total liabilities and net position	<u>\$ 365,130</u>	<u>\$ 18,256,465</u>	<u>\$ 18,621,595</u>

Hi'ilei Aloha LLC and Sub-Entities
(Nonprofit Organizations)
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Condensed Statements of Revenues, Expenses and Changes in Net Position

	2018		
	Hi'ilei	Hi'ipaka	Total
Revenue and support			
Sales			
Gift store, food service and other	\$ 668	\$ 2,324,122	\$ 2,324,790
Cost of sales	(1,257)	(2,449,575)	(2,450,832)
Gross margin (loss)	(589)	(125,453)	(126,042)
Admissions and tours	-	4,671,269	4,671,269
Other, net	10,860	816,676	827,536
Grants and donations	52	149,060	149,112
Consulting and training services	552,026	-	552,026
Flood insurance recoveries, net	-	34,286	34,286
Total revenue and support	<u>562,349</u>	<u>5,545,838</u>	<u>6,108,187</u>
Expenses			
Depreciation expense	31,363	337,846	369,209
Other operating expenses	1,186,439	4,692,881	5,879,320
Total expenses	<u>1,217,802</u>	<u>5,030,727</u>	<u>6,248,529</u>
Operating income (loss)	<u>(655,453)</u>	<u>515,111</u>	<u>(140,342)</u>
Nonoperating activity			
Grants from OHA	700,000	7,800	707,800
Change in net position	44,547	522,911	567,458
Net assets			
Beginning of fiscal year	238,037	17,845,669	18,083,706
End of fiscal year	<u>\$ 282,584</u>	<u>\$ 18,368,580</u>	<u>\$ 18,651,164</u>

Hi'ilei Aloha LLC and Sub-Entities
(Nonprofit Organizations)
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Condensed Statements of Revenues, Expenses and Changes in Net Position (Continued)

	2017			
	Hi'ilei	Hi'ipaka	Hi'ipoi	Total
Revenue and support				
Sales				
Gift store, food service and other	\$ 5	\$ 2,171,216	\$ -	\$ 2,171,221
Cost of sales	105	(2,307,259)	-	(2,307,154)
Gross margin (loss)	110	(136,043)	-	(135,933)
Admissions and tours	-	4,344,144	-	4,344,144
Other, net	5,635	792,976	-	798,611
Grants and donations	6,512	74,557	-	81,069
Consulting and training services	479,684	-	-	479,684
Flood insurance recoveries, net	-	49,935	-	49,935
Total revenue and support	491,941	5,125,569	-	5,617,510
Expenses				
Depreciation expense	15,230	302,434	-	317,664
Other operating expenses	969,152	4,208,437	45	5,177,634
Total expenses	984,382	4,510,871	45	5,495,298
Operating income (loss)	(492,441)	614,698	(45)	122,212
Nonoperating activity				
Grants from OHA	152,800	10,000	-	162,800
Grant to Hi'ipaka	(21,223)	21,223	-	-
Change in net position	(360,864)	645,921	(45)	285,012
Net assets				
Beginning of fiscal year	598,901	17,199,748	45	17,798,694
End of fiscal year	\$ 238,037	\$ 17,845,669	\$ -	\$ 18,083,706

Hi'ilei Aloha LLC and Sub-Entities
(Nonprofit Organizations)
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Condensed Statements of Cash Flows

	2018		
	Hi'ilei	Hi'ipaka	Total
Net cash provided by (used in)			
Operating activities	\$ (686,371)	\$ 651,602	\$ (34,769)
Capital and related financing activities	(2,649)	(462,609)	(465,258)
Noncapital financing activities	692,200	7,800	700,000
Investing activities	14,942	-	14,942
Total change in cash	<u>18,122</u>	<u>196,793</u>	<u>214,915</u>
Cash and cash equivalents			
Beginning of year	157,490	2,871,365	3,028,855
End of year	<u>\$ 175,612</u>	<u>\$ 3,068,158</u>	<u>\$ 3,243,770</u>
	2017		
	Hi'ilei	Hi'ipaka	Total
Net cash provided by (used in)			
Operating activities	\$ (459,354)	\$ 916,685	\$ 457,331
Capital and related financing activities	(25,984)	(444,822)	(470,806)
Noncapital financing activities	152,800	10,000	162,800
Investing activities	(34,942)	-	(34,942)
Total change in cash	<u>(367,480)</u>	<u>481,863</u>	<u>114,383</u>
Cash and cash equivalents			
Beginning of year	524,970	2,389,502	2,914,472
End of year	<u>\$ 157,490</u>	<u>\$ 2,871,365</u>	<u>\$ 3,028,855</u>

**Auditor's Report on Internal Control Over Financial
Reporting and on Compliance and Other Matters**

**Independent Auditor's Report
on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an
Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards***

To the Member and Managers
Hi'ilei Aloha LLC and Sub-Entities

I have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Hi'ilei Aloha LLC and Sub-Entities (the "Organization"), which comprise the statement of net position as of December 31, 2018, and the related statements of revenues, expenses, and changes in net position, and of cash flows for the year then ended, and the related notes to the financial statements, and have issued my report thereon dated August 30, 2019.

Internal Control over Financial Reporting

In planning and performing my audit of the financial statements, I considered the Organization's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control. Accordingly, I do not express an opinion on the effectiveness of the Organization's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

My consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during my audit I did not identify any deficiencies in internal control that I consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Organization's financial statements are free from material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of my testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Organization's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

James P. Hesselman, CPA, LLC

Honolulu, Hawaii
August 30, 2019

Hi'ipaka LLC

(A Nonprofit Organization)

A sub-entity of Hi'ilei Aloha LLC which is a component unit for financial reporting purposes of the Office of Hawaiian Affairs

Financial Statements

December 31, 2018 and 2017

Hi'ipaka LLC
(A Nonprofit Organization)
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Independent Auditor's Report

To the Member and Managers
Hi'ipaka LLC

Report on the Financial Statements

I have audited the accompanying financial statements of Hi'ipaka LLC (a nonprofit organization), a component unit of Hi'ilei Aloha LLC and the Office of Hawaiian Affairs, State of Hawai'i, which comprise the statements of net position as of December 31, 2018 and 2017, and the related statements of revenues, expenses, and changes in net position, and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audits. I conducted my audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Hi‘ipaka LLC as of December 31, 2018 and 2017, and the changes in its financial and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter – Supplementary Information

My audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The schedules of functional expenses on pages 13-14 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In my opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Other Matter – Omission of Management’s Discussion and Analysis

Management has omitted management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. My opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, I have also issued my report dated August 30, 2019 on my consideration of Hi‘ipaka LLC’s internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Hi‘ipaka LLC’s internal control over financial reporting and compliance.

James P. Hesselman, CPA, LLC

Honolulu, Hawai‘i
August 30, 2019

Hi'ipaka LLC
(A Nonprofit Organization)
Statements of Net Position
December 31, 2018 and 2017

	2018	2017
Assets		
Current Assets		
Cash	\$ 3,053,133	\$ 2,774,319
Accounts receivable, net of allowance for doubtful accounts of \$15,000 in 2018 and \$2,825 in 2017	298,630	108,093
Inventories	132,425	123,040
Prepaid expenses	181,741	129,090
Total current assets	3,665,929	3,134,542
Cash Restricted for Property Acquisition	15,025	97,046
Capital Assets		
Buildings and improvements	3,396,571	3,055,473
Furniture, fixtures and equipment	878,097	842,360
Vehicles	227,402	217,742
	4,502,070	4,115,575
Less accumulated depreciation	(2,424,095)	(2,094,519)
	2,077,975	2,021,056
Land	13,072,711	13,003,821
Total capital assets	15,150,686	15,024,877
Total assets	\$ 18,831,640	\$ 18,256,465
Liabilities and Net Position		
Current Liabilities		
Accounts payable	\$ 130,655	\$ 94,488
Accrued liabilities	242,818	276,322
Deferred revenue	89,587	39,986
Total current liabilities	463,060	410,796
Net Position		
Unrestricted	3,202,869	2,723,746
Restricted - property acquisition	15,025	97,046
Net investment in capital assets	15,150,686	15,024,877
Total net position	18,368,580	17,845,669
Total liabilities and net position	\$ 18,831,640	\$ 18,256,465

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

Hi'ipaka LLC

(A Nonprofit Organization)

Statements of Revenues, Expenses, and Changes in Net Position Years Ended December 31, 2018 and 2017

	2018	2017
Operating revenue and support		
Sales		
Gift store and food service	\$ 2,324,122	\$ 2,171,216
Cost of sales, including gift store and food service departmental expenses	<u>(2,449,575)</u>	<u>(2,307,259)</u>
Gross margin (loss)	(125,453)	(136,043)
Admissions and tours	4,671,269	4,344,144
Shuttle service	272,563	240,932
Special events and other	189,116	58,906
Less bad debt expense	<u>(23,726)</u>	<u>(2,254)</u>
Total net sales	<u>4,983,769</u>	<u>4,505,685</u>
Parking, rental and other	357,140	397,485
Audio visual production	21,583	97,907
Grants and donations	149,060	74,557
Flood insurance recoveries, net of losses incurred	<u>34,286</u>	<u>49,935</u>
Other revenue and support	<u>562,069</u>	<u>619,884</u>
Total operating revenue and support	<u>5,545,838</u>	<u>5,125,569</u>
Operating expenses		
Program services		
Cultural	854,415	831,476
Botanical	1,401,788	1,249,379
Preservation and stewardship	<u>1,320,104</u>	<u>1,279,688</u>
	3,576,307	3,360,543
Management and general	1,435,918	1,133,028
Fundraising	<u>18,502</u>	<u>17,300</u>
Total operating expenses	<u>5,030,727</u>	<u>4,510,871</u>
Operating income	515,111	614,698
Nonoperating activity		
Grants from Office of Hawaiian Affairs and/or Hi'ilei Aloha LLC	<u>7,800</u>	<u>31,223</u>
Change in net position	522,911	645,921
Net position		
Beginning of year	<u>17,845,669</u>	<u>17,199,748</u>
End of year	<u>\$ 18,368,580</u>	<u>\$ 17,845,669</u>

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

Hi'ipaka LLC
(A Nonprofit Organization)
Statements of Cash Flows
Years Ended December 31, 2018 and 2017

	2018	2017
Cash flows from operating activities		
Receipts from customers, grantors and funders	\$ 7,855,312	\$ 7,392,823
Payments to suppliers, vendors and service providers	(3,786,766)	(3,443,077)
Payments to employees for salaries and benefits	(3,443,430)	(3,174,645)
Insurance recoveries - flood damage	34,286	141,584
Net cash provided by operating activities	<u>659,402</u>	<u>916,685</u>
Cash flows from capital and related financing activities		
Expenditures for property and equipment	<u>(462,609)</u>	<u>(444,822)</u>
Net cash used in capital and related financing activities	<u>(462,609)</u>	<u>(444,822)</u>
Cash flows from noncapital financing activities		
Grants from Office of Hawaiian Affairs	-	10,000
Net cash provided by noncapital financing activities	<u>-</u>	<u>10,000</u>
Increase in cash	196,793	481,863
Cash and cash equivalents		
Beginning of year	<u>2,871,365</u>	<u>2,389,502</u>
End of year	<u>\$ 3,068,158</u>	<u>\$ 2,871,365</u>
Cash and cash equivalents consist of:		
Cash	\$ 3,053,133	\$ 2,774,319
Restricted cash	<u>15,025</u>	<u>97,046</u>
	<u>\$ 3,068,158</u>	<u>\$ 2,871,365</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 515,111	\$ 614,698
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation and amortization	337,846	302,433
Loss (gain) on disposal of equipment	(1,046)	7,967
Donated advertising services	7,800	-
Change in:		
Accounts receivable	(190,537)	21,836
Inventories	(9,385)	(6,033)
Prepaid expenses	(52,651)	(39,312)
Accounts payable	36,167	(22,989)
Accrued liabilities	(33,504)	27,002
Deferred revenue	49,601	11,083
Net cash provided by operating activities	<u>\$ 659,402</u>	<u>\$ 916,685</u>
Schedule of Noncash Investing and Financing Activities		
Grant from the Office of Hawaiian Affairs		
Donated advertising services	\$ 7,800	\$ -
Grant from Hi'ilei Aloha LLC -		
Equipment and service contract acquired for Hi'ipaka LLC	-	21,223

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

Hi'ipaka LLC
(A Nonprofit Organization)
Notes to Financial Statements
December 31, 2018 and 2017

1. Organization and Summary of Significant Accounting Policies

Hi'ipaka LLC (Company) was established on December 6, 2007, and began operations in February 2008. The Company's purpose is to preserve and perpetuate the human, cultural and natural resources of Waimea Valley, O'ahu for future generations through education and stewardship. The Company is a limited liability company with Hi'ilei Aloha LLC (Hi'ilei) as its sole member. Hi'ilei is a limited liability company with the Office of Hawaiian Affairs (OHA) as its sole member. The Company's governing body consists of three "Managers" who are senior management officials of OHA. In 2019, OHA approved amending the Company's Operating Agreement to state that the Managers shall not be OHA employees.

Revenues are generated primarily from sales of admission to Waimea Valley and the activities and events (hikes, education programs, tours, gift shop sales, food and beverage sales, etc.) held there. The Company has historically received grants from OHA, primarily through Hi'ilei, to support major restoration efforts, disaster mitigation activities, capital improvements and targeted programmatic activities; however in recent years the Company has been more self sufficient and less reliant on OHA for financial support.

The Company is included in Hi'ilei's consolidated financial statements which in turn are included in OHA's financial statements as a component unit for financial reporting purposes.

Basis of Accounting

The financial statements of the Company have been prepared on the accrual basis of accounting consistent with enterprise fund accounting and accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB).

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid debt investments with original maturities of three months or less when purchased to be cash equivalents.

Concentrations of Credit Risk

The Company maintains cash accounts with a financial institution in the State of Hawai'i. Balances are insured up to \$250,000 per account holder by the Federal Deposit Insurance Corporation (FDIC). The Company's bank balance at December 31, 2018 and 2017, irrespective of outstanding checks and deposits in transit, was \$3,060,975 and \$2,790,798, respectively.

Receivables

Accounts receivable are stated at the amount management expects to collect from outstanding balances. The carrying amount of accounts receivable is reduced by an allowance for doubtful accounts that reflects management's best estimate of the amounts that will not be collected based

Hi'ipaka LLC
(A Nonprofit Organization)
Notes to Financial Statements
December 31, 2018 and 2017

upon prior experience, a review of delinquent accounts, and management's assessment of the credit worthiness of its customers. Management considers accounts past due when they are outstanding beyond 60 days with no payment. Interest is generally not charged on past due accounts. Balances that are still outstanding after management has used reasonable collection efforts are written-off through a charge to the allowance account and a credit to accounts receivable. The Company's allowance for doubtful accounts was \$15,000 and \$2,825 at December 31, 2018 and 2017, respectively, and was established based on a review of specific delinquent accounts.

Inventories

Inventories consist of items held for sale in the Company's gift stores, restaurant and snack shop. Inventories are stated at the lower of cost (first-in, first-out method) or net realizable value.

Capital Assets

Property and equipment is stated at cost if purchased. Property transferred to the Company from OHA as part of the Company's formation is stated at OHA's carrying basis. Property purchased with a cost in excess of \$1,000 and a useful life exceeding one year is capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of such assets (5 to 7 years for furniture, fixtures, equipment and vehicles, and 10 to 30 years for building and improvements). Expenditures for maintenance, repairs, restoration, and minor renewals are charged to expense; expenditures for betterments are capitalized. Property retired or otherwise disposed of is removed from the appropriate asset and related accumulated depreciation accounts. Gains and losses from the disposition of assets are reflected in current operations.

Impairment Review

Long-lived assets such as property and equipment are reviewed for impairment when events or circumstances indicate that their carrying value may not be recoverable. Estimated undiscounted future cash flows are used to determine if an asset is impaired, in which case the asset's carrying value would be reduced to fair value. No impairment charges have been recorded.

Revenue Recognition

Admission and tours revenues are recognized based on the date of admission to the Valley. Gift and food service sales are recognized at the time of sale as sales returns are inconsequential. Revenue from special events and venue rentals are recognized when the event occurs. Revenues are recognized net of all discounts and allowances, including bad debts if any. Grants and contributions are recognized as support in the period in which eligibility requirements imposed by the donor have been met, which is generally when received. Amounts received prior to revenue recognition are recorded as deferred revenue.

Expenses

The costs of conducting programs and other services have been summarized on a functional basis in the statements of revenues, expenses, and changes in net position. The Company's program service expenses consist of cultural, botanical and the preservation and stewardship of Waimea Valley. Cultural expenses include various programs and educational activities. Botanical expenses include all activities related to the flora and fauna of the Valley. Preservation and stewardship expenses include all activities pertaining to maintaining, restoring and improving the physical infrastructure and safety of the Valley. The Company also incurs costs related to its gift stores, restaurant and snack shop, which serve to support the Company's programmatic initiatives and

Hi'ipaka LLC
(A Nonprofit Organization)
Notes to Financial Statements
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enhance the visitor experience. These costs include cost of goods sold, salaries and other departmental expenses. Management and general expenses represent those costs associated with oversight, business management, general recordkeeping, budgeting, advertising and other related administrative activities. Fundraising expenses represent costs associated with obtaining grants and donations. Certain costs have been allocated between programs and supporting services based on various methodologies, including relative personnel costs or other estimates.

When an expense is incurred for purposes for which both restricted and unrestricted resources are available to pay the expenses, resources are generally applied proportionate to the benefit realized. For instances in which such a determination is not feasible or if there are cost compliance issues, unrestricted resources are applied first.

Operating and Nonoperating Revenues and Expenses

Operating revenues and expenses result from the activities described above. Nonoperating activities relate to grants and other amounts received from Hi'ilei (member) and/or Hi'ilei's member, OHA. These revenues are recognized when received. Donations received that are restricted for capital asset acquisition are reflected as capital contributions and reported separately from operating and nonoperating activity.

Advertising Costs

The cost of advertising production is expensed the first time the advertising takes place. Total advertising expense amounted to \$374,247 and \$289,619 in 2018 and 2017, respectively.

General Excise Tax

General excise tax collected from customers is reflected in revenues. General excise taxes paid to the State of Hawai'i is reflected in cost of sales and other expenses.

Income Taxes

The Company is tax exempt under section 501(c)(3) based on an IRS determination letter dated March 2012. Accordingly, the Company is exempt from federal income taxes, except on unrelated business income.

The Company adheres to generally accepted accounting principles (GAAP) pertaining to uncertain tax positions. Those principles call for uncertain tax positions to be recognized in the financial statements only if those positions are more likely than not to be sustained upon regulatory examination. Management is not aware of any uncertain tax positions taken on previously filed tax returns. Such tax returns are generally open for examination by the IRS until the statute of limitations (three years) expires.

Reclassifications

Reclassifications have been made to certain amounts presented in the 2017 financial statements to conform with the 2018 presentation. These reclassifications did not affect the change in net position as previously reported.

Subsequent Events

Management has reviewed and considered whether events occurring after year end should be reflected or disclosed in these financial statements. The date through which this review was conducted was August 30, 2019, the date the financial statements were available to be issued.

Hi'ipaka LLC
(A Nonprofit Organization)
Notes to Financial Statements
December 31, 2018 and 2017

2. Capital Assets

Capital asset activity for the years ended December 31, 2018 and 2017 was as follows:

	Balance January 1, 2018	Additions	Deductions	Balance December 31, 2018
Capital assets not depreciated:				
Land	\$ 13,003,821	\$ 68,890	\$ -	\$ 13,072,711
Total capital assets not depreciated	13,003,821	68,890	-	13,072,711
Capital assets being depreciated				
Buildings and improvements	3,055,473	341,098	-	3,396,571
Furniture, fixtures and equipment	842,360	35,737	-	878,097
Vehicles	217,742	48,257	(38,597)	227,402
Total capital assets being depreciated	4,115,575	425,092	(38,597)	4,502,070
Less accumulated depreciation	(2,094,519)	(337,847)	8,271	(2,424,095)
Capital assets being depreciated, net	2,021,056	87,245	(30,326)	2,077,975
Total capital assets, net	\$ 15,024,877	\$ 156,135	\$ (30,326)	\$ 15,150,686
	Balance January 1, 2017	Additions	Deductions	Balance December 31, 2017
Capital assets not depreciated:				
Land	\$ 13,003,821	\$ -	\$ -	\$ 13,003,821
Total capital assets not depreciated	13,003,821	-	-	13,003,821
Capital assets being depreciated				
Buildings and improvements	2,766,516	288,957	-	3,055,473
Furniture, fixtures and equipment	786,759	93,165	(37,564)	842,360
Vehicles	141,727	76,015	-	217,742
Total capital assets being depreciated	3,695,002	458,137	(37,564)	4,115,575
Less accumulated depreciation	(1,821,683)	(302,433)	29,597	(2,094,519)
Capital assets being depreciated, net	1,873,319	155,704	(7,967)	2,021,056
Total capital assets, net	\$ 14,877,140	\$ 155,704	\$ (7,967)	\$ 15,024,877

Depreciation expense amounted to \$337,846 and \$302,433 in 2018 and 2017, respectively.

In connection with the initial acquisition of Waimea Valley by OHA for purposes of preserving and protecting the Valley and its historical and archaeological sites and artifacts, a conservation easement covering the Valley was granted to the City and County of Honolulu and the State of Hawai'i. The purpose of the easement is to protect and preserve the Conservation Values (as defined in the easement) of the property, through the rights of inspection, monitoring and similar enforcement actions.

Hi'ipaka LLC
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December 31, 2018 and 2017

In 2017, the Company sustained damage from flooding, including the loss of equipment, and water and mud damage to property dwellings. The Company received insurance proceeds of \$141,584 to remediate the water and mud damage. Repairs were largely performed by Company personnel. Total cost of repair (excluding in-house labor costs) and loss on damaged equipment amounted to \$91,649. The net gain recorded for accounting purposes of \$49,935 was utilized to replace damaged equipment and partially cover in-house labor costs of repair. In 2018, the Company received additional insurance proceeds of \$34,286 for business interruption coverage.

3. Restricted Assets and Lease Agreement

In 2016, the Company commenced a process to acquire a real estate parcel adjacent to its Waimea Valley property. This process culminated in 2019 with the acquisition of the property. Donations from the community of \$119,687, net of fundraising expenses, were raised for this purpose in 2016. State and City grants were also received in 2019 to help fund the acquisition. An unrelated third party nonprofit organization held title to the property pending completion of the transaction. The Company had entered into a lease agreement with the title holder, with monthly payments of \$2,000 beginning February 2017 (\$22,000 paid in 2017, and \$12,000 paid in 2018). Donated funds restricted for this transaction have been reflected as restricted net position in the statements of net position.

4. Transactions with OHA

In 2015, the Company and OHA executed an agreement whereby the Company sub-leases property located in Hale'iwa, Hawai'i from OHA. The agreement expires March 2033 but can be cancelled by OHA at any time, or by either party upon the failure to successfully re-negotiate payment terms at defined dates. The agreement calls for the Company to pay annual lease rent to OHA during OHA's fiscal years ended June 30, 2016, 2017 and 2018 of \$7,514, \$7,739 and \$7,971, respectively, with rent to be renegotiated thereafter. The Company made payments aggregating \$19,468 in 2017 under this lease agreement. No payments were made in 2018. As part of this agreement, the Company is responsible for providing building management services, including operating and maintenance costs. OHA has agreed to compensate the Company \$62,400 for these services for the period July 1, 2015 to June 30, 2017, \$41,200 for the period July 1, 2017 to June 30, 2018, and \$41,200 for the period July 1, 2018 to June 30, 2019. Funding beyond June 30, 2019 shall be negotiated at a future date. Payments received from OHA under this agreement amounted to \$46,800 in 2017 and zero in 2018. OHA also provided a \$10,000 grant to the Company in 2017 in support of certain program activities; and provided in-kind advertising support in 2018 of \$7,800.

5. Sub-Lease Agreement

The Company sub-leased part of the Hale'iwa property discussed in Note 4 to an unrelated third party tenant. The agreement, as amended in June 2017, expired June 2018. Rental income was \$5,458 in 2018 and \$8,514 in 2017.

Hi'ipaka LLC
(A Nonprofit Organization)
Notes to Financial Statements
December 31, 2018 and 2017

6. Retirement Plan

The Company maintains a 401(k) profit sharing plan. Employees become eligible upon six months of employment and may contribute to the plan to the extent allowed by law. Under the plan, the Company matches employees' contributions up to 4% of salary. Contribution expense amounted to \$59,107 and \$59,080 in 2018 and 2017, respectively.

7. Limited Liability Company

Since the Company is a limited liability company, no member, manager, agent, or employee of the Company shall be personally liable for debts, obligations, or liabilities of the Company whether arising in contract, tort, or otherwise for the acts or omissions of any other member, director, manager, agent, or employee of the Company, unless the individual has signed a specific personal guarantee. The duration of the Company is perpetual.

Supplementary Information

Hi'ipaka LLC
(A Nonprofit Organization)
Schedule of Functional Expenses
Year Ended December 31, 2018

	Program Services				Management and General	Fundraising	Total
	Cultural	Botanical	Stewardship and Preservation	Total Program Services			
Salaries, payroll taxes and benefits	\$ 430,220	\$ 855,961	\$ 544,484	\$ 1,830,665	\$ 597,839	\$ 18,502	\$ 2,447,006
Advertising	-	-	-	-	374,247	-	374,247
Bank fees	969	1,863	1,226	4,058	1,388	-	5,446
Computer expenses	11,642	22,385	14,733	48,760	16,674	-	65,434
Depreciation & amortization	65,337	125,628	82,690	273,655	30,406	-	304,061
Dues and subscriptions	4,980	9,575	6,303	20,858	7,135	-	27,993
Employee expenses	350	2,500	-	2,850	24,605	-	27,455
Equipment and vehicle expenses	15,355	29,526	19,435	64,316	21,999	-	86,315
Food and honoraria	157,629	-	-	157,629	18,419	-	176,048
Insurance	63,058	121,248	79,804	264,110	29,345	-	293,455
Licenses	826	1,588	1,045	3,459	1,183	-	4,642
Lifeguard services	-	-	234,126	234,126	-	-	234,126
Mileage	132	254	167	553	189	-	742
Other expenses	45,510	5,115	3,448	54,073	3,771	-	57,844
Payroll services	8,672	16,675	10,975	36,322	12,424	-	48,746
Postage	732	1,407	926	3,065	1,049	-	4,114
Professional and consulting fees	-	10,083	18,905	28,988	139,915	-	168,903
Repairs, maintenance and restoration	-	71,460	202,240	273,700	60,810	-	334,510
Special events expenses	9,533	18,330	12,065	39,928	13,657	-	53,585
Supplies	7,400	46,528	46,945	100,873	34,533	-	135,406
Taxes other than income	-	-	-	-	385	-	385
Telephone	3,810	7,326	4,822	15,958	5,460	-	21,418
Travel	89	171	113	373	127	-	500
Uniforms	757	1,456	958	3,171	1,085	-	4,256
Utilities	26,996	51,906	34,165	113,067	38,674	-	151,741
Volunteer expenses	418	803	529	1,750	599	-	2,349
	<u>\$ 854,415</u>	<u>\$ 1,401,788</u>	<u>\$ 1,320,104</u>	<u>\$ 3,576,307</u>	<u>\$ 1,435,918</u>	<u>\$ 18,502</u>	<u>\$ 5,030,727</u>

Hi'ipaka LLC
(A Nonprofit Organization)
Schedule of Functional Expenses
Year Ended December 31, 2017

	Program Services				Management and General	Fundraising	Total
	Cultural	Botanical	Stewardship and Preservation	Total Program Services			
Salaries, payroll taxes and benefits	\$ 415,107	\$ 752,643	\$ 540,403	\$ 1,708,153	\$ 540,938	\$ 17,300	\$ 2,266,391
Advertising	-	-	-	-	289,619	-	289,619
Bank fees	770	1,331	1,002	3,103	1,035	-	4,138
Computer expenses	11,708	20,240	15,241	47,189	15,740	-	62,929
Depreciation & amortization	60,720	104,959	79,035	244,714	27,476	-	272,190
Dues and subscriptions	5,481	9,476	7,136	22,093	7,372	-	29,465
Employee expenses	-	1,868	219	2,087	19,622	-	21,709
Equipment and vehicle expenses	9,126	15,754	11,861	36,741	11,600	-	48,341
Food and honoraria	152,171	-	-	152,171	4,316	-	156,487
Insurance	87,386	151,032	113,732	352,150	39,128	-	391,278
Licenses	509	881	663	2,053	685	-	2,738
Lifeguard services	-	-	240,709	240,709	-	-	240,709
Mileage	165	286	215	666	222	-	888
Other expenses	19,404	10,686	8,140	38,230	8,346	-	46,576
Payroll services	8,941	15,458	11,640	36,039	12,025	-	48,064
Postage	747	1,292	973	3,012	1,005	-	4,017
Professional fees	-	6,420	33,963	40,383	36,748	-	77,131
Repairs, maintenance and restoration	6,657	29,744	116,462	152,863	21,592	-	174,455
Special events expenses	9,688	16,749	12,612	39,049	13,028	-	52,077
Supplies	8,066	50,344	40,338	98,748	35,691	-	134,439
Taxes other than income	7	12	9	28	9	-	37
Telephone	3,947	6,823	5,138	15,908	5,308	-	21,216
Travel	102	176	133	411	137	-	548
Uniforms	1,427	2,468	1,858	5,753	1,920	-	7,673
Utilities	28,872	49,916	37,588	116,376	38,827	-	155,203
Volunteer expenses	475	821	618	1,914	639	-	2,553
	<u>\$ 831,476</u>	<u>\$ 1,249,379</u>	<u>\$ 1,279,688</u>	<u>\$ 3,360,543</u>	<u>\$ 1,133,028</u>	<u>\$ 17,300</u>	<u>\$ 4,510,871</u>

Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters

**Independent Auditor's Report
on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an
Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards***

To the Member and Managers
Hi'ipaka LLC

I have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Hi'ipaka LLC (the "Organization"), which comprise the statement of net position as of December 31, 2018, and the related statements of revenues, expenses, and changes in net position, and of cash flows for the year then ended, and the related notes to the financial statements, and have issued my report thereon dated August 30, 2019.

Internal Control over Financial Reporting

In planning and performing my audit of the financial statements, I considered the Organization's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control. Accordingly, I do not express an opinion on the effectiveness of the Organization's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

My consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during my audit I did not identify any deficiencies in internal control that I consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Organization's financial statements are free from material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of my testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Organization's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

James P. Hesselman, CPA, LLC

Honolulu, Hawaii
August 30, 2019

Ho'okipaipai LLC

(A Nonprofit Organization)

**A component unit for financial reporting purposes of the
Office of Hawaiian Affairs**

**Financial Statements and Independent Auditor's Reports
December 31, 2018 and 2017**

Ho‘okīpaipai LLC
(A Nonprofit Organization)
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Independent Auditor's Report

To the Member and Managers
Ho'okipaipai LLC

Report on the Financial Statements

I have audited the accompanying financial statements of Ho'okipaipai LLC (the "Company") (a nonprofit organization), a component unit of the Office of Hawaiian Affairs, State of Hawai'i, which comprise the statements of net position as of December 31, 2018 and 2017, and the related statements of revenues, expenses, and changes in net position, and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audits. I conducted my audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Ho‘okīpaipai LLC as of December 31, 2018 and 2017, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter Regarding Going Concern

As discussed in Note 1 to the financial statements, subsequent to year end the board of trustees of the Office of Hawaiian Affairs approved a Plan of Dissolution affecting the Company and its member Ho‘okele Pono LLC. Both organizations are expected to begin the dissolution process on or before October 31, 2019. As the Plan of Dissolution was not approved as of December 31, 2018, the accompanying financial statements have been prepared utilizing the going concern basis of accounting, rather than the liquidation basis of accounting. Based on the Plan of Dissolution, management has stated in Note 1 that there is substantial doubt about the organization’s ability to continue as a going concern. Management’s evaluation of the events and conditions and management’s plans regarding this matter, as well as the effects on the financial statements, are also described in Note 1. The financial statements do not include any adjustments that might be required from the use of the liquidation basis of accounting or that might otherwise result from the planned dissolution of the Company. My opinion is not modified with respect to this matter.

Other Matter – Supplementary Information

My audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The schedules of functional expenses on pages 12-13 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In my opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Other Matter – Omission of Management’s Discussion and Analysis

Management has omitted management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. My opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, I have also issued my report dated August 30, 2019 on my consideration of Ho'okipaipai LLC's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Ho'okipaipai LLC's internal control over financial reporting and compliance.

James P. Hesselman, CPA, LLC

Honolulu, Hawai'i
August 30, 2019

Ho‘okīpaipai LLC
(A Nonprofit Organization)
Statements of Net Position
December 31, 2018 and 2017

Assets	2018	2017
Current Assets		
Cash	\$ 24,175	\$ 4,240
Receivable - cooperative agreement	188,870	66,134
Prepaid expenses	1,797	856
Total current assets	<u>214,842</u>	<u>71,230</u>
Total assets	<u>\$ 214,842</u>	<u>\$ 71,230</u>
Liabilities and Net Position		
Current Liabilities		
Accrued payroll and vacation liabilities	\$ 18,119	\$ 13,827
Due to Hi‘ilei Aloha LLC	61,931	34,942
Accounts payable	92,602	-
Total current liabilities	<u>172,652</u>	<u>48,769</u>
Net Position - Unrestricted	<u>42,190</u>	<u>22,461</u>
Total liabilities and net position	<u>\$ 214,842</u>	<u>\$ 71,230</u>

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

Ho‘okīpaipai LLC

(A Nonprofit Organization)

Statements of Revenues, Expenses, and Changes in Net Position Years Ended December 31, 2018 and 2017

	2018	2017
Operating Revenue		
Cooperative agreement - Federal government	\$ 291,036	\$ 100,613
Conference registration fees	-	14,710
Total operating revenue	<u>291,036</u>	<u>115,323</u>
Operating Expenses		
Program services - small business technical assistance	433,497	196,062
Management and general	<u>67,336</u>	<u>60,793</u>
Total operating expenses	<u>500,833</u>	<u>256,855</u>
Operating income (loss)	(209,797)	(141,532)
Nonoperating activity		
Grants from Office of Hawaiian Affairs and Hi‘ilei Aloha LLC	<u>229,526</u>	<u>56,600</u>
Change in net position	19,729	(84,932)
Net position		
Beginning of year	<u>22,461</u>	<u>107,393</u>
End of year	<u>\$ 42,190</u>	<u>\$ 22,461</u>

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

Ho'okipaipai LLC
(A Nonprofit Organization)
Statements of Cash Flows
Years Ended December 31, 2018 and 2017

	2018	2017
Cash flows from operating activities		
Receipts from customers, grantors and funders	\$ 168,300	\$ 80,918
Payments to suppliers, vendors and service providers	(110,146)	(101,805)
Payments to employees for salaries and benefits	(246,203)	(145,758)
Net cash used in operating activities	<u>(188,049)</u>	<u>(166,645)</u>
Cash flows from noncapital financing activities		
Cash grants from Office of Hawaiian Affairs (OHA) and Hi'ilei Aloha LLC	222,926	50,000
Advances from Hi'ilei Aloha LLC	55,000	34,942
Repayments of advances from Hi'ilei Aloha LLC	(69,942)	-
Net cash provided by noncapital financing activities	<u>207,984</u>	<u>84,942</u>
Net increase (decrease) in cash	19,935	(81,703)
Cash and cash equivalents		
Beginning of year	<u>4,240</u>	<u>85,943</u>
End of year	<u>\$ 24,175</u>	<u>\$ 4,240</u>
Reconciliation of operating income (loss) to net cash used in operating activities		
Operating income (loss)	\$ (209,797)	\$ (141,532)
Adjustments to reconcile operating income (loss) to net cash used in operating activities		
Expenses paid by Hi'ilei and OHA	6,600	6,600
Change in:		
Receivables	(122,736)	(34,405)
Prepaid expenses	(941)	94
Payables	138,825	2,598
Net cash used in operating activities	<u>\$ (188,049)</u>	<u>\$ (166,645)</u>
Schedule of Noncash Financing Activities		
Grants from Office of Hawaiian Affairs and Hi'ilei Aloha LLC - payment of Company expenses	\$ 6,600	\$ 6,600

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

Ho'okipaipai LLC
(A Nonprofit Organization)
Notes to Financial Statements
December 31, 2018 and 2017

1. Organization and Summary of Significant Accounting Policies

Ho'okipaipai LLC (the "Company") was established on May 11, 2010, and began operations in May 2011. Its purpose is to engage in community economic development activity in the State of Hawai'i, primarily through the operation of a Hawai'i Procurement Technical Assistance Center (PTAC) under a program sponsored by the Defense Logistics Agency (DLA), U.S. Department of Defense.

The Company is a limited liability company with Ho'okele Pono LLC (Ho'okele Pono) as its sole member. Ho'okele Pono is a limited liability company with the Office of Hawaiian Affairs (OHA) as its sole member. The Company's governing body consists of three "Managers" who are senior management officials of OHA.

The Company's primary source of funding comes from OHA grants and the Defense Logistics Agency. The Company also receives working capital advances from Hi'ilei Aloha LLC (Hi'ilei), which is a limited liability company with OHA as its sole member.

Based on its relationship with OHA, the Company is considered to be a component unit of OHA for financial reporting purposes.

Plan of Dissolution

In May 2019, the board of trustees of OHA approved a Plan of Dissolution (the "Plan") affecting the Company and its member Ho'okele Pono LLC. Both organizations are expected to begin the dissolution process on or before October 31, 2019. Management intends to complete its obligations under its current cooperative agreement with DLA, which ends September 30, 2019 and to effect an orderly cessation of the Company's affairs in accordance with the Plan. Management has evaluated the effects of the Plan on its financial statements and has concluded that: 1) there is substantial doubt as to the Company's ability to continue as a going concern beyond 2019; and 2) no adjustments to the carrying bases of assets and liabilities is required, as all such accounts are current in nature.

Basis of Accounting

The financial statements of the Company have been prepared on the accrual basis of accounting consistent with enterprise fund accounting and accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB). As the Plan of Dissolution described above was not approved as of December 31, 2018, the accompanying financial statements have been prepared utilizing the going concern basis of accounting, rather than the liquidation basis of accounting.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Ho‘okīpaipai LLC
(A Nonprofit Organization)
Notes to Financial Statements
December 31, 2018 and 2017

Cash and Cash Equivalents

The Company considers all highly liquid debt investments with original maturities of three months or less when purchased to be cash equivalents. Cash balances are held with a banking institution in the State of Hawai‘i and are insured up to \$250,000 by the FDIC. Account balances generally do not exceed the FDIC’s insurance limit.

Receivables

Receivables under the organization’s federal cooperative agreement consist of costs that were incurred prior to year-end for which payment has not been received. When necessary, the carrying amount of receivable is reduced by an allowance for doubtful accounts that reflects management's best estimate of the amounts that will not be collected based upon prior experience and management's assessment of the credit worthiness of the counterparty. Management considers accounts past due when they are outstanding beyond 60 days with no payment. Interest is generally not charged on past due accounts. Balances that are still outstanding after management has used reasonable collection efforts are written-off through a charge to the allowance account and a credit to receivables. The allowance for doubtful accounts was zero at December 31, 2018 and 2017.

Long-Lived Assets

The Company capitalizes assets having a useful life of more than one year and a cost of \$1,000 or more. To date, no such assets have been acquired.

Revenue Recognition

The Company recognizes revenue under its cooperative agreement when all eligibility requirements imposed by DLA have been met, that is as reimbursable costs are incurred. Event registration fee revenue is recognized when the related event occurs. Costs charged to and reimbursed by DLA under the cooperative agreement are subject to audit by DLA, which could result in the disallowance of previously reimbursed costs. Management believes all costs charged to DLA to date are allowable and reimbursable under the terms of the cooperative agreement.

Functional Allocation of Expenses

The costs of conducting programs and other services have been summarized on a functional basis in the statement of revenues, expenses, and changes in net position. Program service expense includes direct costs pertaining to the operation of the PTAC, which involves providing technical assistance to entities interested in contracting with the Federal government. Management and general expense represents those costs associated with oversight, business management, general recordkeeping, budgeting and other related administrative activities. Certain costs have been allocated between programs and supporting services based on various methodologies, including relative personnel costs or other estimates.

Operating and Nonoperating Revenues and Expenses

Operating revenues and expenses generally result from the activities associated with operating the PTAC, including revenues from DLA. Nonoperating activities relate to grants received from OHA and/or Hi‘ilei. Certain of the OHA grants may pass through Hi‘ilei as an administrative accommodation. These grants are recognized when received.

Ho'okipaipai LLC
(A Nonprofit Organization)
Notes to Financial Statements
December 31, 2018 and 2017

Income Taxes

The Company has received a determination letter from the Internal Revenue Service dated April 25, 2011, stating that it is tax exempt under section 501(c)(3) of the Internal Revenue Code.

The Company adheres to generally accepted accounting principles (GAAP) pertaining to uncertain tax positions. Those principles call for uncertain tax positions to be recognized in the financial statements only if those positions are more likely than not to be sustained upon regulatory examination. Management is not aware of any uncertain tax positions taken or to be taken on its income tax returns. Such tax returns are generally open for examination by the IRS until the statute of limitations (three years) expires.

Subsequent Events

Management has reviewed and considered whether events occurring after year end should be reflected or disclosed in these financial statements. The date through which this review was conducted was August 30, 2019, the date the financial statements were available to be issued.

2. Retirement Plan

The Company maintains a 401(k) profit sharing plan. Employees become eligible upon six months of employment and may contribute to the plan to the extent allowed by law. Under the plan, the Company matches employees' contributions up to a specified percentage of salary. Employer matching contributions amounted to \$3,800 and \$3,557 in 2018 and 2017, respectively.

3. Transactions with OHA and Hi'ilei

The Company receives grants to support its operations from OHA. Funding from OHA is in the form of cash grants, which amounted to \$222,926 in 2018 and \$50,000 in 2017, and payment of Company advertising expenses which amounted to \$6,600 in both 2018 and 2017. Hi'ilei provides management and administrative services to the Company for a fee, which amounted to \$39,841 in 2018 and \$34,553 in 2017. Additionally, Hi'ilei provided working capital advances of \$55,000 and \$34,942 in 2018 and 2017, respectively, of which \$69,942 was repaid in 2018.

The Company rents office space from Hi'ilei and other third parties (see also Note 4). The agreement with Hi'ilei renews annually so long as the Company continues to operate the PTAC under the DLA agreement. This agreement is expected to terminate September 30, 2019. Total rent expense was \$33,767 and \$21,758 in 2018 and 2017, respectively, including \$21,984 and \$21,758 under the Hi'ilei agreement.

4. Lease Agreement

The Company has a noncancelable lease agreement for office space in Hilo, Hawaii, expiring March 31, 2021. Terms of the agreement call for the Company to pay base rent plus a share of common area maintenance expenses. Minimum base rent payments due under this agreement are \$3,406 in 2019, \$3,495 in 2020, and \$879 in 2021.

Ho‘okīpaipai LLC
(A Nonprofit Organization)
Notes to Financial Statements
December 31, 2018 and 2017

5. Limited Liability Company

Since the Company is a limited liability company, no member, manager, agent, or employee of the Company shall be personally liable for debts, obligations, or liabilities of the Company whether arising in contract, tort, or otherwise for the acts or omissions of any other member, director, manager, agent, or employee of the Company, unless the individual has signed a specific personal guarantee.

Supplementary Information

Ho'okipaipai LLC
(A Nonprofit Organization)
Schedule of Functional Expenses
Year Ended December 31, 2018

	Program Services	Management and General	Total
Salaries	\$ 207,098	\$ -	\$ 207,098
Payroll taxes	16,344	-	16,344
Employee benefits	27,053	-	27,053
Total salaries and related expenses	<u>250,495</u>	<u>-</u>	<u>250,495</u>
Advertising	6,600	-	6,600
Computer and website expenses	15,421	-	15,421
Conferences and events	16,713	-	16,713
Contract services	92,557	40,904	133,461
Dues and subscriptions	2,957	-	2,957
Insurance	1,315	8,211	9,526
Mileage and parking	195	-	195
Other expenses	47	263	310
Payroll services	3,599	-	3,599
Professional fees	-	17,958	17,958
Rent	33,767	-	33,767
Supplies and printing	4,171	-	4,171
Telephone	2,265	-	2,265
Travel	3,395	-	3,395
	<u>\$ 433,497</u>	<u>\$ 67,336</u>	<u>\$ 500,833</u>

Ho'okipaipai LLC
(A Nonprofit Organization)
Schedule of Functional Expenses
Year Ended December 31, 2017

	Program Services	Management and General	Total
Salaries	\$ 97,916	\$ -	\$ 97,916
Payroll taxes	7,915	-	7,915
Employee benefits	12,162	-	12,162
Total salaries and related expenses	<u>117,993</u>	<u>-</u>	<u>117,993</u>
Advertising	6,600	-	6,600
Computer and website expenses	14,996	-	14,996
Conference and events	19,209	-	19,209
Contract services	-	35,081	35,081
Dues and subscriptions	4,150	-	4,150
Insurance	968	7,754	8,722
Mileage and parking	390	-	390
Other expenses	105	-	105
Payroll services	2,114	-	2,114
Professional fees	-	17,958	17,958
Rent	21,758	-	21,758
Supplies and printing	1,056	-	1,056
Telephone	584	-	584
Travel	6,139	-	6,139
	<u>\$ 196,062</u>	<u>\$ 60,793</u>	<u>\$ 256,855</u>

Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters

**Independent Auditor’s Report
on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an
Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards***

To the Member and Managers
Ho‘okīpaipai LLC

I have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Ho‘okīpaipai LLC (the “Organization”), which comprise the statement of net position as of December 31, 2018, and the related statements of revenues, expenses, and changes in net position, and of cash flows for the year then ended, and the related notes to the financial statements, and have issued my report thereon dated August 30, 2019. My report included an emphasis of a matter paragraph regarding a plan to begin the process of dissolving the Organization in 2019.

Internal Control over Financial Reporting

In planning and performing my audit of the financial statements, I considered the Organization’s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organization’s internal control. Accordingly, I do not express an opinion on the effectiveness of the Organization’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

My consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during my audit I did not identify any deficiencies in internal control that I consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Organization's financial statements are free from material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of my testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Organization's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

James P. Hesselman, CPA, LLC

Honolulu, Hawaii
August 30, 2019