

DEPARTMENT OF HAWAIIAN HOME LANDS
STATE OF HAWAII

FINANCIAL STATEMENTS
WITH ACCOMPANYING INFORMATION
FOR THE YEAR ENDED JUNE 30, 2005

AND

INDEPENDENT AUDITORS' REPORT

Akamine, Oyadomari & Kosaki

CERTIFIED PUBLIC ACCOUNTANTS, INC.

November 21, 2005

Mr. Micah Kane, Chairman
Hawaiian Homes Commission
Department of Hawaiian Home Lands
State of Hawaii

Dear Mr. Kane:

This is our report on the audit of the financial statements of the Department of Hawaiian Home Lands, State of Hawaii, for the year ended June 30, 2005. Our audit was performed in accordance with the terms of our contract with the Department.

OBJECTIVES OF THE AUDIT

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the Department of Hawaiian Home Lands, State of Hawaii's, financial statements for the year ended June 30, 2005.

More specifically, the objectives of the audit were as follows:

1. To provide a basis for an opinion on the fairness of the presentation of the Department of Hawaiian Home Lands, State of Hawaii's, financial statements.
2. To determine whether expenditures have been made and all revenues and other receipts to which the Department of Hawaiian Home Lands, State of Hawaii, is entitled have been collected and accounted for in accordance with the laws, rules and regulations, and policies and procedures of the State of Hawaii.
3. To evaluate the adequacy of the Department of Hawaiian Home Lands, State of Hawaii's, internal control over financial reporting to determine whether there is effective control over and proper accounting of revenues, expenditures, disbursements, assets and liabilities and to comply with the applicable laws and regulations.

SCOPE OF THE AUDIT

Our audit was performed in accordance with auditing standards generally accepted in the United States of America, as prescribed by the American Institute of Certified Public Accountants, and Government Auditing Standards, issued by the Comptroller General of the United States, as they pertain to financial audits. The scope of our audit included a general audit of the financial transactions and accounting records of the Department of Hawaiian Home Lands, State of Hawaii, for the year ended June 30, 2005. In addition, as part of our determination as to whether the Department of Hawaiian Home Lands, State of Hawaii, has effective controls over and proper accounting of revenues, receipts, expenditures, disbursements, assets and liabilities we considered the internal control over financial reporting.

We wish to express our appreciation for the excellent cooperation and assistance extended by the officers and staff of the Department of Hawaiian Home Lands, State of Hawaii.

Sincerely,

Abanire Oyedokunai & Herabi CPAs, Inc.

DEPARTMENT OF HAWAIIAN HOME LANDS
STATE OF HAWAII

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STATE OF HAWAII

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PART I
FINANCIAL SECTION

FINANCIAL STATEMENTS

Akamine, Oyadomari & Kosaki

CERTIFIED PUBLIC ACCOUNTANTS, INC.

Independent Auditors' Report

Chairman
Hawaiian Home Lands Commission
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Department of Hawaiian Home Lands, State of Hawaii, as of and for the year ended June 30, 2005, which collectively comprise the Department's basic financial statements, as listed in the foregoing table of contents. These financial statements are the responsibility of the management of the Department of Hawaiian Home Lands, State of Hawaii. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note A to the financial statements, the financial statements of the Department of Hawaiian Home Lands, State of Hawaii, are intended to present the financial position, and the changes in financial position, of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2005, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Department of Hawaiian Home Lands, State of Hawaii, as of June 30, 2005, and the respective changes in financial position thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated November 21, 2005 on our consideration of the Department of Hawaiian Home Lands, State of Hawaii's, internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants 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 our testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

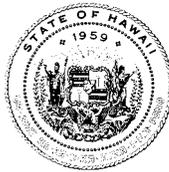
The Management's Discussion and Analysis on pages 9 through 19 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Department of Hawaiian Home Lands, State of Hawaii's, basic financial statements. The information on the Combining Balance Sheet - Nonmajor Governmental Funds and Combining Statement of Revenues, Expenditures and Changes in Fund Balances - Nonmajor Governmental Funds, are presented for purposes of additional analysis and is not a required part of the basic financial statements. The Combining Balance Sheet - Nonmajor Governmental Funds and Combining Statement of Revenues, Expenditures and Changes in Fund Balances - Nonmajor Governmental Funds, have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Aharonne Oyadomai & Kauli CPAs, Inc.

Honolulu, Hawaii
November 21, 2005



STATE OF HAWAII
DEPARTMENT OF HAWAIIAN HOME LANDS

P.O. BOX 1879
HONOLULU, HAWAII 96805

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis (MD&A) is designed to provide an overview of the financial performance of the Department of Hawaiian Home Lands (Department) for the fiscal year ended June 30, 2005. Please read it in conjunction with the transmittal letter at the front of this report and the Department's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS FOR FISCAL YEAR 2005

- The Department's total net assets, the amount of assets exceeding liabilities, totaled \$544.6 million. Of this amount, \$273.2 million is unrestricted and \$271.4 million is invested in capital assets, net of related debt.
- The Department's total net assets increased \$31.4 million over the course of this year's operation.
- In fiscal year 2005, the Department's revenues exceeded expenditures by \$1.4 million. In fiscal year 2004, expenditures exceeded revenues by \$2.6 million.
- The total expenditures of the Department increased by \$0.3 million, or 1.3%.
- The General Fund appropriation was \$473,150 less than fiscal year 2004. This represents a 38.48% decrease in General Fund appropriations.
- The total fund balance of the Department's governmental funds increased by \$6.3 million, which was largely due to the Department's \$30 million annual settlement payment from the State of Hawaii.

OVERVIEW OF THE FINANCIAL STATEMENTS

This MD&A serves as an introduction to the Department's basic financial statements. The basic financial statements are comprised of three components: (1) department-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report

also contains other supplementary information (combining financial statements – nonmajor governmental funds) in addition to the basic financial statements.

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

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

The statements are followed by a section of required supplementary information that further explains and supports the information in the fund financial statements. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

Department-wide Financial Statements

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

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

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

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

Fund Financial Statements

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

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

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

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

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

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

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

Hawaiian Home Lands Trust Fund – This fund was established by Act 14, Special Session 1995 which settles all claims made on behalf of the Hawaiian Home Lands Trust against the State between August 21, 1959 and July, 1988. It requires that the State make twenty annual deposits of \$30,000,000 or their discounted equivalent into the Hawaiian Home Lands Trust Fund. Proceeds of the fund may be used by the Department for capital improvements and other purposes undertaken in furtherance of the Hawaiian Homes Commission Act of 1920, as amended.

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

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

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

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

Temporary Deposits – This fund accounts for trust fund deposits relating to of Hawaiian Home Lands.

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

In addition to the basic financial statements and accompanying notes this report also presents other supplementary information consisting of the Combining Balance Sheet and Combining Statement of Revenues, Expenditures and Changes in Fund Balance in connection with non-major governmental funds and Schedule of Expenditures of Federal Awards.

FINANCIAL ANALYSIS OF THE DEPARTMENT AS A WHOLE

Net Assets

The Department’s total net assets were increased \$31.4 million to approximately \$544.6 million between fiscal year 2004 and 2005. A large portion of the Department’s net assets (50%) reflects its investment in capital assets such as land, buildings, infrastructure and construction-in-progress. The Department uses these capital assets to provide public lands which are leased to native Hawaiians, consequently, these assets are not available for future spending. Although the Department’s investment in its capital assets are reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets cannot be used to liquidate these liabilities.

The following is a comparative statement of net assets:

Summary of Statement of Net Assets
(in millions)

	2005	2004	Increase (Decrease)
Current and Other Assets	\$ 290.9	\$ 277.9	\$ 13.0
Capital Assets	313.3	259.0	54.3
Total Assets	<u>\$ 604.2</u>	<u>\$ 536.9</u>	<u>\$ 67.3</u>
Long-term Debt Outstanding	\$ 41.9	\$ 11.8	\$ 30.1
Other Liabilities	17.7	11.9	5.8
Total Liabilities	<u>\$ 59.6</u>	<u>\$ 23.7</u>	<u>\$ 35.9</u>
Net Assets			
Invested in capital assets, net of related debt	\$ 271.4	\$ 246.6	\$ 24.8
Unrestricted	273.2	266.6	6.6
Total Net Assets	<u>\$ 544.6</u>	<u>\$ 513.2</u>	<u>\$ 31.4</u>

Change in Net Assets

The Department's total program revenues increased by 23.2% to \$20.2 million. (See Statement of Activities). 16.3% of the Department's program revenues come from loan interest income and 39.1% of the Department's program revenues come from the general lease program. A large portion of the revenue, approximately 44.6% of the revenue, comes from grants and contributions. Total general revenues increased by 6.8% to \$7.9 million due to an decrease in State appropriations of \$1.1 million and a increase in investment income of \$1.6 million. The total cost of the Department's program increased by \$0.3 million, or 1.3%. The Department received \$30.0 million as part of the annual settlement payment with the State of Hawaii in accordance with Act 14, SP SLH 1995. Cash was transferred from the Department of Budget and Finance for the Hawaiian Home Lands settlement payment.

Statement of Activities

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

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

Changes in Net Assets (in millions)			
	2005	2004	Increase (Decrease)
Revenues:			
Program Revenues			
Homestead Services	\$ 3.3	\$ 3.0	\$ 0.3
Land Management	7.9	7.3	0.6
Intergovernmental Revenues	9.0	6.1	2.9
Appropriation (Net of Lapsed Appropriation)	0.7	1.8	(1.1)
Interest from Short-term Cash Investment	6.1	4.6	1.5
Other	1.1	1.0	0.1
Total Revenues	<u>28.1</u>	<u>23.8</u>	<u>4.3</u>
Expenses:			
Administration and support services	7.2	6.5	0.7
Homestead Services	12.6	17.2	(4.6)
Land Development	4.7	1.5	3.2
Land Management	2.2	1.2	1.0
Total Expenditures	<u>26.7</u>	<u>26.4</u>	<u>0.3</u>
Excess (deficiency) of revenues over expenditures	1.4	(2.6)	4.0
Other Financing Sources			
Operating Transfer in/out (net)	<u>30.0</u>	<u>30.0</u>	<u>-</u>
Change in Net Assets	<u>31.4</u>	<u>27.4</u>	<u>4.0</u>
Net Assets, Beginning Year, as previously reported	<u>513.2</u>	<u>485.8</u>	<u>27.4</u>
Net Assets, Ending Year	<u>\$ 544.6</u>	<u>\$ 513.2</u>	<u>\$ 31.4</u>

As noted, net assets increased \$31.4 million, a 6.1% growth this year. This amount is higher than fiscal 2004 when net assets increased \$27.4 million, a 4.7% growth. Total revenue increased 18.1% over last year and expenses increased by 1.1%. Major factor in revenue increasing 18.1% was:

- In fiscal year 2005, the Department is the recipient of an annual block grant under the Native American Housing and Self-Determination Act (NAHASDA). The Department requested and received funding of \$9.0 million from NAHASDA and other federal funds

As noted earlier, expenses increased by 1.1%, largely due to increase activities in land development.

FINANCIAL ANALYSIS OF THE DEPARTMENT'S GOVERNMENTAL FUNDS
Governmental Funds

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

As of the end of fiscal year 2005, the Department's governmental funds reported a combined increase in fund balance of \$6.2 million. The changes in fund balance for the governmental funds differ from the change in net assets for governmental activities. The differences relate to certain financial resources and expenditures such as debt financing and capital outlays that are included in the changes in fund balances but are not reported in the changes in net assets.

Comparison of Balance Sheets
(in millions)

	Assets			Liabilities			Fund Balances		
	2005	2004	Change	2005	2004	Change	2005	2004	Change
General Fund	\$ 0.1	\$ 0.1	\$ -	\$ 0.1	\$ 0.1	\$ -	\$ -	\$ -	\$ -
General Loan Fund	65.2	63.2	2.0	5.2	3.0	2.2	60.0	60.2	(0.2)
Trust Fund	139.1	129.5	9.6	3.6	2.9	0.7	135.4	126.6	8.8
Federal Grants	2.6	0.8	1.8	2.6	0.8	1.8	-	-	-
Operating Fund	19.3	16.9	2.4	1.0	0.8	0.2	18.3	16.1	2.2
Receipts Fund	3.0	2.7	0.3	3.0	2.5	0.5	-	0.2	(0.2)
Administration Account	8.0	13.2	(5.2)	1.9	0.8	1.1	6.1	12.4	(6.3)
Temporary Deposits	2.4	2.0	0.4	2.2	1.8	0.4	0.2	0.2	-
Other Funds	51.2	49.4	1.8	-	0.1	(0.1)	51.2	49.3	1.9
Total	<u>\$290.9</u>	<u>\$277.8</u>	<u>\$13.1</u>	<u>\$ 19.6</u>	<u>\$ 12.8</u>	<u>\$ 6.8</u>	<u>\$271.2</u>	<u>\$265.0</u>	<u>\$ 6.2</u>

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

	Revenues			Expenditures			Net Change in Fund Balances		
	2005	2004	Change	2005	2004	Change	2005	2004	Change
General Fund	\$ 0.8	\$ 1.3	\$(0.5)	\$ 0.7	\$ 1.2	\$ (0.5)	\$ -	\$ -	\$ -
General Loan Fund	-	-	-	0.2	0.4	(0.2)	(0.2)	0.3	(0.5)
Trust Fund	3.6	3.0	0.6	24.8	9.8	15.0	8.8	23.2	(14.4)
Federal Grants	9.0	6.0	3.0	9.0	6.0	3.0	-	-	-
Operating Fund	0.8	0.4	0.4	8.3	5.8	2.5	2.1	2.5	(0.4)
Receipts Fund	4.5	5.2	(0.7)	-	-	-	(0.2)	1.0	(1.2)
Administration Account	8.0	8.3	(0.3)	5.6	4.9	0.7	(6.2)	4.4	(10.6)
Temporary Deposits	-	-	-	-	-	-	-	-	-
Other Funds	1.1	1.5	(0.4)	2.7	4.3	(1.6)	2.0	(8.3)	10.3
Total	\$ 27.8	\$ 25.7	\$ 2.1	\$ 51.3	\$ 32.4	\$ 18.9	\$ 6.3	\$ 23.1	\$(16.8)

At the end of fiscal year 2005, the Hawaiian Home Lands Trust Fund reported an increase in the fund balance of \$8.8 million. The increase in the fund balance is the result of the receipt of the \$30 million from the Department of Budget and finance for the settlement. The fund balance of the Hawaiian Home Operating Fund increased by \$2.1 million. The increase is the result of funds being transferred in from the Hawaiian Home Receipts Fund and the Hawaiian Home Administration Account. Overall, the assets for the Department increased by \$13.1 million and fund balance increased by \$6.3 million despite several funds declining in their values.

BUDGETARY HIGHLIGHTS

There was reduction between the original budget and the final budget. Actual expenditures were less than budgetary estimates by \$98,306 or 12.7%. The favorable variance was created by expenditure control measures.

In the Hawaiian Home Administration Account, the actual revenue exceeded the budgeted amount by \$187,837 and expenditures were \$2.1 million less than the budgeted amount. The favorable variances were created by increased general lease collections and spending cuts.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of fiscal year 2005, the Department had invested \$402.5 million in a broad range of capital assets, including land, building, improvements, equipment and infrastructure. This amount represents a net increase (including additions, deductions and reclassifications) of \$62.9 million, or 18.5%, over last year.

	Capital Assets (in millions)		
	2005	2004	Increase (Decrease)
Buildings and Improvements	\$ 9.6	\$ 9.0	\$ 0.6
Furniture and Equipment	0.6	0.6	-
Motor Vehicles	0.8	0.7	0.1
Infrastructure	287.3	255.7	31.6
Total Depreciable Assets	298.3	266.0	32.3
Less: Accumulated Depreciation	(89.2)	(80.5)	8.7
Net Depreciable Assets	209.1	185.5	23.6
Land	33.7	17.5	16.2
Construction in Progress	70.5	56.0	14.5
Total Capital Assets	\$ 313.3	\$ 259.0	\$ 54.3

In fiscal year 2005, the Department expended \$63.4 million for various capital projects. The Department has no plan to issue additional debt to finance these projects. Rather, the Department will continue to use its trust funds and federal funds to fund these projects.

Long-term Debt

At the end of fiscal year 2005, the Department had \$9.9 million in revenue bonds outstanding, all from the 1999 series revenue bonds. These revenue bonds will be paid off in year 2012. The Department is also obligated to repay a portion of the State general obligation bonds issued on the Department's behalf through Reimbursable General Obligation Bonds. The total obligation is \$1.2 million and will be paid in full through fiscal year 2018.

Outstanding Debt
(in millions)

	2005	2004	Increase (Decrease)
Revenue Bonds	\$ 9.9	\$ 11.1	\$ (1.2)
General Obligation Bonds	1.2	1.3	(0.1)
Total	\$ 11.1	\$ 12.4	\$ (1.3)

ECONOMIC FACTORS AND NEXT YEAR’S BUDGETS AND RATES

In the 2005-2006 budget, the general fund appropriation is \$0.8 million and reflects a decrease of \$6,298, or 1% from fiscal year 2005.

Revenues generated from general leases, revocable permits, licenses and right of entry agreements are projected to total \$8 million. This represents a 6.7% increase from the prior fiscal year. The increases are primarily due to new general lease dispositions and general lease rental re-openings.

SUBSEQUENT OR FUTURE EVENTS

Based on DHHL's 2003-2008 Strategic Plan that outlined the department's four goals: Providing 6,000 native Hawaiians with homeownership opportunities, addressing the findings of the State Auditor’s Report, attaining financial self-sufficiency, and empowering our homestead communities, the Department is on target in meeting its strategic plan expectations. The department will continue this effort by implementing the following in the upcoming fiscal years.

Providing 6,000 native Hawaiians with homeownership opportunities

DHHL will begin construction on development projects on Hawaii, Kaua'i, Maui, and Oahu over the next three years. A total of 18 projects have been identified that is expected to produce an estimated 4,100 units with an infrastructure cost of approximately \$282 million. All of these projects are expected to be funded out of our existing budget. These development plans reflect a new philosophy for the department of building communities of 500-1,000 lots rather than historical small pocket type developments (i.e. 50 lots).

To facilitate homeownership for native Hawaiians, the department created a new type of lease award called Ho'ohiki, or Undivided Interest. Undivided Interest is an award to a group of individuals for a non-parceled land base. Unlike accelerated awards in the past, this award provides our beneficiaries the time to prepare for homeownership while DHHL develops the project. As development occurs, our beneficiaries are provided with financial assistance, education, and personalized case management that addresses homeownership needs. Furthermore, participants in Undivided Interest are kept abreast of the status of development, and homeownership information through DHHL's Ho'opaepae community newsletter. Unlike Ka

Nuhou, which is mailed to all DHHL lessees, the Ho'opaepae newsletter is specifically written and sent to Undivided Interest lessees. To date, DHHL has awarded 620 Undivided Interest awards during fiscal year 2005-06, and plans to award an additional 851 Undivided Interest awards within the next two fiscal years.

Concurrently with Undivided Interest, the department also developed the Home Ownership Assistance Program (HOAP). This program was created to support the efforts of native Hawaiians interested in achieving homeownership by providing native Hawaiians with financial literacy training, homebuyer education, mortgage products, credit counseling, and access to relevant experts and resources in the homebuyer, financial literacy, and mortgage lending industries. To date, 621 native Hawaiians are participating in HOAP. We estimate this amount to increase to over 1,500 within the next two fiscal years.

Addressing the findings of the State Auditor's Report

In order to address findings from previous State Audits, DHHL has focused its efforts to establish better management controls for internal operations. For example, DHHL's delinquency ratio for our direct loan portfolio existed at 43.6% in 2002. This fiscal year, DHHL decreased this to 27.35%. By 2008, our goal is to reduce these delinquencies at, or below, 20%. Other management controls established by DHHL include the publication and distribution of a procurement manual, and the creation of internal loan policies and procedures manual. An internal application procedure manual is planned for completion by next fiscal year.

Attaining financial self-sufficiency

DHHL must generate significant non-governmental revenue in the amount of \$30 million a year by 2013 in order for the DHHL to become financially self-sufficient. During calendar year 2005, the DHHL generated nearly \$10 million in revenues that are used towards fulfilling the department's mission. This is expected to increase to \$11.5 million in calendar year 2006, and \$14 million in calendar year 2007.

Empowering our homestead communities

In an effort to empower our native Hawaiian communities, DHHL is developing regional island plans for all of our exiting homestead communities on all islands. These plans not only cover data from a respective homestead community, but also include information on surrounding communities, infrastructure, stakeholders, and cultural areas. Also, these plans identify community priorities and input so that future developments and projects may be developed in partnership with the community.

FINANCIAL CONTACT

This financial report is designed to provide our citizens, taxpayers, lessees, investors and creditors with a general overview of the Department's finances and to demonstrate the Department's accountability for monies received. If there are any questions regarding this report or if additional financial information is required, please contact the Fiscal Office. The Department is located at 1099 Alakea Street, Suite 2000, Honolulu, Hawaii 96813.

Department of Hawaiian Home Lands

State of Hawaii

Statement of Net Assets

June 30, 2005

ASSETS

Cash and short-term cash investments held in State Treasury (Note C)	\$	231,855,459
Receivables (Note D):		
Loans, net of allowance for losses of \$4,187,000		46,552,751
Accrued interest		4,057,290
Note receivable		4,274,196
General leases and licenses, net of allowance for losses of \$955,000		763,315
Other		2,647,472
Other assets		737,900
Capital assets:		
Land, improvements, construction-in-progress and other capital assets, net of depreciation (Note I)		313,333,834
Total assets	\$	<u>604,222,217</u>

LIABILITIES

Vouchers and contracts payable	\$	6,751,297
Accrued wages and employee benefits payable (Note B)		478,640
Due to State Treasury		10,000
Other liabilities		7,989,443
Deferred revenue		1,296,280
Purchase note payable (Note P):		
Due within one year		2,200,000
Due in more than one year		28,600,000
Bonds payable (Note J):		
Due within one year		1,427,000
Due in more than one year		9,713,473
Accrued vacation (Note J):		
Due within one year		364,000
Due in more than one year		794,818
Total liabilities		<u>59,624,951</u>

Commitments and contingencies (Notes E, K, L, M, N and O)

NET ASSETS

Invested in capital assets, net of related debt		271,393,361
Unrestricted		<u>273,203,905</u>
Total net assets		<u>544,597,266</u>
Total liabilities and net assets	\$	<u>604,222,217</u>

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

Department of Hawaiian Home Lands

State of Hawaii

Statement of Activities
for the year ended June 30, 2005

Functions/Programs	Expenses	Program Revenue		Net (Expense) Revenue and Changes in Net Assets
		Interest, Rents and Fees	Operating Grants and Contributions	
Departmental activities:				
Administration and support services	\$ 7,171,562	\$ -	\$ 734,778	\$ (6,436,784)
Homestead services	12,625,811	3,277,322	-	(9,348,489)
Land development	4,731,674	-	8,273,593	3,541,919
Land management	<u>2,188,573</u>	<u>7,882,047</u>	<u>-</u>	<u>5,693,474</u>
 Total departmental activities	 <u>\$ 26,717,620</u>	 <u>\$ 11,159,369</u>	 <u>\$ 9,008,371</u>	 <u>(6,549,880)</u>
General revenues:				
Appropriations, net of lapsed appropriations of \$168,175				655,682
Interest from short-term cash investments				6,139,715
Other				<u>1,115,770</u>
Total general revenues before transfers				7,911,167
Transfers, net (Note L)				<u>30,000,000</u>
Total general revenues and transfers				<u>37,911,167</u>
Change in net assets				31,361,287
Net assets at July 1, 2004				<u>513,235,979</u>
Net assets at June 30, 2005				<u>\$ 544,597,266</u>

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

Department of Hawaiian Home Lands
State of Hawaii
Balance Sheet
Governmental Funds
June 30, 2005

	General Fund	Hawaiian Home General Loan Fund	Hawaiian Home Lands Trust Fund	Hawaiian Home Operating Fund	Hawaiian Home Receipts Fund	Hawaiian Home Administration Account	Federal Grants	Temporary Deposits	Other Funds	Total
ASSETS										
Cash and short-term cash investments held in State Treasury (Note C)	\$ 86,020	\$ 21,895,131	\$ 133,895,526	\$ 19,229,399	\$ -	\$ 7,281,359	\$ 21,000	\$ 2,390,314	\$ 47,056,710	\$ 231,855,459
Receivables (Note D):										
Loans, net of allowance for losses of \$4,187,000	-	42,701,673	-	-	-	-	-	-	3,851,078	46,552,751
Accrued interest	-	-	878,696	17,236	2,984,901	-	-	-	176,457	4,057,290
Note receivable	-	-	4,274,196	-	-	-	-	-	-	4,274,196
General leases and licenses, net of allowance for losses of \$955,000	-	-	-	210	-	763,105	-	-	-	763,315
Other	-	(428)	-	42,595	-	1,492	2,601,802	-	2,011	2,647,472
Other assets	-	589,600	-	-	-	-	-	-	148,300	737,900
Total assets	\$ 86,020	\$ 65,185,976	\$ 139,048,418	\$ 19,289,440	\$ 2,984,901	\$ 8,045,956	\$ 2,622,802	\$ 2,390,314	\$ 51,234,556	\$ 290,888,383
LIABILITIES										
Vouchers and contracts payable	\$ -	\$ -	\$ 3,632,742	\$ 390,203	\$ -	\$ 105,376	\$ 2,605,537	\$ -	\$ 17,439	\$ 6,751,297
Accrued wages and employee benefits payable (Note B)	28,515	-	-	235,456	-	214,669	-	-	-	478,640
Due to State Treasury	10,000	-	-	-	-	-	-	-	-	10,000
Other liabilities	-	5,178,394	-	148,853	476,719	15,163	-	2,170,314	-	7,989,443
Deferred revenue	-	-	-	253,699	2,523,000	1,599,581	-	-	-	4,376,280
Total liabilities	38,515	5,178,394	3,632,742	1,028,211	2,999,719	1,934,789	2,605,537	2,170,314	17,439	19,605,660
Commitments and contingencies (Notes E, K, L, M, N, and O)										
FUND BALANCES										
Reserved for:										
Encumbrances	76,020	-	49,462,789	5,633,079	-	373,420	-	220,000	1,679,924	57,445,232
Receivables (Note D)	-	42,701,245	5,152,892	60,041	2,984,901	764,597	2,601,802	-	4,029,546	58,295,024
Loan commitments (Note E)	-	1,010,379	-	-	-	-	-	-	-	1,010,379
Unexpended Federal grants	-	-	-	-	-	-	2,971,233	-	-	2,971,233
Guaranteed and insured loans (Note K)	-	150,000	-	-	-	-	-	-	10,850,100	11,000,100
Total reserved fund balances	76,020	43,861,624	54,615,681	5,693,120	2,984,901	1,138,017	5,573,035	220,000	16,559,570	130,721,968
Unreserved	(28,515)	16,145,958	80,799,995	12,568,109	(2,999,719)	4,973,150	(5,555,770)	-	-	105,903,208
Unreserved reported in nonmajor:										
Special revenue funds	-	-	-	-	-	-	-	-	34,657,547	34,657,547
Total unreserved fund balances	(28,515)	16,145,958	80,799,995	12,568,109	(2,999,719)	4,973,150	(5,555,770)	-	34,657,547	140,560,755
Total fund balances	47,505	60,007,582	135,415,676	18,261,229	(14,818)	6,111,167	17,265	220,000	51,217,117	271,282,723
Total liabilities and fund balances	\$ 86,020	\$ 65,185,976	\$ 139,048,418	\$ 19,289,440	\$ 2,984,901	\$ 8,045,956	\$ 2,622,802	\$ 2,390,314	\$ 51,234,556	\$ 290,888,383

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

Department of Hawaiian Home Lands
State of Hawaii
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
for the year ended June 30, 2005

	General Fund	Hawaiian Home General Loan Fund	Hawaiian Home Lands Trust Fund	Hawaiian Home Operating Fund	Hawaiian Home Receipts Fund	Hawaiian Home Administration Account	Federal Grants	Temporary Deposits	Other Funds	Total
Revenues										
Appropriations	\$ 823,857	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 823,857
General leases	-	-	-	-	-	5,739,010	-	-	-	5,739,010
Licenses and permits	-	-	-	-	-	1,928,037	-	-	-	1,928,037
Interest from loans and note receivable	-	-	-	106,406	2,965,916	-	-	-	-	3,072,322
Interest from short-term cash investments	-	-	3,330,605	15,402	1,541,172	328,779	-	-	923,757	6,139,715
Intergovernmental revenues	-	-	-	-	-	-	9,008,371	-	-	9,008,371
Other	-	-	246,700	645,627	-	39,904	-	-	183,539	1,115,770
Total revenues	823,857	-	3,577,305	767,435	4,507,088	8,035,730	9,008,371	-	1,107,296	27,827,082
Expenditures										
Current:										
Administration and support services	187,677	-	62,273	2,290,824	-	2,802,328	670,770	-	1,068,773	7,082,645
Homestead services	385,885	225,503	-	1,172,776	-	1,730,106	-	-	(23,000)	3,491,270
Land development	82,474	-	3,930,182	884,052	-	857,167	734,365	-	-	6,488,240
Land management	48,624	-	38,460	1,806,543	-	248,740	3,735	-	9,507	2,155,609
Capital outlay:										
Home construction/capital projects	-	-	20,776,924	2,004,556	-	-	7,569,638	-	6,207	30,357,325
Debt service:										
Principal on long-term debt	-	-	-	100,083	-	-	-	-	1,200,000	1,300,083
Interest on long-term debt	-	-	-	58,330	-	-	-	-	440,297	498,627
Total expenditures	704,660	225,503	24,807,839	8,317,164	-	5,638,341	8,978,508	-	2,701,784	51,373,799
Excess (deficiency) of revenues over (under) expenditures	119,197	(225,503)	(21,230,534)	(7,549,729)	4,507,088	2,397,389	29,863	-	(1,594,488)	(23,546,717)
Other financing sources (uses)										
Operating transfers in (Note L)	-	-	30,000,000	9,672,364	-	8,000,852	-	-	11,625,691	59,298,907
Operating transfers out	-	-	-	-	(4,672,364)	(16,625,691)	-	-	(8,000,852)	(29,298,907)
Total other financing sources (uses)	-	-	30,000,000	9,672,364	(4,672,364)	(8,624,839)	-	-	3,624,839	30,000,000
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	119,197	(225,503)	8,769,466	2,122,635	(165,276)	(6,227,450)	29,863	-	2,030,351	6,453,283
Lapsed appropriations	(98,306)	-	-	-	-	-	-	-	(69,869)	(168,175)
Net change in fund balances	20,891	(225,503)	8,769,466	2,122,635	(165,276)	(6,227,450)	29,863	-	1,960,482	6,285,108
Fund balances at July 1, 2004	26,614	60,233,085	126,646,210	16,138,594	150,458	12,338,617	(12,598)	220,000	49,256,635	264,997,615
Fund balances at June 30, 2005	\$ 47,505	\$ 60,007,582	\$ 135,415,676	\$ 18,261,229	\$ (14,818)	\$ 6,111,167	\$ 17,265	\$ 220,000	\$ 51,217,117	\$ 271,282,723

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

Department of Hawaiian Home Lands
State of Hawaii
Reconciliation of Governmental Funds Balance Sheet to the Statement of Net Assets
June 30, 2005

	Total Governmental Funds	Long-Term Assets, Liabilities	Reclassifications and Eliminations	Statement of Net Assets
ASSETS				
Cash and short-term cash investments held in State Treasury	\$ 231,855,459	\$ -	\$ -	\$ 231,855,459
Receivables:				
Loans, net of allowance for losses	46,552,751	-	-	46,552,751
Accrued interest	4,057,290	-	-	4,057,290
Note receivable	4,274,196	-	-	4,274,196
General leases and licenses, net of allowance for losses	763,315	-	-	763,315
Other	2,647,472	-	-	2,647,472
Other assets	737,900	-	-	737,900
Capital assets:				
Land, improvements, construction-in-progress and other capital assets, net of depreciation	-	313,333,834 (1)	-	313,333,834
Total assets	<u>\$ 290,888,383</u>	<u>\$ 313,333,834</u>	<u>\$ -</u>	<u>\$ 604,222,217</u>
LIABILITIES				
Vouchers and contracts payable	\$ 6,751,297	\$ -	\$ -	\$ 6,751,297
Accrued wages and employee benefits payable	478,640	-	-	478,640
Due to State Treasury	10,000	-	-	10,000
Other liabilities	7,989,443	-	-	7,989,443
Deferred revenue	4,376,280	(3,080,000) (5)	-	1,296,280
Note payable:				
Due within one year	-	2,200,000 (2)	-	2,200,000
Due in more than one year	-	28,600,000 (2)	-	28,600,000
Bonds payable:				
Due within one year	-	1,427,000 (3)	-	1,427,000
Due in more than one year	-	9,713,473 (3)	-	9,713,473
Accrued vacation:				
Due within one year	-	364,000 (4)	-	364,000
Due in more than one year	-	794,818 (4)	-	794,818
Total liabilities	<u>19,605,660</u>	<u>40,019,291</u>	<u>-</u>	<u>59,624,951</u>
FUND BALANCES/NET ASSETS				
Invested in capital assets, net of related debt	-	259,084,721 (1)	-	271,393,361
		63,429,629 (1)		
		(8,709,059) (1)		
		(471,457) (1)		
		(30,800,000) (2)		
		(12,442,480) (3)		
		1,300,083 (3)		
		1,924 (3)		
Reserved/Restricted for:				
Encumbrances	57,445,232	-	(57,445,232) (6)	-
Receivables	58,295,024	-	(58,295,024) (6)	-
Loan commitments	1,010,379	-	(1,010,379) (6)	-
Unexpended Federal grants	2,971,233	-	(2,971,233) (6)	-
Guaranteed and insured loans	11,000,100	-	(11,000,100) (6)	-
Unreserved/Unrestricted:	140,560,755	(1,063,877) (4)	130,721,968 (6)	273,203,905
		(94,941) (4)		
		2,523,000 (5)		
		557,000 (5)		
Total fund balances/net assets	<u>271,282,723</u>	<u>273,314,543</u>	<u>-</u>	<u>544,597,266</u>
Total liabilities and fund balances/net assets	<u>\$ 290,888,383</u>	<u>\$ 313,333,834</u>	<u>\$ -</u>	<u>\$ 604,222,217</u>

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

Department of Hawaiian Home Lands
State of Hawaii

Reconciliation of Governmental Funds Balance Sheet to the Statement of Net Assets
June 30, 2005 (continued)

Total fund balances - governmental funds \$ 271,282,723

Amounts reported for governmental activities in the statement of net assets are different because:

- (1) Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. These assets consist of:

Infrastructure assets	\$	287,309,872	
Other capital assets		10,965,286	
Accumulated depreciation		(89,176,016)	
Land		33,680,905	
Construction in progress		70,553,787	
Total capital assets			313,333,834

- (2) Notes payable that are not due and payable in the current period are not reported in the funds. (30,800,000)

- (3) Bonds payable that are not due and payable in the current period are not reported in the funds. (11,140,473)

- (4) Compensated absences that are not due and payable in the current period are not reported in the funds. (1,158,818)

- (5) Lease rents and loan interest receivables are not available soon enough after year end to pay for the current period's expenditures and are therefore deferred in the funds. 3,080,000

- (6) Reclassify reserved fund balance/net assets to unrestricted fund balance/net assets. -

Total net assets \$ 544,597,266

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

**Department of Hawaiian Home Lands
State of Hawaii**

Reconciliation of Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balances
to the Statement of Activities
for the year ended June 30, 2005

	Total Governmental Funds	Long-Term Assets, Liabilities	Reclassifications and Eliminations	Statement of Activities
Revenues				
Appropriations	\$ 823,857	\$ -	\$ (168,175) (6)	\$ 655,682
General leases	5,739,010	215,000 (5)	-	5,954,010
Licenses and permits	1,928,037	-	-	1,928,037
Interest from loans and note receivable	3,072,322	205,000 (5)	-	3,277,322
Interest from short-term cash investments	6,139,715	-	-	6,139,715
Intergovernmental revenues	9,008,371	-	-	9,008,371
Other	1,115,770	-	-	1,115,770
Total revenues	27,827,082	420,000	(168,175)	28,078,907
Expenditures				
Administration and support services	7,082,645	55,225 (1) (14,421) (1) (1,924) (3) 50,037 (4)	-	7,171,562
Homestead services	3,491,270	8,640,672 (1) (33,423) (1) 28,665 (4)	498,627 (7)	12,625,811
Land development	6,488,240	6,532 (1) (24,460) (1) 471,457 (1) (2,200,000) (2) (10,095) (4)	-	4,731,674
Land management	2,155,609	6,630 (1) 26,334 (4)	-	2,188,573
Home construction/capital projects	30,357,325	(30,357,325) (1)	-	-
Principal on long-term debt	1,300,083	(1,300,083) (3)	-	-
Interest on long-term debt	498,627	-	(498,627) (7)	-
Total expenditures	51,373,799	(24,656,179)	-	26,717,620
	(23,546,717)	(24,236,179)	(168,175)	1,361,287
Other financing sources and lapsed appropriations:				
Net operating transfers	30,000,000	-	-	30,000,000
Lapsed appropriations	(168,175)	-	168,175 (6)	-
Change in fund balances/net assets	\$ 6,285,108	\$ (24,236,179)	\$ -	\$ 31,361,287

The accompanying notes are an integral part of the financial statements

**Department of Hawaiian Home Lands
State of Hawaii**

Reconciliation of Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balances
to the Statement of Activities
for the year ended June 30, 2005 (continued)

Change in fund balances - governmental funds \$ 6,285,108

Amounts reported for governmental activities in the statement of activities are different because:

- (1) Capital outlays are reported as expenditures in governmental funds, however in the statement of activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense. In the current period, these outlays are:

Capital outlay	\$	30,429,629	
Depreciation expense		(8,709,059)	
Expense asset additions under the capitalization threshold		<u>(471,457)</u>	
Excess of capital outlay over depreciation expenses			21,249,113

- (2) Payment of note payable is reported as an expenditure in governmental funds, but the payment reduces notes payable in the statement of net assets. 2,200,000

- (3) Repayment of bond principal is reported as an expenditure in governmental funds, but the repayment reduces bonds payable in the statement of net assets. Also, the decrease in bonds payable due to discounts from refunding bonds is shown in the statement of net assets.

Repayment of bond principal	\$	1,300,083	
Discount from refunding bonds issued		<u>1,924</u>	
Net bond repayments			1,302,007

- (4) The net increase in accrued vacation is reported in the statement of activities and does not require the use of current financial resources and is therefore not reported as expenditures in governmental funds. (94,941)

- (5) Lease rent and loan interest that is not collected for several months after June 30 are not considered available revenues and are deferred in the governmental funds. Deferred revenues decreased by this amount in the current year. 420,000

- (6) Lapsed appropriations are net against appropriations in the statement of activities. -

- (7) Reclassify interest from interest on long-term debt to Homestead Services Division. -

Change in net assets \$ 31,361,287

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

Department of Hawaiian Home Lands

State of Hawaii

Statement of Revenues and Expenditures - Budget and Actual

General Fund

for the year ended June 30, 2005

	Budgeted Amounts		Actual (Budgetary Basis)	Variance with Final Budget - Positive (Negative)
	Original	Final		
Appropriations	\$ 1,277,007	\$ 775,293	\$ 823,857	\$ 48,564
Expenditures:				
Administration and support services	471,846	201,812	196,991	4,821
Homestead services	546,600	437,560	391,420	46,140
Land developement	80,444	80,444	85,986	(5,542)
Land management	178,117	55,477	51,154	4,323
Total expenditures	<u>1,277,007</u>	<u>775,293</u>	<u>725,551</u>	<u>49,742</u>
Excess of revenues over expenditures	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 98,306</u>	<u>\$ 98,306</u>

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

Department of Hawaiian Home Lands
State of Hawaii
Statement of Revenues and Expenditures - Budget and Actual
Other Major Funds
for the year ended June 30, 2005

	Budgeted Amounts		Actual (Budgetary Basis)	Variance with Final Budget - Positive (Negative)
	Original	Final		
<u>Hawaiian Home Administration Account</u>				
Revenues	\$ 7,172,586	\$ 7,847,893	\$ 8,035,730	\$ 187,837
Expenditures:				
Administration and support services	3,182,451	3,500,524	2,620,775	879,749
Homestead services	2,329,963	2,522,123	1,686,011	836,112
Land development	1,146,107	1,146,107	871,741	274,366
Land management	514,065	679,139	537,113	142,026
Total expenditures	<u>7,172,586</u>	<u>7,847,893</u>	<u>5,715,640</u>	<u>2,132,253</u>
Excess of revenues over expenditures	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,320,090</u>	<u>\$ 2,320,090</u>

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

Department of Hawaiian Home Lands
State of Hawaii

Notes to the Financial Statements
June 30, 2005

NOTE A - SIGNIFICANT ACCOUNTING POLICIES

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

The accompanying financial statements of the DHHL have been prepared in conformity with accounting principles generally accepted in the United State of America (GAAP) for state and local governments as prescribed by the Governmental Accounting Standards Board (GASB). The GASB is the accepted standard-setting body for establishing governmental accounting and financial principles. DHHL has defined its financial reporting entity in accordance with GASB Statement No. 14, *The Financial Reporting Entity*.

The accompanying financial statements present the financial position of the DHHL and the various funds and fund types and the changes in financial position of the DHHL and the various funds and fund types. The financial statements are presented as of June 30, 2005, and for the year then ended. The financial statements include the public trusts controlled by the Hawaiian Homes Commission.

The following is a summary of significant accounting policies:

1. Reporting Entity - The DHHL is part of the executive branch of the State. The DHHL's financial statements are intended to present the financial position and the changes in financial position, of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the DHHL. The State Comptroller maintains the central accounts for all State funds and publishes financial statements for the State annually which includes the DHHL's assets, liabilities, net assets and financial activities.
2. Departmental and Governmental Fund Financial Statements – The departmental financial statements (the statement of net assets and the statement of activities) report information of all of the non-fiduciary activities of the DHHL. The effect of interfund activity has been removed from these departmental financial statements.

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

Department of Hawaiian Home Lands

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Notes to the Financial Statements

June 30, 2005

NOTE A - SIGNIFICANT ACCOUNTING POLICIES (continued)

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

Net assets are restricted when constraints placed on them are either externally imposed or are imposed by constitutional provisions or enabling legislation. At June 30, 2005, there were no restricted net assets.

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

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

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

Financial statements are provided for DHHL's governmental funds. The DHHL has no proprietary funds or fiduciary funds. Major individual governmental funds are reported as separate columns in the governmental fund financial statements.

3. Measurement Focus, Basis of Accounting and Financial Statement Presentation –

Departmental Financial Statements – The departmental 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.

Governmental Fund Financial Statements – The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay

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Notes to the Financial Statements

June 30, 2005

NOTE A - SIGNIFICANT ACCOUNTING POLICIES (continued)

liabilities of the current period. For this purpose, the DHHL considers revenues to be available if they are collected within 60 days of the end of the current fiscal year end. Principal revenue sources considered susceptible to accrual include lease payments, sales, federal grants and interest on loans and investments, and loan principal and interest receivable. Some revenue items that are considered measurable and available to finance operations during the year from an accounting perspective are not available for expenditure due to the State's present appropriation system. These revenues have been accrued in accordance with accounting principles generally accepted in the United States of America since they are both measurable and are expected to be collected within sixty days of the end of the period.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. Exceptions include:

- Employees' vested annual leave which is recorded as an expenditure when utilized. The amount of accumulated annual leave unpaid at June 30, 2005, has been reported only in the departmental financial statements.
- Interest on bonds payable which is recognized when paid.

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

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

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

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

Hawaiian Home General Loan Fund – This fund accounts for DHHL loans made to native Hawaiian homesteaders.

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Notes to the Financial Statements
June 30, 2005

NOTE A - SIGNIFICANT ACCOUNTING POLICIES (continued)

Hawaiian Home Operating Fund – This fund accounts for operations of the DHHL and is funded by monies transferred from the Hawaiian Home Receipts Fund.

Hawaiian Home Receipts Fund – This fund accounts for receipts of investment interest and loan interest payments from DHHL loans to homesteaders.

Hawaiian Home Administration Account – This fund accounts for commercial general leases, revocable permits and licenses of homestead lands. Lease revenues are used to fund operations of the DHHL.

Federal Grants – This fund accounts for grants the DHHL has with the Federal Government.

Temporary Deposits – This fund accounts for refundable deposits to lessees of homestead lands.

Hawaiian Home Lands Trust Fund – This expendable trust fund accounts for funds from the State to be expended by the DHHL as provided by law upon approval by the Commission and used for capital improvements and other purposes undertaken in furtherance of the Hawaiian Homes Commission Act of 1920.

5. Appropriations - An authorization granted by the State Legislature permitting a State agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are allotted quarterly. The allotted appropriations lapse if not expended by or encumbered at the end of the fiscal year, except for allotted appropriations related to capital projects.
6. Encumbrances - Encumbrance accounting, under which purchase orders, contracts and other commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation, is employed as an extension of formal budgetary integration in the governmental fund types. Encumbrances outstanding at fiscal year end are reported as reservations of fund balances since they do not constitute expenditures or liabilities.
7. Cash and Short-term Cash Investments - Cash and short-term cash investments reported in the statement of net assets and the governmental funds balance sheet consist of cash and short-term cash investments in the State Treasury.

The State of Hawaii maintains a cash pool that is available for all funds. Each fund type's portion of this pool is displayed on the statement of net assets and the governmental funds balance sheet within cash and short-term cash investments. Those funds are pooled with funds from other State agencies and departments and deposited in

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Notes to the Financial Statements
June 30, 2005

NOTE A - SIGNIFICANT ACCOUNTING POLICIES (continued)

approved financial institutions by the State Director of Finance. Deposits not covered by federal deposit insurance are fully collateralized by government securities held in the name of the State by third party custodians. Interest income from this cash pool is allocated to the various departments and agencies based upon their average cash balance for the period.

The Hawaii Revised Statutes (HRS) authorized the State Director of Finance to invest in obligations of or obligations 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.

8. Accumulated Vacation and Sick Leave - Eligible employees are credited with vacation at a rate of 168 hours per calendar year. Accumulation of such vacation credits is limited to 720 hours at calendar year-end. The governmental fund financial statements record expenditures when employees are paid for leave. The departmental financial statements present the cost of accumulated vacation leave as a liability. Liabilities for vacation pay are inventoried at the end of each accounting period and adjusted to current salary levels.

Eligible employees are credited with sick leave at a rate of one and three-quarter days per month of service. Unused sick leave may be accumulated without limit but can be taken only in the event of illness or other incapacitation and is not convertible to pay upon termination of employment. Accordingly, accumulated sick leave is not included in the DHHL's statement of net assets or governmental fund balance sheet. However, an employee who retires or leaves government service in good standing with sixty days or more in unused sick leave is entitled to additional service credit in the Employees' Retirement System of the State of Hawaii (ERS). Accumulated sick leave as of June 30, 2005, was approximately \$3,491,000.

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

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

10. Inventory - Inventory of materials and supplies is recorded as expenditures when purchased.

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Notes to the Financial Statements

June 30, 2005

NOTE A - SIGNIFICANT ACCOUNTING POLICIES (continued)

11. Capital Assets – Capital assets, which include land, buildings, improvements, equipment and infrastructure assets, are reported in the departmental financial statements. Capital assets are assets which have a cost of \$5,000 or more at the date of acquisition and have an expected useful life of five or more years. Purchased and constructed capital assets are valued at historical cost or estimated historical cost. Donated fixed assets are recorded at their fair market value at the date of donation.

Capital assets utilized in the governmental funds are recorded as expenditures in the governmental fund financial statements. Depreciation expense is recorded in the departmental financial statements.

Capital assets are depreciated on the straight-line method over the assets' estimated useful life. There is no depreciation recorded for land and construction in progress. Generally, estimated useful lives are as follows:

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

Certain office space is provided by the Department of Accounting and General Services, State of Hawaii, at no cost to the DHHL.

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

12. General Leases and Licenses - General leases and licenses received in advance are recognized on a straight-line basis over the lease or license term.
13. Lease Rents and Interest Income - The DHHL's governmental fund financial statements recognizes lease rent and mortgage interest of its governmental funds as revenues when they are measurable and available. Revenues are measurable when they are subject to reasonable estimation. The available criterion is satisfied when revenues are collectible during the period and the actual collection will occur either during the period or after the end of the period, but in time to pay fund liabilities. The DHHL considers revenues available if they are expected to be collected within 60 days of the end of the year. Amounts not collected within this period approximated \$3,080,000 as of June 30, 2005, and are recorded as deferred revenue. The departmental financial statements present lease rents and mortgage interest under the accrual method of accounting.

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Notes to the Financial Statements

June 30, 2005

NOTE A - SIGNIFICANT ACCOUNTING POLICIES (continued)

14. Use of Estimates - In preparing financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

NOTE B - BUDGETING AND BUDGETARY CONTROL

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

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

For purposes of budgeting, the DHHL's budgetary fund structure and accounting principles differ from those utilized to present the financial statements in conformity with accounting principles generally accepted in the United States of America. Since the budgetary basis differs from accounting principles generally accepted in the United States of America, budget and actual amounts in the statement of revenues and expenditures – budget and actual – general fund, are presented on the budgetary basis. A reconciliation of general fund revenues in excess of expenditures on a budgetary basis for the year ended June 30, 2005, to general fund revenues in excess of expenditures presented in conformity with accounting principles generally accepted in the United States of America, is set forth below.

Under Section 78-13 HRS, staff salaries and wages amounting to \$28,515 and \$214,669 in the general fund and Hawaiian Home Administration Account, respectively, for the period from June 16, 2005 through June 30, 2005, are to be funded with monies budgeted for fiscal year 2006. In addition, at June 30, 2005, DHHL accrued expenditures of \$32,176 in the Hawaiian Home Administration Account for certain goods and services received through June 30, 2005, which DHHL will fund with monies budgeted for fiscal 2006. Accordingly, these amounts are excluded from the statements of revenues and expenditures – budget and actual of the general fund and Hawaiian Home Administration Account. For accounting purposes these amounts are reflected in the departmental and governmental fund financial statements at June 30, 2005, in accordance with accounting principles generally accepted in the United States of America.

Department of Hawaiian Home Lands
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Notes to the Financial Statements
June 30, 2005

NOTE B - BUDGETING AND BUDGETARY CONTROL (continued)

In fiscal year 2004, under section 78-13 HRS salaries and wages for the period from June 16, 2004 to June 30, 2004, were funded with monies budgeted for fiscal year 2005. Accordingly, these amounts are included in the statements of revenues and expenditures – budget and actual of the general fund and Hawaiian Home Administration Account, for the year ended June 30, 2005. These expenditures, aggregated \$49,406 for the general fund and \$186,121 for the Hawaiian Home Administration Account.

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

	General Fund	Hawaiian Home Administration Account
Excess of revenues over expenditures - actual on budgetary basis	\$ 98,306	\$ 2,320,090
Current year's appropriations included in reserved for encumbrances at June 30, 2005	-	292,057
Expenditures for liquidation of prior years' encumbrances	-	(483,035)
Reverse for losses adjustment	-	332,000
Fiscal 2004 expenditures funded by fiscal 2005 budget	49,406	186,121
Fiscal 2005 expenditures funded by fiscal 2006 budget under Section 78-13 HRS	(28,515)	(246,845)
Excess of revenues over expenditures - GAAP basis	\$ 119,197	\$ 2,397,389

NOTE C - CASH AND SHORT-TERM CASH INVESTMENTS

Cash and short-term cash investments includes monies in the State Treasury. The State Treasury maintains an investment pool for all state monies. Hawaii Revised Statutes (HRS) authorize the State Director of Finance to invest any monies of the State which in the Director's judgment are in excess of amounts necessary for meeting the immediate requirements of the State. Legally authorized investments include 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.

Department of Hawaiian Home Lands

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Notes to the Financial Statements

June 30, 2005

NOTE C - CASH AND SHORT-TERM CASH INVESTMENTS (continued)

Information relating to the bank balance, insurance and collateral of cash deposits is determined on a statewide basis and not for individual departments or divisions.

As of June 30, 2005, the carrying amount, which approximates the bank balance, of the DHHL's cash and short-term cash investments was \$231,855,459.

NOTE D - RECEIVABLES

As of June 30, 2005, receivables consisted of the following:

Loans (Note E)	\$ 50,740,051
Allowance for losses	(4,187,300)
Accrued interest	4,057,290
Note receivable (Note F)	4,274,196
General leases and licenses (Note G)	1,718,315
Allowance for losses	(955,000)
Other	2,647,472
	<u>\$ 58,295,024</u>

As of June 30, 2005, general leases and licenses receivable included installment agreements with eight lessees with an aggregate balance of approximately \$405,000. The agreements provide for varying monthly or quarterly payments, accrued interest at 10% per annum and varying terms extending through March 2009.

NOTE E - LOANS RECEIVABLE

Loans receivable consist of approximately 1,700 loans made to native Hawaiian lessees for the purposes specified in the Hawaiian Homes Commission Act. Loans are for a maximum amount of approximately \$192,000 and for a maximum term of 30 years. Interest rates on outstanding loans range from 2.5% to 10.0%. The DHHL's loan portfolio consists of loans that the DHHL has originated and that generally are collateralized by improvements on the leased properties located in the State. Loan commitments as of June 30, 2005 were \$1,010,379. The DHHL has provided an allowance for loan losses as of June 30, 2005. The allowance for loan losses is a valuation reserve, which has been provided through charges to operations. This charge to operations is the amount necessary, in the opinion of management, to maintain the balance in the allowance for loan losses at a level adequate to absorb potential losses for loans in the loan portfolio as of June 30, 2005.

Department of Hawaiian Home Lands

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Notes to the Financial Statements

June 30, 2005

NOTE F – NOTE RECEIVABLE

The DHHL has a note receivable from the developer of the DHHL's Waimanalo Kupuna Housing Project in the amount of \$4,274,196. The DHHL paid development costs for this project and will be reimbursed after the developer obtains permanent financing for the project. The note is non-interest bearing and was due 18 months after the completion of the project. In December 2005, the note was paid.

NOTE G – GENERAL LEASES AND LICENSES

The DHHL's general leasing operations (Section 204 of Hawaiian Homes Commission Act of 1920, as amended) consist principally of the leasing of its Hawaiian Home Lands. The general leases have varying terms extending through 2066.

The future minimum lease income from general leases as of June 30, 2005, is as follows:

<u>Year ending June 30,</u>	
2006	\$ 6,178,000
2007	6,386,000
2008	6,549,000
2009	6,783,000
2010	6,984,000
Thereafter	<u>226,062,000</u>
	<u>\$ 258,942,000</u>

As of June 30, 2005, approximately 60% of the DHHL's land (based on acreage) was under homestead or general leases and license agreements. The cost of this land was not significant.

NOTE H – SALE OF HOMES

Under certain circumstances, the DHHL purchases homes from former lessees due to voluntary and involuntary cancellations of land leases. The homes are subsequently resold to qualified lessees. During the year ended June 30, 2005, the DHHL had purchased homes from former lessees with costs aggregating \$587,900.

Department of Hawaiian Home Lands

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Notes to the Financial Statements

June 30, 2005

NOTE I – CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2005, was as follows:

	Beginning Balance July 1, 2004	Additions	Disposals and Transfers	Reclassifications And Adjustments	Ending Balance June 30, 2005
Capital assets not being depreciated -					
Land	\$ 17,535,594	\$ 16,145,311	\$ -	\$ -	\$ 33,680,905
Construction in progress	55,965,302	27,404,014	(471,457)	(12,344,072)	70,553,787
Total capital assets, not being depreciated -	73,500,896	43,549,325	(471,457)	(12,344,072)	104,234,692
Capital assets, being depreciated -					
Buildings and improvements	9,023,223	-	-	579,544	9,602,767
Infrastructure	255,737,344	19,808,000	-	11,764,528	287,309,872
Furniture and equipment	606,858	15,275	(28,635)	-	611,594
Motor vehicles	709,444	57,029	(15,548)	-	750,925
Total capital assets, being depreciated	266,076,869	19,880,304	(26,087)	12,344,072	298,275,158
Less: accumulated					
Depreciation for -					
Buildings and improvements	(3,032,598)	(290,918)	-	-	(3,323,516)
Infrastructure	(76,430,349)	(8,339,982)	-	-	(84,770,331)
Furniture and equipment	(379,437)	(52,648)	28,635	-	(421,546)
Motor vehicles	(650,660)	(25,511)	(18,096)	-	(660,623)
Total accumulated depreciation	(80,493,044)	(8,709,059)	26,087	-	(89,176,016)
Total capital assets, being depreciated, net	185,583,825	11,171,245	-	12,344,072	209,099,142
Capital assets, net	\$ 259,084,721	\$ 54,720,570	\$ (471,457)	\$ -	\$ 313,333,834

The capital asset additions includes \$33 million of land and infrastructure acquired under a transfer agreement with the Housing and Community Development Corporation of Hawaii. See Note P.

Department of Hawaiian Home Lands

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Notes to the Financial Statements

June 30, 2005

NOTE I – CAPITAL ASSETS (continued)

Depreciation expense for the year ended June 30, 2005, was charged to functions of the DHHL as follows:

Administration and support services	\$ 55,225
Homestead services	8,640,672
Land development	6,532
Land management	<u>6,630</u>
Total depreciation	<u>\$ 8,709,059</u>

NOTE J – LONG-TERM OBLIGATIONS

For the year ended June 30, 2005, changes in long-term obligations were as follows:

	Accrued Vacation	Bonds Payable
Balances at July 1, 2004	\$ 1,063,877	\$ 12,442,480
Principal payments	-	(1,300,083)
Bond issued	-	112,963
Bonds refunded	-	(114,887)
Net increase in accrued vacation	<u>94,941</u>	<u>-</u>
Balances at June 30, 2005	<u>\$ 1,158,818</u>	<u>\$ 11,140,473</u>

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

Bonds Payable

Revenue Bonds -

The State Legislature, by Act 316, SLH 1989, as amended by Act 299, SLH 1990, and further amended by Act 296, SLH 1991, authorized the issuance of revenue bonds amounting to \$43,768,000 to finance the cost of developing Hawaiian home lands. Of the total amount authorized, the DHHL issued \$18,000,000 of 1991 series revenue bonds in October 1991.

On January 15, 1999, the DHHL issued \$13,370,000 of 1999 series revenue bonds to advance refund \$12,060,000 of outstanding 1991 series revenue bonds. The net proceeds of \$13,055,195, after payment of issuance cost and \$207,950 of the DHHL's funds, were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the 1991 series revenue bonds. As a result, the 1991 series revenue bonds are considered to be defeased and the liability for those bonds has been removed from the general long-term debt account.

Department of Hawaiian Home Lands

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Notes to the Financial Statements

June 30, 2005

NOTE J- LONG-TERM OBLIGATIONS (continued)

The revenue bonds are payable from and collateralized by the DHHL's revenues from available lands and are due in annual installments through July 1, 2011. The balance of bonds payable as of June 30, 2005, is \$9,900,000 for the 1999 series revenue bonds.

The unrefunded series 1991 bonds were repaid on July 1, 2001.

Interest on the series 1999 bonds increases annually from 3.8% to 4.45% and is payable semi-annually on January 1 and July 1. Commencing on July 1, 2002, annual principal payments were required.

The annual requirements of the revenue bonds are as follows:

<u>Year ending June 30,</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>
2006	\$ 391,298	\$ 1,250,000	\$ 1,641,298
2007	339,973	1,300,000	1,639,973
2008	285,870	1,355,000	1,640,870
2009	228,835	1,410,000	1,638,835
2010	168,446	1,465,000	1,633,446
2011	104,146	1,525,000	1,629,146
2012	35,489	1,595,000	1,630,489
Total	<u>\$ 1,554,057</u>	<u>\$ 9,900,000</u>	<u>\$ 11,454,057</u>

General Obligation Bonds -

The following are portions of the State general obligation bonds allocated to the DHHL under acts of various Session Laws of Hawaii. These bonds are backed by the full faith, credit and taxing power of the State. Repayments of allocated bond debts are made to the State General Fund. Details of the allocated bonds as of June 30, 2005, are as follows:

\$1,000,346 Series BW bonds dated March 1, 1992; \$166,708 was refunded on February 15, 2002 and \$112,089 was refunded on June 15, 2005; due in annual principal installments of \$55,569 commencing March 1, 2006 through March 1, 2008 and \$54,619 on March 1, 2011 and \$55,569 on March 1, 2012; interest at 5.875% to 6.40% payable semi-annually	\$ 276,896
\$124,303 Series BZ bonds dated October 1, 1992; \$7,769 was refunded on April 1, 1998 and \$23,307 was refunded on February 15, 2002; due in annual principal installments of \$7,769 commencing October 1, 2005 through October 1, 2012; interest at 5.40% to 6.25% payable semi-annually	<u>62,151</u>
Subtotal carried forward	\$ 339,047

Department of Hawaiian Home Lands
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Notes to the Financial Statements
June 30, 2005

NOTE J - LONG-TERM OBLIGATIONS (continued)

Bonds Payable (continued)

General Obligation Bonds (continued) -

Subtotal brought forward	\$	339,047
\$758,726 Series CI refunding bonds dated November 1, 1993; due in annual principal installments of \$50,587 through November 1, 2003 and \$50,575 through November 1, 2010; interest at 4.20% to 4.90% payable semi-annually		303,452
\$66,394 Series CH bonds dated November 1, 1993; \$55,335 was refunded on October 1, 1997; due in annual principal installments of \$3,689 through November 1, 2013; interest at 4.10% to 6.00% payable semi-annually		33,194
\$86,517 Series CO bonds dated March 1, 1997; \$11,940 was refunded on April 1, 1998; due in semi-annual principal installments of \$2,646 to \$4,250 through March 1, 2011; interest at 4.625% to 6.00% payable semi-annually		43,580
\$321,472 Series CS refunding bonds dated April 1, 1998; due in annual principal installments of \$45,740 on April 1, 2006; \$48,137 on April 1, 2007; \$50,548 on April 1, 2008 and \$53,074 on April 1, 2009; interest at 5.00% to 5.25% payable semi-annually		197,499
\$65,992 Series CW refund bonds dated August 1, 2001; \$2,118 was refunded on June 15, 2005 due in annual principal installments of \$4,679 on August 1, 2005; \$4,873 on August 1, 2006; \$5,073 on August 1, 2007; \$5,311 on August 1, 2008; \$5,585 on August 1, 2009; \$5,885 on August 1, 2010; \$6,203 on August 1, 2011; \$6,540 on August 1, 2012; \$6,896 on August 1, 2013; \$7,273 on August 1, 2014; \$5,555 on August 1, 2015		63,873
\$140,129 Series CY refunding bonds dated February 15, 2002; \$680 was refunded on June 15, 2005; due in annual principal installments of \$12,633 on February 1, 2007; \$13,217 on February 1, 2008; \$13,910 on February 1, 2009; \$14,582 on February 1, 2010; \$15,347 on February 1, 2011; \$16,192 on February 1, 2012; \$17,081 on February 1, 2013; \$18,064 on February 1, 2014 and \$19,104 on February 1, 2015; interest at 3.60% to 5.75% payable semi-annually		139,449
Subtotal carried forward	\$	1,120,094

**Department of Hawaiian Home Lands
State of Hawaii**

Notes to the Financial Statements

June 30, 2005

NOTE J - LONG-TERM OBLIGATIONS (continued)

Bonds Payable (continued)

General Obligation Bonds (continued) –

Subtotal brought forward	\$ 1,120,094
\$7,415 Series DB refunding bonds dated September 16, 2003; due in annual principal installments of \$675 on September 1, 2008; \$703 on September 1, 2009; \$738 on September 1, 2010; \$778 on September 1, 2011; \$815 on September 1, 2012; \$857 on September 1, 2013; \$902 on September 1, 2014; \$949 on September 1, 2015 and \$1,000 on September 1, 2016; interest at 5.00% to 5.25% payable semi-annually	7,415
\$110,109 Series DG refunding bonds dated June 15, 2005; due in annual principal installments of \$9,933 on June 1, 2010; \$10,443 on June 1, 2011; \$10,978 on June 1, 2012; \$11,541 on June 1, 2013; \$12,133 on June 1, 2014; \$12,755 on June 1, 2015; \$13,409 on June 1, 2016; \$14,097 on June 1, 2017; \$14,820 on June 1, 2018.	110,109
\$2,855 Series DH refunding bonds dated June 15, 2005; due in annual principal installment of \$2,855 on June 1, 2006.	<u>2,855</u>
	<u>\$ 1,240,473</u>

At June 30, 2005, all of the remaining principal had been spent on capital projects.

Department of Hawaiian Home Lands
State of Hawaii

Notes to the Financial Statements
June 30, 2005

NOTE J- LONG-TERM OBLIGATIONS (continued)

Bonds Payable (continued)

General Obligation Bonds (continued) -

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

<u>Year ending June 30,</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>
2006	\$ 48,431	\$ 177,111	\$ 225,542
2007	41,642	189,858	231,500
2008	33,032	193,455	226,487
2009	24,241	142,446	166,687
2010	19,527	100,052	119,579
2011	15,248	157,442	172,690
2012	8,816	101,175	109,991
2013	3,999	47,434	51,433
2014	2,836	41,638	44,474
2015	1,953	40,032	41,985
2016	1,123	19,913	21,036
2017	672	15,097	15,769
2018	227	14,820	15,047
	<u>\$ 201,747</u>	<u>\$ 1,240,473</u>	<u>\$ 1,442,220</u>

NOTE K - COMMITMENTS AND CONTINGENCIES

Litigation -

The DHHL is involved in several lawsuits and complaints which management believes arose in the normal course of operations. Based on discussions with counsel, management has ascertained that lawsuits and complaints against the State of Hawaii are typically paid through an appropriation from the General Fund of the State of Hawaii. Accordingly, management is of the opinion that the outcome of these lawsuits and complaints will not have a material adverse effect on the financial position of the DHHL.

Insurance -

Insurance coverage is maintained at the State level. The State is substantially self-insured for all perils including workers' compensation. Effective July 1, 1997, all benefits paid for workers' compensation are reflected in the respective department or agency's financial statements. No benefits were paid by the DHHL for the year ended June 30, 2004. Expenditures for other insurance claims are made by the Department of Accounting and General Services, State of Hawaii, and are not reflected in the DHHL financial statements. Workers' compensation benefit claims reported, as well as incurred but not reported, were reviewed at year end. The estimated losses from these claims are not material.

Department of Hawaiian Home Lands
State of Hawaii

Notes to the Financial Statements
June 30, 2005

NOTE K - COMMITMENTS AND CONTINGENCIES (continued)

Deferred Compensation Plan -

In 1983, the State established a deferred compensation plan which enables State employees to defer a portion of their compensation. The Department of Human Resources Development, State of Hawaii, has the fiduciary responsibility of administering the plan. The plan assets are protected from claims of the State's creditors and from diversion to any uses other than paying benefits to participants and beneficiaries. The deferred compensation is not available to employees until termination, retirement, death or any unforeseeable emergency.

Guaranteed and Insured Loans -

As of June 30, 2005, the DHHL was contingently liable for approximately \$11,172,000 in loans originated primarily by the U.S. Department of Agriculture Rural Development for which the DHHL has guaranteed repayment. A total of \$387,000 of these loans has been reported delinquent as of June 30, 2005.

The DHHL is also a party to a mortgage loan insurance agreement with the U.S. Department of Housing and Urban Development (HUD). The agreement provides that HUD will perform underwriting processing for the insurance of mortgage and will administer an insurance fund for mortgages originated and held by HUD-approved lenders. The DHHL will maintain and provide the necessary and proper funds for payment of any mortgage insurance claims and expenditures incurred by HUD in connection with the lessee borrowers. The DHHL has reserved cash of approximately \$10,850,100 in the special revenue fund and has deposited \$150,000 with HUD. As of June 30, 2005, loans outstanding totaled approximately \$239,224,000 under this agreement, of which \$7,505,000 has been reported as delinquent.

As of June 30, 2005, the DHHL is also contingently liable for approximately \$29,489,000 in loans originated by financial institutions and other lenders for which it has guaranteed repayment. A total of \$500,000 of these loans has been reported delinquent as of June 30, 2005.

As of June 30, 2005, the DHHL paid approximately \$4,965,000 for delinquent mortgage loan payments of lessees. These payments are carried as loans receivable from lessees and bear similar terms as stipulated in the lessees' mortgage note with the lenders.

The DHHL has certain loans for which the collateral for the loans is not covered by casualty insurance. The number of such loans is not known.

Other -

As of June 30, 2005, the reserve for encumbrances relating to construction contracts approximated \$52,408,000.

Department of Hawaiian Home Lands
State of Hawaii

Notes to the Financial Statements
June 30, 2005

NOTE L - COMPENSATION FOR PAST USE OF HAWAIIAN HOME LANDS BY THE STATE OF HAWAII

Pursuant to Act 14, SP SLH 1995, the Hawaiian Home Lands Trust Fund was established to account for funds to be paid by the State for the use or disposition of lands, which were alleged to have been Hawaiian home lands or covered by the Hawaiian Homes Commissions Act of 1920 arising between August 21, 1959 and June 30, 1988.

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

NOTE M - HAWAIIAN HOME LANDS TRUST INDIVIDUAL CLAIMS

In 1991, the Legislature enacted HRS Chapter 674 entitled "Individual Claims Resolution Under the Hawaiian Home Lands Trust" which establishes a process for individual beneficiaries of the Hawaiian Home Lands Commission Act of 1920 to file claims to recover actual economic damages they believed they suffered from a breach of trust that occurred between August 21, 1959, when Hawaii became a state and June 30, 1988. The breach must have been caused by an act or omission of an employee or officer of the State in the management and disposition of trust resources.

A Hawaiian Home Lands Trust Individual Claims Review Panel (Panel) was established under Chapter 674 to receive claims of individual beneficiaries. The Panel is required to prepare a record of each claim, including the Panel's non-binding findings and an advisory opinion concerning the probable merits of the claim. The Panel's advisory findings and advisory opinions, which are issued after adversarial hearings, must be submitted to the Legislature. The Legislature may take such action upon the claims as it deems appropriate. If the Legislature's proffered resolution is not satisfactory to a claimant, a civil action for corrective action and the recovery of actual economic damages could be initiated after October 1, 1999, but no later than December 31, 1999.

Department of Hawaiian Home Lands

State of Hawaii

Notes to the Financial Statements

June 30, 2005

NOTE M - HAWAIIAN HOME LANDS TRUST INDIVIDUAL CLAIMS (continued)

The deadline to file a claim with the Panel was August 31, 1995. A total of 4,327 claims were filed by 2,753 individuals. As of September 1999, claims from 1,376 claimants had not been reviewed by the Panel, and all but the claims of two claimants had not been acted upon by the Legislature. In 1997, the Legislature declared it to be its intent to postpone acting upon the Panel's recommendations until all claims had been reviewed and forwarded to it.

Also arising from Chapter 674, in December 1999, three claimants filed a class action lawsuit in the State Circuit Court for declaratory and injunctive relief, and for damages under HRS Chapter 673 for the Panel's and Legislature's alleged failure to remedy their breach of trust claims under HRS Chapter 674. In August 2000, the Circuit Court entered an order granting the plaintiffs' motion for summary judgment and declaratory relief as to Count I of the Complaint, and denied the State's motions on the pleadings. The plaintiff is appealing the judgment relating to the other Counts in the lawsuit with the State Supreme Court. Five other claimants filed similar individual claims actions for themselves. The plaintiffs in these other actions have stipulated to stay all proceedings in their actions pending the resolution of all questions of law in the class action lawsuit that are common to the questions of law presented in their suits. Outcome of these cases are pending.

Claims for actual damages under Chapter 674 are made against the State of Hawaii. Accordingly, counsel for the DHHL does not believe that the final settlement of the claims will have an impact on the DHHL's funds.

NOTE N - ASSESSMENTS FOR CENTRAL SERVICE AND ADMINISTRATIVE EXPENSES

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

Department of Hawaiian Home Lands

State of Hawaii

Notes to the Financial Statements

June 30, 2005

NOTE N - ASSESSMENTS FOR CENTRAL SERVICE AND ADMINISTRATIVE EXPENSES
(continued)

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

The DHHL's estimate of the asserted assessments is as follows:

<u>Year ending June 30,</u>	
1994	\$ 1,300,000
1995	2,200,000
1996	2,100,000
1997	1,900,000
1998	1,900,000
1999	679,000
2000	775,000
2001	735,000
2002	739,000
2003	1,158,000
2004	1,224,000
2005	1,055,000
	<u>\$ 15,765,000</u>

NOTE O - RETIREMENT BENEFITS

Substantially all employees of the DHHL are required by Chapter 88 of the Hawaii Revised Statutes to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost sharing multiple employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. Prior to June 30, 1984, the ERS consisted only of a contributory plan. In 1984, legislation was enacted to create a new noncontributory plan for members of the ERS who are also covered under Social Security. Persons employed in positions not covered by Social Security are excluded from the noncontributory plan. The noncontributory plan provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory plan or to elect the new noncontributory plan and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory plans, respectively. Contributions for employees of the DHHL are paid from the State General Fund.

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

Department of Hawaiian Home Lands

State of Hawaii

Notes to the Financial Statements

June 30, 2005

NOTE O - RETIREMENT BENEFITS (continued)

The State's policy is to fund its required contribution annually. The DHHL's share of the retirement system expense for the year ended June 30, 2005, was included as an item to be expended by the Department of Budget and Finance and is not reflected in the DHHL's financial statements. The DHHL's special revenue funds expended approximately \$477,000 for employer contributions for the year ended June 30, 2005. The entire ERS' actuarial determination of the employer contribution requirements was met as of June 30, 2005.

The ERS issues a publicly available financial report that includes financial statements and required supplemental information. That report may be obtained from the ERS.

In addition to providing pension benefits, the State provides certain health care and life insurance benefits to all DHHL employees, their spouses and dependent children under age 19. Employees hired before July 1, 1996, who retire with at least ten years of credited service, qualify for health benefits at no cost. Employees who were hired on or after July 1, 1996, with at least ten years of credited service, qualify for health benefits on a cost-sharing basis. Employees with 25 or more years of credited service qualify for health benefits at no cost.

There are currently approximately 32,000 state retirees and beneficiaries receiving such benefits. Employees hired after July 1, 2002 will not receive health benefits for their spouse and dependents when they retire.

NOTE P – LAND ACQUISITION

In December 2004, the Department entered into a transfer agreement with the State of Hawaii in connection with the acquisition of approximately 1,800 acres of land consisting of four properties on three islands, to the Department. Certain of the land is partially developed and is intended to be utilized for 3,500 homes for native Hawaiians.

As part of the transfer agreement, the Department will pay \$2.2 million a year for 15 years, for a total of \$33 million, to reimburse the Housing and Community Development Corporation of Hawaii (HCDCH), State of Hawaii, for infrastructure costs at three of the properties. This note is non interest bearing. At June 30, 2005, DHHL owed \$30,800,000 to HCDCH. The note will be repaid with monies in the DHHL's Hawaiian Home Lands Trust Fund.

SUPPLEMENTAL INFORMATION

Department of Hawaiian Home Lands

State of Hawaii

Combining Balance Sheet
Nonmajor Governmental Funds
June 30, 2005

Supplemental Information

	<u>Hawaiian Home Loan Fund</u>	<u>Department of Hawaiian Home Lands Revenue Bond Special Fund</u>	<u>Hawaiian Home Trust Fund</u>	<u>Native Hawaiian Rehabilitation Fund</u>	<u>Protocol Funds</u>	<u>Construction Funds</u>	<u>Total Other Governmental Funds</u>
ASSETS							
Cash and short-term cash investments held in State Treasury	\$ 675,595	\$ 24,485,136	\$ 10,850,100	\$ 10,927,949	\$ 754	\$ 117,176	\$ 47,056,710
Receivables							
Loans, net of allowance for losses	3,847,766	-	-	3,312	-	-	3,851,078
Accrued interest	-	46,420	-	130,058	(21)	-	176,457
Other	2,011	-	-	-	-	-	2,011
Other assets	148,300	-	-	-	-	-	148,300
	<u>\$ 4,673,672</u>	<u>\$ 24,531,556</u>	<u>\$ 10,850,100</u>	<u>\$ 11,061,319</u>	<u>\$ 733</u>	<u>\$ 117,176</u>	<u>\$ 51,234,556</u>
LIABILITIES							
Vouchers and contracts payable	\$ -	\$ -	\$ -	\$ 17,439	\$ -	\$ -	\$ 17,439
Other liabilities	-	-	-	-	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>17,439</u>	<u>-</u>	<u>-</u>	<u>17,439</u>
FUND BALANCES							
Reserved for:							
Encumbrances	-	-	-	1,562,748	-	117,176	1,679,924
Receivables	3,849,777	46,420	-	133,370	(21)	-	4,029,546
Guaranteed and insured loans	-	-	10,850,100	-	-	-	10,850,100
	<u>3,849,777</u>	<u>46,420</u>	<u>10,850,100</u>	<u>1,696,118</u>	<u>(21)</u>	<u>117,176</u>	<u>16,559,570</u>
Unreserved reported in nonmajor:							
Special revenue funds	823,895	24,485,136	-	9,347,762	754	-	34,657,547
	<u>823,895</u>	<u>24,485,136</u>	<u>-</u>	<u>9,347,762</u>	<u>754</u>	<u>-</u>	<u>34,657,547</u>
Total fund balances	<u>4,673,672</u>	<u>24,531,556</u>	<u>10,850,100</u>	<u>11,043,880</u>	<u>733</u>	<u>117,176</u>	<u>51,217,117</u>
Total liabilities and fund balances	<u>\$ 4,673,672</u>	<u>\$ 24,531,556</u>	<u>\$ 10,850,100</u>	<u>\$ 11,061,319</u>	<u>\$ 733</u>	<u>\$ 117,176</u>	<u>\$ 51,234,556</u>

Department of Hawaiian Home Lands

Supplemental Information

State of Hawaii

Combining Statement of Revenues, Expenditures and Changes in Fund Balances

Nonmajor Governmental Funds

for the year ended June 30, 2005

	<u>Hawaiian Home Loan Fund</u>	<u>Department of Hawaiian Home Lands Revenue Bond Special Fund</u>	<u>Hawaiian Home Trust Fund</u>	<u>Native Hawaiian Rehabilitation Fund</u>	<u>Protocol Funds</u>	<u>Construction Funds</u>	<u>Total Other Governmental Funds</u>
Revenues							
Appropriations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Interest from short-term cash investments	-	599,631	-	324,079	47	-	923,757
Other	-	-	-	183,539	-	-	183,539
Total revenues	-	599,631	-	507,618	47	-	1,107,296
Expenditures							
Current:							
Administration and support services	-	-	-	1,086,383	1,790	(19,400)	1,068,773
Homestead services	(23,000)	-	-	-	-	-	(23,000)
Land management	-	-	-	9,507	-	-	9,507
Capital outlay:							
Home construction/capital projects	-	-	-	6,207	-	-	6,207
Debt service:							
Principal on long-term debt	-	1,200,000	-	-	-	-	1,200,000
Interest on long-term debt	-	440,297	-	-	-	-	440,297
Total expenditures	(23,000)	1,640,297	-	1,102,097	1,790	(19,400)	2,701,784
Excess (deficiency) of revenues over (under) expenditures	23,000	(1,040,666)	-	(594,479)	(1,743)	19,400	(1,594,488)
Other financing sources (uses)							
Operating transfers in	-	11,623,191	-	-	2,500	-	11,625,691
Operating transfers out	-	(8,000,000)	-	-	(852)	-	(8,000,852)
Total other financing sources (uses)	-	3,623,191	-	-	1,648	-	3,624,839
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	23,000	2,582,525	-	(594,479)	(95)	19,400	2,030,351
Lapsed appropriations	-	-	-	-	-	(69,869)	(69,869)
Net change in fund balances	23,000	2,582,525	-	(594,479)	(95)	(50,469)	1,960,482
Fund balances at July 1, 2004	4,650,672	21,949,031	10,850,100	11,638,359	828	167,645	49,256,635
Fund balances at June 30, 2005	\$ 4,673,672	\$ 24,531,556	\$ 10,850,100	\$ 11,043,880	\$ 733	\$ 117,176	\$ 51,217,117

Department of Hawaiian Home Lands**State of Hawaii**

Schedule of Expenditures of Federal Awards
for the year ended June 30, 2005

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Grant Identification Number	Federal Expenditures
<u>U.S. Department of Housing and Urban Development</u>			
Native Hawaiian Housing Block Grant, Year 1	14.873	02NHGHI0001	\$ 2,267,983
Native Hawaiian Housing Block Grant, Year 2	14.873	03NHGHI001	4,661,289
Native Hawaiian Housing Block Grant, Year 3	14.873	04NH4HI0001	205,813
Total U.S. Department of Housing and Urban Development			<u>7,135,085</u>
<u>U.S. Department of the Interior</u>			
U.S. Fish and Wildlife Service			
Partners for Fish and Wildlife's Humuula Koa Buffer Project	16.UNK	122002J003	3,734
Total U.S. Department of the Interior			<u>3,734</u>
Total Expenditures of Federal Awards			<u>\$ 7,138,819</u>

The above schedule is prepared on the cash basis of accounting.

PART II

COMPLIANCE AND INTERNAL CONTROL

Akamine, Oyadomari & Kosaki

CERTIFIED PUBLIC ACCOUNTANTS, INC.

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

Hawaiian Homes Commission
State of Hawaii

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Department of Hawaiian Home Lands, State of Hawaii, as of and for the year ended June 30, 2005, which collectively comprise the Department's basic financial statements and have issued our report thereon dated November 21, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department of Hawaiian Home Lands, State of Hawaii's, internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgement, could adversely affect the Department of Hawaiian Home Lands, State of Hawaii's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the accompanying schedule of findings and questioned costs as item 05-1.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that the reportable condition described above is not a material weakness. We also noted other matters involving the internal control over financial reporting that we have reported to management of the Department of Hawaiian Home Lands, State of Hawaii, in a separate letter dated November 21, 2005.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department of Hawaiian Home Lands, State of Hawaii's, financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D of Hawaii Revised Statutes), and procurement rules, directives and circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards. However, we noted certain matters that we have reported to the management of the Department of Hawaiian Home Lands, State of Hawaii, in a separate letter dated November 21, 2005.

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

Akamine Oyadomari + Hiroshi CPAs, Inc.

Honolulu, Hawaii
November 21, 2005

Akamine, Oyadomari & Kosaki

CERTIFIED PUBLIC ACCOUNTANTS, INC.

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

Hawaiian Homes Commission
State of Hawaii

Compliance

We have audited the compliance of the Department of Hawaiian Home Lands, State of Hawaii, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to its major federal program for the year ended June 30, 2005. The Department of Hawaiian Home Lands, State of Hawaii's, major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of the Department of Hawaiian Home Lands, State of Hawaii's, management. Our responsibility is to express an opinion on the Department of Hawaiian Home Lands, State of Hawaii's, compliance based on our audit.

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

In our opinion, the Department of Hawaiian Home Lands, State of Hawaii, complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2005.

Internal Control Over Compliance

The management of the Department of Hawaiian Home Lands, State of Hawaii, is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Department of Hawaiian Home Lands, State of Hawaii's, internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

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

Ahantse Oyedemai & Herold CPAs, Inc.

Honolulu, Hawaii
November 21, 2005

PART III

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

**Department of Hawaiian Home Lands
State of Hawaii**

Schedule of Findings and Questioned Costs
for the year ended June 30, 2005

Section I - Summary of Auditor's Results

Financial Statements -

Type of auditor's report issued: unqualified

Internal control over financial reporting:

- Material weakness(es) identified? _____ Yes x No
- Reportable condition(s) identified that
are not considered to be material
weakness(es)? x Yes _____ None reported

Noncompliance material to financial
statements noted? _____ Yes x No

Federal Awards -

Internal control over major programs:

- Material weakness(es) identified? _____ Yes x No
- Reportable condition(s) identified that
are not considered to be material
weakness(es)? _____ Yes x None reported

Type of auditor's report issued on compliance for major programs: unqualified

Any audit findings disclosed that are
required to be reported in accordance
with section 510(a) of Circular A-133? _____ Yes x No

Identification of major programs:

CFDA Number(s)	Name of Federal Program or Cluster
<u>14.873</u>	<u>Native Hawaiian Housing Block Grant</u>

Department of Hawaiian Home Lands
State of Hawaii

Schedule of Findings and Questioned Costs
for the year ended June 30, 2005
(continued)

Section I - Summary of Auditor's Results (continued)

Dollar threshold used to distinguish between
type A and type B programs:

\$ 300,000

Auditee qualified as low-risk auditee?

Yes

 X

No

Department of Hawaiian Home Lands
State of Hawaii

Schedule of Findings and Questioned Costs
for the year ended June 30, 2005
(continued)

Section II - Financial Statement Findings

05-1 Policies and Procedures over Accounting for Infrastructure Assets Should be Implemented

Condition - The Department has not implemented policies and procedures to properly account for its infrastructure assets.

Criteria - Infrastructure assets should be properly recorded and accounted for in the accounting records and financial statements.

Effect - During our audit, errors in the recording of infrastructure assets were identified, and accordingly, the Department made the necessary adjustments to its accounting records.

Recommendation - We recommend that the Department implement policies and procedures to help ensure that infrastructure assets are properly accounted for.

Status - We understand that the Department is in the process of implementing policies and procedures to help ensure that the Department's infrastructure assets will be properly accounted for and recorded.

**Department of Hawaiian Home Lands
State of Hawaii**

Schedule of Findings and Questioned Costs
for the year ended June 30, 2005
(continued)

Section III - Federal Award Findings and Questioned Costs

None

**Department of Hawaiian Home Lands
State of Hawaii**

Schedule of Prior Findings and Questioned Costs
for the year ended June 30, 2005

Financial Statement Findings

04-1 Controls Over Accounting for Infrastructure Should be Improved

Condition - The Department did not have the necessary controls to properly account for its infrastructure assets.

Criteria - Capital assets should be properly recorded and accounted for in the accounting records and financial statements.

Effect - Due to errors in the recording of certain infrastructure assets, an adjustment was necessary to eliminate \$26,163,395 of infrastructure costs and reverse \$2,772,000 of accumulated depreciation relating to these costs. This resulted in a \$23,391,985 restatement to the Department's July 31, 2004 net investment in capital assets.

Recommendation - We recommended that the Department establish controls to properly account for its infrastructure assets.

Status - This condition has not been resolved. See Financial Statement Finding 05-1.

Federal Award Findings and Questioned Costs

None