Accuity LLP
CERTIFIED PUBLIC ACCOUNTANTS

# Kamehameha Schools and Subsidiaries

## Consolidated Financial Statements and Supplemental Schedules

## June 30, 2009 and 2008

# Kamehameha Schools and Subsidiaries
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## June 30, 2009 and 2008

Accuity LLP
CERTIFIED PUBLIC ACCOUNTANTS

## Report of Independent Auditors

To the Audit Committee
Kamehameha Schools

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of activities and cash flows present fairly, in all material respects, the financial position of Kamehameha Schools and Subsidiaries (the "Organization") at June 30, 2009 and 2008, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These consolidated financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Our audits for the years ended June 30, 2009 and 2008 were made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplementary information included in Schedules 1 and 2 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information for the years ended June 30, 2009, 2008 and 2007 has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole. The supplementary information included in Schedules 1 and 2 for the years ended June 30, 2006 and 2005 was audited by other auditors, whose report dated October 24, 2006 expressed an opinion that the schedules were fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole.

Accuity LLP

Honolulu, Hawaii
October 20, 2009

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# Kamehameha Schools and Subsidiaries
## Consolidated Balance Sheets
## June 30, 2009 and 2008
*(All dollars in thousands)*

| | 2009 | 2008 |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents | $ 52,820 | $ 91,450 |
| Investments | 4,865,963 | 6,504,783 |
| Amounts receivable for securities sold | 30,276 | 33,034 |
| Receivables, net | 19,504 | 26,841 |
| Property and equipment, net | 862,052 | 847,874 |
| Real estate held for development and sale | 26,435 | 24,059 |
| Deferred charges and other | 105,958 | 96,358 |
| Collateral received for loaned securities | - | 252,009 |
| Total assets | $ 5,963,008 | $ 7,876,408 |
| **Liabilities and Net Assets** | | |
| Notes payable | $ 235,416 | $ 244,062 |
| Amounts payable for securities purchased | 25,746 | 61,976 |
| Accounts payable and accrued expenses | 66,569 | 79,332 |
| Accrued pension liability | 86,330 | 28,505 |
| Accrued postretirement benefits | 26,553 | 23,759 |
| Deferred compensation payable | 4,961 | 7,497 |
| Deferred income and other | 19,948 | 19,014 |
| Obligation to repay securities lending collateral | - | 252,009 |
| Total liabilities | 465,523 | 716,154 |
| Commitments and contingencies | | |
| Net assets – unrestricted | 5,497,485 | 7,160,254 |
| Total liabilities and net assets | $ 5,963,008 | $ 7,876,408 |

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

# Kamehameha Schools and Subsidiaries
## Consolidated Statements of Activities
## Years Ended June 30, 2009 and 2008
***(All dollars In thousands)***

| | 2009 | 2008 |
|---|---|---|
| **Revenues, gains (losses), and other support** | | |
| Tuition and fees | $ 26,289 | $ 25,152 |
| Less: Financial aid | (15,008) | (13,062) |
| Net tuition and fees | 11,281 | 12,090 |
| Investment gains (losses), net | (1,399,669) | 124,931 |
| Rental | 227,273 | 194,452 |
| Net gains on property sales | 21,635 | 35,373 |
| Other | 1,807 | 1,097 |
| Total revenues, gains (losses), and other support | (1,137,673) | 367,943 |
| **Expenses** | | |
| Educational programs | 237,784 | 235,002 |
| Management and general | | |
| Rental | 140,568 | 119,413 |
| Other | 85,887 | 70,474 |
| Total expenses | 464,239 | 424,889 |
| Change in net assets before retirement plan related changes other than net periodic cost | (1,601,912) | (56,946) |
| Retirement plan related changes other than net periodic cost | (60,857) | 4,038 |
| Change in net assets | (1,662,769) | (52,908) |
| **Net assets** | | |
| Beginning of year | 7,160,254 | 7,213,162 |
| End of year | $ 5,497,485 | $ 7,160,254 |

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

# Kamehameha Schools and Subsidiaries
## Consolidated Statements of Cash Flows
## Years Ended June 30, 2009 and 2008
***(All dollars In thousands)***

| | 2009 | 2008 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Change in net assets | $ (1,662,769) | $ (52,908) |
| Adjustments to reconcile change in net assets to net cash used in operating activities | | |
| Depreciation and amortization | 50,068 | 38,614 |
| Net realized and unrealized (gains) losses on investments | 1,461,110 | (21,839) |
| Net gains on property sales | (21,635) | (35,373) |
| Retirement plan related changes other than net periodic cost | 60,857 | (4,038) |
| Changes in operating assets and liabilities | | |
| Receivables, net | 7,337 | (1,245) |
| Real estate held for development and sale | (2,385) | (1,483) |
| Deferred charges and other | (9,600) | (3,199) |
| Accounts payable, accrued expenses, and other liabilities | (14,603) | 6,513 |
| Net cash used in operating activities | (131,620) | (74,958) |
| **Cash flows from investing activities** | | |
| Proceeds from sales of property and equipment | 26,154 | 34,404 |
| Purchases of property and equipment | (68,756) | (82,913) |
| Proceeds from sales of investments | 4,504,547 | 4,286,969 |
| Purchases of investments | (4,360,309) | (4,111,545) |
| Net cash provided by investing activities | 101,636 | 126,915 |
| **Cash flows from financing activities** | | |
| Proceeds from borrowings | 21,500 | - |
| Repayment of borrowings | (30,146) | (26,146) |
| Net cash used in financing activities | (8,646) | (26,146) |
| Net increase (decrease) in cash and cash equivalents | (38,630) | 25,811 |
| **Cash and cash equivalents** | | |
| Beginning of year | 91,450 | 65,639 |
| End of year | $ 52,820 | $ 91,450 |
| **Supplemental disclosure of cash flow information** | | |
| Income taxes paid | $ 1,233 | $ 1,933 |
| Interest paid | $ 13,727 | $ 14,469 |

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

## 1. Summary of Significant Accounting Policies

### Description of the Organization

Kamehameha Schools (the "Schools") is a charitable trust established under Hawaii law and operates under the terms of the Will of Bernice Pauahi Bishop, deceased. The Schools are governed by a Board of Trustees (the "Trustees") and subject to the jurisdiction of the First Circuit Court of the State of Hawaii (the "Court"). The primary assets of the Schools are lands and properties located in the State of Hawaii (the "State") and debt and equity investments.

The Schools provide a variety of educational services for students of Hawaiian ancestry, including early education, campus-based programs, and other extension and enrichment and summer school programs. Early education programs are conducted in various facilities throughout the State. The campus-based programs include campuses on the islands of Oahu, Maui, and Hawaii which serve students from kindergarten through grade 12. The Schools are also engaged in summer programs, educational partnerships, and other outreach programs that are intended to provide educational opportunities to a greater population of students of Hawaiian ancestry. In addition, the Schools provide a significant amount of scholarships for post-secondary education.

### Principles of Consolidation

The consolidated financial statements of Kamehameha Schools and Subsidiaries (the "Organization") include the accounts of the Schools, Bishop Holdings Corporation and its Subsidiaries ("BHC"), Ke Ali'i Pauahi Foundation ("KAPF"), P&C Insurance Co., LLC ("P&C"), Newport Kohala, LLC and Bishop Financial Limited.

The consolidated financial statements of BHC include the accounts of:

- Pauahi Management Corporation and its wholly-owned subsidiaries – KDP Limited; KBH, Inc.; Lake Manassas Limited Liability Company; RTJ Limited Liability Company (dissolved in 2008); and Paradise Petroleum, Inc. dba Ali'i Petroleum.

- P&C Insurance Company, LLC, formerly known as P&C Insurance Company, Inc. (distributed to the Schools on June 30, 2009).

- Kamehameha Investment Corporation ("KIC") and its wholly-owned subsidiaries – Keauhou Community Services, Inc.; Paki, Inc. (dissolved in 2009); Keauhou Resort Development Corporation (dissolved in 2008); KIC Development Venture LLC ("KDV") (dissolved in 2009); and Keauhou Kona Resort Company (dissolved in 2009).

BHC is a taxable holding corporation with subsidiaries primarily involved in property investment and management and the development and sale of real estate.

In 2008, the Organization created KDV and had KDV enter into a joint venture with Brookfield Keauhou LLC ("Brookfield") to carryout the development, construction and sales portion of the strategic master plan for the economic, educational and cultural development of Keauhou Resort Community. The joint venture was named Keauhou Resort Development Venture LLC ("KRDV"), with both KDV and Brookfield being the sole members. KRDV created two single member limited liability company subsidiaries, Keauhou Resort Development Venture One LLC ("DV 1") and Keauhou Resort Development Venture Two LLC ("DV 2") to develop the entitled and partially entitled land, respectively, contributed by KDV. In 2009, KDV and Brookfield reached an irreconcilable impasse regarding the management of KRDV and its subsidiaries and their respective obligations under the operating agreement. Accordingly, both KDV and Brookfield agreed to rescind the formation of KRDV, DV 1 and DV 2.

In 2008, the Schools initiated a review of P&C Insurance Company, Inc., the captive insurance subsidiary of BHC, to determine its optimal governance and tax structure. Upon completion of the review in 2009, P&C Insurance Company, Inc. was converted into a limited liability company and restructured as a subsidiary of the Schools effective June 30, 2009. P&C provides property and liability coverage for the Schools and its affiliates.

KAPF is a charitable organization whose exclusive purpose is to actively engage in fundraising, scholarship, and development activities for the Schools.

In addition, under accounting principles generally accepted in the United States of America ("GAAP"), certain investments may be considered as entities for consolidation should they meet specified criteria. Newport Kohala, LLC and Bishop Financial Limited met these criteria as they both have a specific purpose and are managed by an independent investment management firm. Newport Kohala, LLC was terminated in December 2007.

All significant intercompany transactions and accounts have been eliminated in consolidation.

**Basis of Financial Statement Presentation**
The Organization's consolidated financial statements have been prepared on the accrual basis of accounting, and are presented in conformity with GAAP. Net assets, revenues, gains and other support, and expenses are classified based on the existence or absence of donor-imposed restrictions. KAPF's combined temporarily and permanently restricted net assets amounted to approximately $9.4 million and $10.0 million at June 30, 2009 and 2008, respectively. The Schools have no board or donor designated funds. As the amounts are not significant, all net assets of the Organization and changes therein are classified and reported as unrestricted net assets.

**Use of Estimates**
The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

**Concentration of Credit Risk**
Financial instruments that potentially subject the Organization to significant concentrations of credit risk consist principally of cash and cash equivalents and investments. While the majority of cash and cash equivalent accounts exceed available depository insurance limits, management does not anticipate non-performance by their financial institutions and regularly reviews the viability of these institutions. The Organization also attempts to limit its risk in investments by maintaining a diversified investment portfolio. In addition to credit risk, investments are exposed to both interest rate and market risk.

**Fair Value Measurements**

On July 1, 2008, the Organization adopted Statement of Financial Accounting Standards ("SFAS") No. 157, *Fair Value Measurements.* SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. It applies under other pronouncements that require or permit fair value measurements, and clarifies the definition of fair value as a price that would be received to sell, as opposed to acquire, an asset or transfer a liability. SFAS No. 157 emphasizes that fair value is a market-based measurement, and establishes a fair value hierarchy that distinguishes between assumptions developed based on market data obtained from independent external sources and the reporting entity's own assumptions. The hierarchy is broken down into levels based on the reliability of the inputs as follows:

- **Level 1** – Valuations based on quoted prices in active markets for identical assets or liabilities that the Organization has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

- **Level 2** – Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, directly or indirectly.

- **Level 3** – Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

Further, fair value measurements should consider adjustments for risk, such as the risk inherent in a valuation technique or its inputs. For assets and liabilities measured at fair value on a recurring basis, SFAS No. 157 expands the required disclosures concerning the inputs used to measure fair value.

The Organization also adopted Financial Accounting Standards Board ("FASB") Staff Position ("FSP") FAS 157-2, *Effective Date of FASB Statement No. 157,* which deferred the effective date of SFAS No. 157 for one year for certain nonfinancial assets and liabilities measured at fair value on a nonrecurring basis.

The following methods and assumptions were used by the Organization to estimate the fair value of financial instruments:

*Cash and cash equivalents, amounts receivable for securities sold, amounts payable for securities purchased, collateral received for loaned securities, obligation to repay securities lending collateral, and accounts payable and accrued expenses:* The carrying amounts approximate fair value because of the short maturity of these instruments.

*Investments:* The fair value of the Organization's investments was determined as follows:

- *Common and preferred stocks, short-term investments and cash equivalents, and mutual funds* – The fair value of these investments are estimated using quoted prices in an active market or exchange and are generally categorized in Level 1.

- *U.S. government obligations* – The fair value of these investments are generally based on quoted prices in active markets and are generally categorized in Level 1.

- *International government bonds and other debt securities* – The fair value of these investments are estimated using both observable prices in an active market and unobservable inputs such as extrapolated data and proprietary pricing models and are generally categorized in Level 2.

- *Commingled funds, hedge funds, private equity funds, and other investments* – These investments are generally reported at fair value based on information provided by the respective external investment managers at the most recent valuation date and adjusted for cash flows from the valuation date to fiscal year end, if applicable. Because these investments are not readily marketable, their estimated value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investment existed. These funds are generally categorized in Level 3.

*Receivables, net:* The fair value of note agreements and mortgage notes is valued at the present value of expected future cash flows discounted at an interest rate commensurate with the risk associated with the respective receivables. The carrying value of interest and other receivables approximates fair value because of the short maturity of these instruments.

*Notes payable:* The fair value of notes payable is estimated using the current rates at which similar loans would be made by lenders to borrowers with similar credit ratings and similar remaining maturities.

The following table presents the Organization's financial instruments with carrying amounts that differ from estimated fair values at June 30, 2009 and 2008 (in thousands):

| | 2009 | | 2008 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Receivables, net | $ 19,504 | $ 33,288 | $ 26,841 | $ 41,611 |
| Notes payable | 235,416 | 222,825 | 244,062 | 242,139 |

Fair value estimates are made at a specific point in time based on relevant market information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore, cannot be determined with precision. Changes in assumptions could significantly affect these estimates.

**Cash and Cash Equivalents**

Cash and cash equivalents include unrestricted demand deposits and all highly liquid deposits with an original maturity of three months or less. Cash and cash equivalents are held in financial institutions located in the State and other states, and in an investment company. Cash balances are maintained in excess of depository institution insurance limits. Cash equivalents held by external investment managers are classified as investments in the consolidated balance sheets and are not included in cash and cash equivalents.

**Investments**

Unrealized gains and losses for marketable debt and equity securities and other investments are included in the change in net assets. Management fees vary depending on investment structure, and as such, are presented net of realized and unrealized gains and losses.

***Marketable Debt and Equity Securities – The Organization***

Investments in marketable debt and equity securities are reported at fair value.

### *Other Investments – The Schools*

Other investments are reported at fair value and include limited partnerships, hedge funds, commingled funds and other equity securities that do not have a readily determinable fair value. In addition, certain other investments contain lock-up periods where capital contributions may not be readily distributed.

### Receivables

Notes receivable are recognized from the sale of residential leasehold lots to lessees under the single-family and multi-family residential land sales program and mortgage agreements from the sale of real estate to developers. The residential leasehold interests were sold under various collateralized financing arrangements with 12 to 15-year terms and monthly payments of both principal and interest or interest only. Annual interest rates range from 7% to 10% with a weighted average interest rate of approximately 7% at June 30, 2009 and 2008. The sale of leasehold lots under the financing arrangements are accounted for using the cost-recovery method whereby no profit is recognized until cash payments are received.

### Property and Equipment

Property and equipment are carried at cost, less accumulated depreciation. The Organization provides for depreciation on property and equipment using the straight-line method over the estimated useful lives of the assets as follows:

| | Years |
|---|---|
| Land improvements | 30 |
| Buildings and improvements | 30 |
| Equipment | 5 to 10 |

The Organization reviews its long-lived assets, such as property and equipment, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss exists for an asset held for use when the cash flows expected to be generated by an asset are less than the carrying amount. Measurement of the impairment loss is based on the fair value of the asset. No significant impairment losses were recorded for the years ended June 30, 2009 and 2008.

### Real Estate Held for Development and Sale

Real estate assets held for development and sale include land acquisition and holding costs, site development, construction, and other project-related costs. The Organization capitalizes development costs as required by SFAS No. 67, *Accounting for Costs and Initial Rental Operation of Real Estate Projects*.

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* management uses estimated expected future net cash flows (undiscounted and excluding interest costs) to measure the recoverability of real estate assets held for development. The recoverability of real estate assets held for sale is determined by comparing appraised value or the net present value of the estimated expected future cash flows (using a discount rate commensurate with the risks involved) to the carrying amount of the asset. The estimate of expected future net cash flows is inherently uncertain and relies to a considerable extent on assumptions regarding current and future economic conditions. If in future periods there are changes in estimates or assumptions, the changes could result in an adjustment to the carrying amount of real estate. No impairment losses were recognized in 2009 and 2008.

**Revenue Recognition**
Profits on sales of real estate are recognized in full when title has passed, minimum down payment criterion is met, the terms of any note received are such as to satisfy continuing investment requirements and collectibility of the note is reasonably assured, the risks and rewards of ownership have been transferred to the buyer, and there is no substantial continuing involvement with the property. If any of the aforementioned criteria are not met, the profit is deferred and recognized under either the installment, cost recovery, deposit, or percentage-of-completion methods. Costs are charged to cost of sales on the basis of the relative sales value of the units sold to the total sales value of all units in the project.

Lease rental income is recognized on a straight-line basis ratably over the fixed term of the respective leases.

The Organization recognizes non-real estate revenue in the period in which services are rendered.

The Schools present taxes collected from customers and remitted to government agencies on a gross basis in its consolidated statement of activities. For the years ended June 30, 2009 and 2008, the Schools collected and remitted $45.0 million and $40.9 million in taxes, respectively.

**Income Taxes**
In a ruling dated February 9, 1939, and reaffirmed in 1969, 1986, and 2000, the Internal Revenue Service ("IRS") determined that the Schools are exempt from federal income taxes under Internal Revenue Code ("IRC") Section 501(c)(3) as they are organized and operated for educational purposes within the meaning of IRC Section 170(b)(1)(A)(ii). KAPF is also exempt from federal income taxes under IRC Section 501(c)(3) and qualifies as a supporting organization as described in IRC Section 509(a)(3). To the extent that the Schools and KAPF receive unrelated business income, such earnings are subject to unrelated business income tax.

Income taxes for BHC are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Income taxes are calculated by each subsidiary as if it filed separate income tax returns.

P&C is exempt from Hawaii income taxes, however is subject to tax on direct written premiums.

**Commitments and Contingencies**
Liabilities for loss contingencies, including environmental remediation costs, arising from claims, assessments, litigation, fines and penalties, and other sources, are recorded when it is probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated.

**Pension and Postretirement Obligation**
In accordance with SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement*, the Organization recognizes the difference between the benefit obligation and fair value of plan assets on the consolidated balance sheet. In addition, the Organization recognizes, as part of unrestricted net assets, the gains and losses due to differences between actuarial assumptions and actual experience and any effects on prior service due to plan amendments that arise during the period which are not yet recognized as net periodic benefit costs.

**Subsequent Events**
The Organization has reviewed all events that have occurred from July 1, 2009 through the date of financial statement issuance for proper accounting and disclosure in the consolidated financial statements.

**New Accounting Standards**
In June 2006, the FASB issued FASB Interpretation No. 48 ("FIN 48"), *Accounting for Uncertainty in Income Taxes,* which clarifies and provides guidance on the accounting for uncertain tax positions taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. In December 2008, the FASB deferred the effective date for another year and therefore, the standard will be effective for the Organization's fiscal year ending June 30, 2010. Management is currently reviewing the potential impact of this standard on the consolidated financial statements.

In December 2008, the FASB issued FSP FAS 132(R)-1, *Employers' Disclosures about Postretirement Benefit Plan Assets*, which requires additional disclosures related to pension and postretirement plan assets and will be effective for the Organization's fiscal year ending June 30, 2010. The adoption is not expected to have a material impact on the Organization's consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168, *the FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*, which establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied in the preparation of financial statements in conformity with GAAP. The standard will be effective for the Organization's fiscal year ended June 30, 2010. The adoption is not expected to have a material impact on the Organization's consolidated financial statements.

**Reclassifications**
Certain balances in the 2008 consolidated financial statements have been reclassified to conform to the 2009 presentation. Such reclassifications had no effect on the change in net assets as previously reported.

## 2. Investments

A summary of investments, at fair value, at June 30, 2009 and 2008 is as follows (in thousands):

| | 2009 | 2008 |
|---|---|---|
| **Marketable debt and equity securities** | | |
| Common and preferred stocks | $ 803,926 | $ 1,761,350 |
| Fixed income | 761,290 | 846,812 |
| Short-term investments and cash equivalents | 369,109 | 115,393 |
| Mutual funds | 160,143 | 211,988 |
| **Other investments** | | |
| Hedge funds | 1,769,841 | 2,219,339 |
| Private equity funds | 630,658 | 614,138 |
| Commingled funds | 333,923 | 646,687 |
| Other | 37,073 | 89,076 |
| | $ 4,865,963 | $ 6,504,783 |

The Schools' investment policy guides its asset allocation, which allows for the use of derivatives and other strategies which are achieved, in part, through limited partnership and mutual funds. These investments pose no off-balance sheet risk to the Schools due to the limited liability structure of the investments.

The Organization's investments reported at fair value on a recurring basis have been categorized based on the fair value hierarchy in Note 1 at June 30, 2009 as follows (in thousands):

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Common and preferred stocks | $ 803,926 | $ - | $ - | $ 803,926 |
| Fixed income | | | | |
| U.S. government obligations | 557,629 | - | - | 557,629 |
| International government bonds | - | 131,988 | - | 131,988 |
| Other debt securities | - | 71,673 | - | 71,673 |
| Short-term investments and cash equivalents | 368,083 | 1,026 | - | 369,109 |
| Mutual funds | 160,143 | - | - | 160,143 |
| Hedge funds | - | - | 1,769,841 | 1,769,841 |
| Private equity funds | - | - | 630,658 | 630,658 |
| Commingled funds | - | - | 333,923 | 333,923 |
| Other | - | - | 37,073 | 37,073 |
| **Total investments** | $ 1,889,781 | $ 204,687 | $ 2,771,495 | $ 4,865,963 |

Net realized and unrealized losses on Level 3 investments were included in the change in net assets on the statement of activities. Changes in Level 3 investments measured at fair value on a recurring basis for the year ended June 30, 2009 were as follows (in thousands):

| | Hedge Funds | Private Equity Funds | Commingled Funds | Other | Total |
|---|---|---|---|---|---|
| **As of July 1, 2008** | $ 2,219,339 | $ 614,138 | $ 646,687 | $ 89,076 | $ 3,569,240 |
| Net realized and unrealized losses on investments | (402,640) | (138,238) | (204,536) | (46,454) | (791,868) |
| Purchases, sales, issuance, and settlements, net | (46,858) | 154,758 | (108,228) | (5,549) | (5,877) |
| **As of June 30, 2009** | $ 1,769,841 | $ 630,658 | $ 333,923 | $ 37,073 | $ 2,771,495 |
| Change in unrealized losses relating to investments held at June 30, 2009 | $ (329,812) | $ (155,754) | $ (147,839) | $ (46,454) | $ (679,859) |

Investment income (losses) for the years ended June 30, 2009 and 2008 were as follows (in thousands):

| | 2009 | 2008 |
|---|---|---|
| Interest and dividend income | $ 79,359 | $ 131,156 |
| Realized and unrealized gains/losses, net of investment fees | (1,479,028) | (6,225) |
| | $ (1,399,669) | $ 124,931 |

**Securities Lending**
The Schools participated in a securities lending program administered by its custodian bank. Under the program, certain equity and fixed income securities of the Schools were lent to participating financial institutions in exchange for collateral which was marked to market daily. Borrowers were required to deliver collateral equal to a minimum of 102% of the securities loaned. As of June 30, 2008, the Schools had limited credit exposure to borrowers because the fair value of collateral held by the Schools exceeded the fair value of securities loaned. As of June 30, 2008, the fair value of securities loaned amounted to $241.7 million and the associated collateral, comprised primarily of money market funds, amounted to $252.0 million. There was no activity since January 2009.

**Direct Financing Lease**
BHC held a 40-year lease for a golf course facility located in Virginia, which had been accounted for as a direct financing lease. In 2008, BHC sold the golf course back to the golf club and recognized a loss of approximately $11.3 million.

## 3. Receivables

Receivables, net, at June 30, 2009 and 2008 were as follows (in thousands):

| | 2009 | 2008 |
|---|---|---|
| Note agreements | $ 14,009 | $ 15,627 |
| Less: Deferred profit on note agreements | (14,009) | (15,627) |
| | - | - |
| Interest | 12,965 | 16,105 |
| Tenant and tuition | 8,084 | 8,612 |
| Trade | 3,019 | 3,573 |
| Other | 1,906 | 3,080 |
| | 25,974 | 31,370 |
| Less: Allowance for doubtful accounts | (6,470) | (4,529) |
| | $ 19,504 | $ 26,841 |

## 4. Property and Equipment

Property and equipment, net, at June 30, 2009 and 2008 consisted of the following (in thousands):

| | 2009 | 2008 |
|---|---|---|
| **Educational property and equipment** | | |
| Land | $ 16,201 | $ 16,201 |
| Buildings, improvements and equipment | 698,426 | 689,789 |
| Less: Accumulated depreciation | (215,099) | (193,360) |
| | 499,528 | 512,630 |
| **Non-educational property and equipment** | | |
| Land and land improvements | 77,434 | 67,728 |
| Buildings, improvements and equipment | 476,676 | 370,550 |
| Less: Accumulated depreciation and amortization | (238,193) | (214,163) |
| | 315,917 | 224,115 |
| Construction in progress | 46,607 | 111,129 |
| | $ 862,052 | $ 847,874 |

Non-educational property and equipment are primarily comprised of assets used in leasing arrangements where the Schools act as the lessor.

Depreciation and amortization expense amounted to approximately $50.1 million and $38.6 million for the years ended June 30, 2009 and 2008, respectively.

## 5. Notes Payable

At June 30, 2009 and 2008, unsecured notes payable consisted of the following (columns in thousands):

| | 2009 | 2008 |
|---|---|---|
| Senior promissory notes payable at the rate of 6.89% per annum with annual principal payments of $11,900,000 beginning on June 22, 2004, with final payment on June 22, 2013 | $ 47,440 | $ 59,300 |
| Senior promissory notes payable under a $150,000,000 private shelf facility: | | |
| Interest rate of 6.80% per annum with annual principal payments of $952,000 beginning on March 1, 2007, with final payment on March 1, 2027 | 17,143 | 18,095 |
| Interest rate of 4.88% per annum with annual principal payments of $3,333,000 beginning on June 10, 2008, with final payment on June 10, 2028 | 63,333 | 66,667 |
| Interest rate of 4.93% per annum with annual principal payments of $4,000,000 beginning on April 14, 2009, $3,000,000 beginning on April 14, 2016, $2,000,000 beginning on April 14, 2022, and $1,000,000 beginning on April 14, 2028, with final payment due on April 14, 2029 | 56,000 | 60,000 |
| Senior promissory notes payable under a $200,000,000 private shelf facility at a rate of 5.15% per annum with annual principal payments of $10,000,000 beginning on March 1, 2008, with the final payment on March 1, 2012 | 30,000 | 40,000 |
| Credit facility payable under a $15,000,000 unsecured revolving line of credit for a six-month LIBOR term at LIBOR plus one-eighth of one percentage point (1.88% at June 30, 2009), with principal due on September 3, 2011 | 10,000 | - |
| Credit facility payable under a $56,000,000 unsecured revolving line of credit for a three-month LIBOR term at LIBOR plus 125 basis points (1.86% at June 30, 2009), with principal due on June 19, 2014, with an option to extend an additional two years | 11,500 | - |
| | $ 235,416 | $ 244,062 |

All note and credit agreements contain certain restrictions and require the maintenance of a minimum endowment value and liquidity ratio.

In November 2007, the Schools entered into a $200 million uncommitted private shelf facility. Notes may be issued under this facility through June 2012 at interest rates determined at the time of issuance. As of June 30, 2009, the Schools did not draw upon the uncommitted private shelf facility.

Annual maturities of notes payable are as follows (in thousands):

| **Year ending June 30,** | | |
|---|---|---|
| 2010 | $ | 30,145 |
| 2011 | | 30,145 |
| 2012 | | 40,145 |
| 2013 | | 20,145 |
| 2014 | | 19,785 |
| Thereafter | | 95,051 |
| | $ | 235,416 |

Interest expense incurred for the years ended June 30, 2009 and 2008 is summarized as follows (in thousands):

| | | **2009** | | **2008** |
|---|---|---|---|---|
| Interest expense incurred | $ | 13,583 | $ | 15,027 |
| Less: Interest expense capitalized | | - | | (781) |
| Interest expense | $ | 13,583 | $ | 14,246 |

## 6. Income Taxes

Total income tax expense (benefit) amounted to approximately $2.1 million and ($4.6) million for the years ended June 30, 2009 and 2008, respectively. These amounts are included in other management and general expenses in the accompanying consolidated statement of activities.

The components of deferred tax assets and liabilities as of June 30, 2009 and 2008 were as follows (in thousands):

| | 2009 | 2008 |
|---|---|---|
| **Deferred tax assets** | | |
| Charitable contribution carryforwards | $ 11,893 | $ 8,205 |
| Difference in basis of investments and real estate | 17,766 | 16,848 |
| Passive activity loss carryforwards | 10,184 | 8,167 |
| Net operating loss carryforwards | 8,375 | 4,234 |
| Capital loss carryforwards | 3,771 | 4,174 |
| Other | 4,386 | 2,922 |
| | 56,375 | 44,550 |
| Less: Valuation allowance | (50,934) | (37,828) |
| | 5,441 | 6,722 |
| **Deferred tax liabilities** | | |
| Other | - | (220) |
| | - | (220) |
| Net deferred taxes | $ 5,441 | $ 6,502 |

The change in valuation allowance was an increase of $13.1 million and $12.0 million for the years ended June 30, 2009 and 2008, respectively.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portions or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods which the deferred tax assets are deductible, management believes it is more likely than not that it will realize these deductible differences, net of the existing valuation allowance at June 30, 2009 and 2008. The amount of deferred tax assets considered realizable, however, could be increased in the near term if estimates of future taxable income during the carryforward period are increased. The Organization has passive activity losses of $26.1 million available to carryforward indefinitely for federal and state tax purposes and charitable contribution carryforwards of $30.5 million expiring at various dates beginning in 2011 through 2014, net operating loss carryforwards of $21.5 million expiring at various dates beginning in 2026 through 2029 and capital loss carryforwards of $9.7 million expiring at various dates beginning in 2013 through 2014.

In fiscal year 2008 the Organization reduced its previously accrued tax reserves by $2.7 million. The reserve related to potential income tax liabilities for prior years unrelated business taxable income from sources within states other than Hawaii. As a result of Voluntary Disclosure Agreements reached between the Organization and those respective states, the potential tax liabilities have either been substantially eliminated or settled and the Organization has adjusted its tax reserves accordingly.

As of June 30, 2009 and 2008, there were no significant pending federal or state income tax audits. The federal statute of limitations remains open for the Organization for the years ended June 30, 2006 through 2009.

## 7. Pension and Other Postretirement Benefits

The Organization has a defined benefit pension plan which covers substantially all employees after satisfying age and length of service requirements. The Organization makes annual contributions to the plan equal to the maximum amount that can be deducted for income tax purposes.

In addition to the Organization's defined benefit pension plan, the Schools sponsor a defined benefit health care plan that provides postretirement medical benefits to eligible full-time employees who meet minimum age and service requirements.

The following table reconciles the changes to the benefit obligations and plan assets for the years ended June 30, 2009 and 2008 to the funded status of the plans and amounts recognized in the consolidated financial statements as of June 30, 2009 and 2008 (in thousands):

| | Pension Benefits | | Postretirement Benefits | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| **Change in benefit obligation** | | | | |
| Benefit obligation at beginning of year | $ 222,197 | $ 221,395 | $ 23,759 | $ 26,090 |
| Service cost | 8,725 | 10,219 | 833 | 1,073 |
| Interest cost | 14,386 | 13,679 | 1,489 | 1,466 |
| Benefits paid | (9,337) | (8,499) | (1,036) | (986) |
| Actuarial (gains) losses | 12,426 | (14,236) | 1,508 | (3,884) |
| Other | (481) | (361) | - | - |
| Benefit obligation at end of year | 247,916 | 222,197 | 26,553 | 23,759 |
| **Change in fair value of plan assets** | | | | |
| Fair value of plan assets at beginning of year | 193,692 | 193,544 | - | - |
| Actual return on plan assets | (30,967) | 75 | - | - |
| Employer contributions | 8,679 | 8,933 | 1,036 | 986 |
| Benefits paid | (9,337) | (8,499) | (1,036) | (986) |
| Other | (481) | (361) | - | - |
| Fair value of plan assets at end of year | 161,586 | 193,692 | - | - |
| Net amount recognized | $ (86,330) | $ (28,505) | $ (26,553) | $ (23,759) |

The accumulated benefit obligation for the pension plan was $214.4 million and $182.7 million at June 30, 2009 and 2008, respectively.

The net periodic benefit cost consisted of the following for the years ended June 30, 2009 and 2008 (in thousands):

| | Pension Benefits | | Postretirement Benefits | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Service cost | $ 8,725 | $ 10,219 | $ 833 | $ 1,073 |
| Interest cost | 14,386 | 13,679 | 1,489 | 1,466 |
| Expected return on plan assets | (16,224) | (14,669) | - | - |
| Amortization of prior service cost and net actuarial losses (gains) | 387 | 419 | (120) | 73 |
| Net periodic benefit cost | $ 7,274 | $ 9,648 | $ 2,202 | $ 2,612 |

Actuarial losses (gains) and prior service cost arising during the year and amounts amortized into net periodic benefit cost at June 30, 2009 and 2008 are as follows (in thousands):

| | Pension Benefits | | Postretirement Benefits | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Actuarial losses (gains) arising during the year | $ 59,617 | $ 339 | $ 1,507 | $ (3,885) |
| Prior service costs and net actuarial gains (losses) reclassified as a component of net periodic benefit cost | (387) | (419) | 120 | (73) |
| Change in amounts not yet recognized as net periodic benefit cost | $ 59,230 | $ (80) | $ 1,627 | $ (3,958) |

The prior service cost and actuarial losses (gains) that have not yet been recognized as components of net periodic benefit cost at June 30, 2009 and 2008 are as follows (in thousands):

| | Pension Benefits | | Postretirement Benefits | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Actuarial losses (gains) | $ 38,600 | $ (21,049) | $ (1,520) | $ (3,190) |
| Prior service cost | 1,840 | 2,259 | 174 | 217 |
| Amounts not yet recognized as net periodic benefit cost | $ 40,440 | $ (18,790) | $ (1,346) | $ (2,973) |

The estimated prior service cost expected to be amortized into net periodic benefit cost in 2010 is $419,000 and $39,000 for the pension and postretirement plans, respectively. No actuarial gains related to the pension or postretirement plans are expected to be amortized into net periodic benefit cost in 2010.

| | Pension Benefits | | Postretirement Benefits | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| **Weighted average assumptions** | | | | |
| Benefit obligation | | | | |
| Discount rate | 6.25% | 6.75% | 6.25% | 6.75% |
| Rate of compensation increase | 4.20% | 4.80% | N/A | N/A |
| Net periodic benefit cost | | | | |
| Discount rate | 6.75% | 6.25% | 6.75% | 6.25% |
| Expected return on plan assets | 8.50% | 8.50% | N/A | N/A |
| Rate of compensation increase | 4.20% | 4.80% | N/A | N/A |

The Schools' overall expected long-term rate of return on plan assets is 8.5%. The expected long-term rate of return on plan assets was projected by the plan's investment consultants based on strategies outlined in the portfolios policies and guidelines.

The assumed healthcare cost trend rates at June 30, 2009 and 2008 were as follows:

| | 2009 | 2008 |
|---|---|---|
| Healthcare cost trend rate assumed for the next year | 9.00% | 9.00% |
| Rate to which the cost trend rate is assumed to decline (ultimate trend rate) | 5.00% | 5.00% |
| Year that the rate reaches the ultimate trend rate | 2016 | 2015 |

The weighted average and target asset allocation of the Organization's pension plan assets is as follows:

| | Pension Plan Assets at June 30 | Targeted Allocation | Targeted Range |
|---|---|---|---|
| **Asset category** | | | |
| **2009** | | | |
| Equity securities | 49.0 % | 47.0 % | 25.0 – 65.0% |
| Alternative investments | 24.0 % | 17.0 % | 10.0 – 30.0% |
| Debt securities | 22.0 % | 25.0 % | 15.0 – 40.0% |
| Inflation hedging assets | 5.0 % | 11.0 % | 8.0 – 25.0% |
| | 100.0 % | 100.0 % | |
| **2008** | | | |
| Equity securities | 48.0 % | 47.0 % | 25.0 – 65.0% |
| Alternative investments | 24.0 % | 17.0 % | 10.0 – 30.0% |
| Debt securities | 23.0 % | 25.0 % | 15.0 – 40.0% |
| Inflation hedging assets | 5.0 % | 11.0 % | 8.0 – 25.0% |
| | 100.0 % | 100.0 % | |

The investment goals for defined benefit pension plan assets are to maximize returns subject to specific risk management policies. The risk management policies permit investments in debt and equity securities, real estate and other inflation hedging assets. Readily marketable securities are utilized to pay benefit obligations as they become due.

The following benefit payments are expected to be paid from the respective plans as follows (in thousands):

| | Pension Benefits | Postretirement Benefits |
|---|---|---|
| **Year ending June 30** | | |
| 2010 | $ 11,696 | $ 1,096 |
| 2011 | 12,651 | 1,186 |
| 2012 | 13,298 | 1,251 |
| 2013 | 14,236 | 1,342 |
| 2014 | 15,088 | 1,427 |
| 2015–2019 | 90,026 | 8,613 |
| | $ 156,995 | $ 14,915 |

The expected benefits are based on the same assumptions used to measure the benefit obligation at June 30 and include estimated future employee service.

The Organization expects to contribute $10.6 million to their pension plan in 2010. The Organization does not expect to make any contributions to their postretirement medical plan in 2010.

The Organization has employee savings plans under Sections 403(b) and 401(k) of the IRC. The plans cover substantially all the Organization's employees after satisfying service requirements. Participating employees may defer up to 50% (subject to certain limitations) of their pretax earnings to the Section 401(k) plan.

The Organization makes matching contributions to the 401(k) plan up to a maximum 3% of employee pretax earnings. Participants are immediately and fully vested in the Schools' contribution. Contributions to the 401(k) plan for the years ended June 30, 2009 and 2008 amounted to approximately $2.9 million and $2.7 million, respectively.

## 8. Deferred Compensation Plan

On January 1, 1976, the Schools adopted a deferred compensation plan that allowed employees and others who perform services for the Schools under contract to defer compensation earned. Individual accounts are maintained for each participant and earnings are computed on the basis of alternative investment programs available. The liability has been fully funded and investments are included in investments in the consolidated balance sheets.

## 9. Commitments and Contingencies

### Rental Income

The majority of land and buildings are generally leased under long-term lease arrangements. At June 30, 2009, future rental income from these leases based on present effective minimum rentals is summarized as follows (in thousands):

| **Year ending June 30,** | |
|---|---|
| 2010 | $ 126,744 |
| 2011 | 118,678 |
| 2012 | 110,628 |
| 2013 | 100,212 |
| 2014 | 86,776 |
| Thereafter | 1,048,012 |
| | $ 1,591,050 |

Percentage rental income, based on stipulated percentages of gross lessees' sales, amounted to approximately $10.5 million and $12.5 million for the years ended June 30, 2009 and 2008, respectively.

### Capital Commitments

At June 30, 2009 and 2008, the Schools were committed under agreements with certain partnerships and corporations to invest an additional $523 million and $618 million, respectively.

At June 30, 2009 and 2008, open construction, renovation, major repair and other contracts amounted to $58 million and $37 million, respectively.

### Litigation

There are various claims and complaints against the Organization that are incidental to its operations. Management, after consideration with in-house legal counsel, is of the opinion that the ultimate resolution of these matters will not have a material adverse effect on the consolidated financial statements.

**Trustee Matters**

From July 2008 through February 2009, the Trustees received an annual retainer of $30,000, payable monthly, and received a meeting fee of $1,500 per meeting, except for the chairperson, who received $2,000 per meeting. Effective March 2009, the Trustees elected to take a 10% decrease in compensation, thereby receiving an annual retainer of $27,000, payable monthly, and receiving a meeting fee of $1,350 per meeting, except for the chairperson, who will receive $1,800 per meeting. On January 23, 2004, the Court approved increasing the maximum number of meetings from 45 to 90 during a 12-month period. The Trustees elected to waive compensation for meetings in excess of 45 during the calendar years 2004 through 2009. For the years ended June 30, 2009 and 2008, total Trustee compensation amounted to $522,150 and $514,500, respectively.

# Supplemental Schedules

# Kamehameha Schools and Subsidiaries
## Schedules of Trust Spending
## Years Ended June 30, 2009, 2008, 2007, 2006 and 2005
*(All dollars In thousands)* **Schedule 1**

| | 2009 | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|
| **Trust spending, net** | | | | | |
| Campus-based programs | | | | | |
| Kapalama | $ 77,951 | $ 76,788 | $ 74,124 | $ 75,342 | $ 74,931 |
| Hawaii | 27,271 | 25,814 | 25,805 | 24,509 | 22,400 |
| Maui | 25,744 | 26,798 | 24,636 | 24,253 | 20,286 |
| Outreach programs | | | | | |
| Community Education (includes funding for Ho'okako'o, a not-for-profit organization, of $2,771, $2,858, $1,850, $2,517 and $790 for the years ended June 30, 2009, 2008, 2007, 2006 and 2005, respectively) | 72,709 | 59,546 | 59,112 | 42,674 | 36,793 |
| Scholarships | 24,369 | 22,197 | 17,899 | 14,662 | 15,650 |
| Educational support services | 10,299 | 9,210 | 10,495 | 8,372 | 5,821 |
| Ke Ali'i Pauahi Foundation | (9) | 244 | 451 | 559 | 378 |
| Other program expenditures | 7,154 | 6,422 | 8,999 | 8,654 | 9,845 |
| Base spending | 245,488 | 227,019 | 221,521 | 199,025 | 186,104 |
| Less: Tuition, fees and other educational income, net | (11,332) | (12,076) | (13,614) | (12,978) | (10,313) |
| Base distributions | 234,156 | 214,943 | 207,907 | 186,047 | 175,791 |
| Information technology investment plan | 7,068 | 12,276 | 4,002 | - | - |
| Major repairs | 2,634 | 7,878 | 10,427 | 4,341 | 5,738 |
| Capital projects | 16,050 | 26,102 | 20,689 | 18,060 | 36,995 |
| Interest on debt | 7,369 | 7,669 | 7,734 | 7,335 | 7,734 |
| Debt financing of capital projects | 8,286 | 4,286 | 952 | - | - |
| In-kind transactions | 2,298 | 251 | 1,500 | - | - |
| Total trust spending before reserve activity | 277,861 | 273,405 | 253,211 | 215,783 | 226,258 |
| Reserve activity – operating, net | (20,000) | - | (3,000) | 5,000 | (3,800) |
| Total trust spending | $ 257,861 | $ 273,405 | $ 250,211 | $ 220,783 | $ 222,458 |
| Average fair value of Endowment | $ 7,512,346 | $ 6,690,039 | $ 6,136,107 | $ 5,803,821 | $ 5,614,498 |
| Trust spending rate before reserve activity | 3.7% | 4.1% | 4.1% | 3.7% | 4.0% |
| Trust spending rate | 3.4% | 4.1% | 4.1% | 3.8% | 4.0% |

See accompanying Report of Independent Auditors and notes to schedules of trust spending.

## 1. Background and Purpose

The Schools' spending policy governs annual trust spending from their Endowment to support its educational purpose. The spending policy targets annual trust spending at 4% of the average fair value of the Endowment plus the net income, if any, generated from the Schools' agriculture and conservation lands. The spending policy also provides for actual trust spending to vary annually at a range of 2.5% to 6.0%.

For the year ended June 30, 2009, the schedule was prepared on a modified accrual basis of accounting and presented total distributions made from the Endowment to fund educational programs (trust spending) by major program and activity. It also presented trust spending rates for five fiscal years through June 30, 2009. Prior to fiscal year 2009, the schedule was prepared on a cash basis.

## 2. Trust Spending and Trust Spending Rate

Trust spending represents the amounts spent during the fiscal year on educational programs by major program and activity. The campus-based and outreach program costs represent direct and indirect costs of providing these programs. The Educational Support Services programs represent the costs of administering scholarships, financial aid, admissions, ancestry verification and other supporting functions for educational programs. Ke Ali'i Pauahi Foundation expenditures represent the direct and indirect costs of providing scholarship and financial aid programs, net of realized gains and losses and investment income. Other program expenditures represent the direct and indirect costs related to certain educational services that benefit the various campus-based and outreach programs. Indirect costs, which represents the portion of the finance, operations, and legal services cost that support the Schools' educational programs and purpose are allocated to education based on various methods depending on the type of cost including headcount, square footage, and proportion in relation to the other estimates based on management's best judgment. Information technology investment plan includes information technology projects that are directly attributable to education as well as an allocation of information technology projects that are attributable to the entire organization. Major repairs, capital projects, interest on debt, net borrowing of debt and repayment of principal, and in-kind transactions are directly attributable to education. Reserve activity represents the funding of an operating reserve, as approved by the Court, to ensure assets are readily available for unanticipated educational program expenses or the use of the operating reserve to fund educational program expenses. Reserve activity may also include returning funds to the Endowment if there are sufficient operating reserves.

For the purposes of this schedule, trust spending on educational programs includes major repairs and capital projects, an allocation of indirect costs, borrowing of debt, repayment of principal and the reserve activity. These items are not included in educational program expenses on the consolidated statements of activities. The trust spending rates are determined by dividing the total trust spending before reserve activity and the total trust spending by the average fair value of the Endowment.

## 3. Endowment and Average Fair Value of the Endowment

The Endowment consists of all consolidated investment assets of the Schools except agriculture and conservation lands and reserve funds as defined in the Schools' investment policy. The average fair value of the Endowment is based on the average of the prior 20-quarter-end fair values. Accordingly, the trust spending rates for the years ended June 30, 2009, 2008, 2007, 2006 and 2005 are based on the estimated average fair values over the last five fiscal years utilizing the respective quarter-end values. For information on fair values, see note 2 in the Notes to Schedules of Total Return.

# Kamehameha Schools and Subsidiaries
## Schedules of Total Return
## June 30, 2009 — Schedule 2

| | Fair Value at June 30, 2009 (In Thousands) | One-Year Total Return % | Three-Year Total Return % | Five-Year Total Return % | Ten-Year Total Return % |
|---|---|---|---|---|---|
| Hawaii real estate | $ 2,344,033 | -19.0 | 9.5 | 14.1 | 9.8 |
| CPI+5% | | 3.6 | 7.1 | 7.6 | 7.6 |
| U.S. equity | 604,598 | -24.3 | -7.2 | -1.0 | 2.6 |
| Russell 3000 | | -26.6 | -8.3 | -1.8 | -1.5 |
| Non-U.S. equity | 682,414 | -31.3 | -7.2 | 2.2 | 4.3 |
| MSCI EAFE net | | -31.4 | -8.0 | 2.3 | 1.2 |
| Emerging markets | 317,035 | -27.7 | 3.2 | 15.1 | N/A |
| Emerging Markets Composite | | -28.1 | 2.6 | 13.3 | N/A |
| U.S. Fixed Income | 525,671 | 7.4 | 7.9 | 6.2 | 6.7 |
| U.S. Fixed Income Composite | | 7.3 | 8.1 | 6.0 | 6.5 |
| Global Fixed Income | 211,871 | -5.3 | N/A | N/A | N/A |
| Citigroup World Government | | 4.0 | N/A | N/A | N/A |
| Cash equivalents | 307,407 | 0.5 | 3.5 | 3.3 | 3.4 |
| Three-month U.S. Treasury Bill | | 1.0 | 3.2 | 3.2 | 3.2 |
| Venture and private equity | 472,286 | -22.3 | 0.9 | 7.7 | 3.3 |
| Venture and Private Equity Long-Term Objective | | 7.3 | 10.8 | 11.4 | 12.1 |
| Absolute return | 987,463 | -18.6 | -1.2 | 2.1 | N/A |
| CPI+5% | | 3.6 | 7.1 | 7.6 | N/A |
| Energy and other | 673,941 | -18.8 | 4.8 | 14.7 | 30.2 |
| CPI+5% | | 3.6 | 7.1 | 7.6 | 7.6 |
| Real estate (Mainland) | 59,787 | -39.9 | -11.5 | 11.3 | 11.6 |
| CPI +5% | | 3.6 | 7.1 | 7.6 | 7.6 |
| Total endowment | $ 7,186,506 | -20.9 | 1.3 | 6.5 | 7.2 |
| Endowment Fund Composite Benchmark | | -25.2 | -5.4 | 0.6 | 2.7 |
| Cambridge Associates Large Endowment Fund Median | | -19.8 | -0.8 | 4.8 | 5.9 |
| CPI+5% | | 3.6 | 7.1 | 7.6 | 7.6 |

See accompanying Report of Independent Auditors and notes to schedules of total return.

## 1. Background and Purpose

The Schools' investment policy establishes long-term and intermediate-term investment objectives, asset allocation targets, and performance measurement guidelines for the Endowment. The overall long-term investment objective of the Endowment is to earn an average annual real return of 5% net of all investment related expenses.

The purpose of this schedule is to report the Schools' total return results for the Endowment (by asset class) as compared to long-term benchmark indices approved in the investment policy. The Schools' Endowment asset classes include:

**Hawaii Real Estate**
The Hawaii real estate assets can be divided into traditional land holdings, improved commercial properties, real estate held for development and sale, and purchase money mortgages. The traditional land holdings are typically leased to third parties under long-term ground leases while the improved commercial properties are actively managed by various third-party managers to generate space rents. Improved commercial properties are comprised of shopping centers, office buildings, and warehouse facilities.

**U.S. Equity**
U.S. equity is comprised of marketable equity securities and derivative instruments of U.S. companies.

**Non-U.S. Equity**
Non-U.S. equity is comprised of marketable equity securities and derivative instruments of companies in developed markets.

**Emerging Markets**
Emerging markets is comprised of marketable equity securities and derivative instruments of companies in emerging markets.

**U.S. Fixed Income**
Fixed income is comprised of investments in debt securities issued by a corporation, government, or government agency. This asset class also includes, to a lesser degree, money market instruments, which include U.S. Treasury bills, bank certificates of deposit, repurchase agreements, commercial paper, bankers' acceptances and derivative instruments. As of June 30, 2009, fixed income is comprised of investments in debt securities issued primarily by governments and money market funds.

**Global Fixed Income**
Fixed income is comprised of investments in debt securities issued by a corporation, government, or government agency. This asset class also includes, to a lesser degree, money market instruments, which include U.S. Treasury bills, bank certificates of deposit, repurchase agreements, commercial paper, bankers' acceptances and derivative instruments.

**Cash Equivalents**
Cash equivalents are comprised of short-term investments in debt securities issued by a corporation, government or government agency, and money market instruments.

**Venture and Private Equity**
Venture and private equity investments are high risk, high potential return investments in illiquid privately placed equity or equity-related securities of nonpublic companies, companies or parts of companies that are being taken private, or public entities. The Schools' private equity and venture capital portfolio currently consists of limited partnership interests in pooled funds.

**Absolute Return**
Absolute return investments have the general objective of producing positive returns independent of the performance of the broad equity and fixed income markets though the underlying instruments are primarily equity and fixed income securities and derivatives. Absolute return investments include event-driven, relative value, market neutral, and equity long-short strategies. This asset class includes hedge funds and funds of funds.

**Energy and Other**
Energy and other investments are intended to serve as the inflation hedge component of the portfolio. This asset class includes marketable and illiquid exposures to energy assets, inflation-indexed bonds, commodities, mining, timber, and real estate. Forms of investments include separate accounts, hedge funds, mutual funds, and limited partnership interests in pooled funds.

**Real Estate (Mainland)**
Mainland real estate assets consist of pooled and direct investments in residential, office, retail, timberland and a variety of other property types.

## 2. Fair Values

The following methods and assumptions were used to estimate the fair value of each asset class:

**Hawaii Real Estate**
The fair value of residential real property interests (single-family and multifamily) is estimated by internal appraisals using a discounted cash flow method for leased properties and a sales comparison approach for unleased properties. An independent agreed upon procedures review of the residential appraisal methodology and input assumptions is obtained each year.

The fee simple land values used as inputs within the discounted cash flow model for leased properties are based on estimates by external appraisers and are updated internally for current market conditions since the last external appraisals were performed. Tax-assessed land values are applied as inputs within the discounted cash flow analysis for residential properties that are not included within the leased-fee sales program.

Commercial properties are divided into two primary categories – leased and unleased. In general, commercial properties are internally-appraised using a discounted cash flow model. An independent agreed upon procedures review of the appraisal methodology and input assumptions is obtained each year. Prior to June 2009, commercial properties were externally appraised every three years. Since June 2009, commercial properties are valued using a combination of quarterly internal valuations, and annual external valuation reviews.

The fair value of leased properties is typically estimated by using an income approach, while the value of unleased properties is typically estimated using a sales comparison approach. Prior to June 30, 2003, the fair value of internally-appraised leased properties was estimated by discounting future net cash flows at an appropriate discount rate over a ten-year period while the current tax-assessed value was used to approximate the fair value of unleased commercial properties.

The fair value of purchase money mortgages is estimated by discounting the expected future net cash flows at a discount rate commensurate with the risk associated with the respective receivables.

The fair value of all real property interests is reduced by the fair value of any associated debt.

**U.S. Equity, Non-U.S. Equity, and Emerging Markets**
The market value of marketable equity securities and derivatives are based on quoted market prices.

**U.S. Fixed Income, Global Fixed Income and Cash Equivalents**
The market values of marketable debt securities, cash equivalents and derivatives are primarily based on quoted market prices.

**Venture and Private Equity**
Different techniques and many factors were considered in deriving the fair value of these investments. Several investments have been valued based on the underlying asset value and are based on a number of different factors including, among others, original cost, third-party financing transactions, discounted cash flows and comparable industry multiples.

**Absolute Return**
Different techniques and many factors were considered in deriving the fair value of these investments. These investments have been valued based on the underlying asset value.

**Energy and Other**
Different techniques have been utilized and factors considered in deriving the fair value of these investments. Marketable instruments are based on quoted market prices. Hedge funds, direct investments, and limited partnership interests have been valued based on underlying asset values. For certain assets, the fair value was deemed to approximate the carrying value.

**Real Estate (Mainland)**
Different techniques were considered in deriving the fair value including net operating income divided by a capitalization rate, estimated cash flows discounted at a rate commensurate with risks involved, market comparables, independent appraisals, carrying value of a direct financing lease, and carrying value of operating assets reduced by liabilities.

The fair value is reduced by the carrying value of any debt associated with such properties.

## 3. Total Return

Total return is calculated using the time weighted rate of return methodology. Total returns for periods greater than one year are annualized.

"N/A" indicates that an asset class was not active for the respective time period.

### 4. Benchmark Indices

The benchmark indices are set forth in the Schools' investment policy. Amendments to the benchmark indices are incorporated when effective and include revised benchmarks, asset class target weights, and blended benchmark allocation methodologies. Blended portfolio benchmarks are generally weighted based upon the asset class targets set forth in the Schools' approved investment but may be based upon actual weights. The following composites are comprised of the respective benchmarks:

- **Emerging Markets Composite**
  MSCI Emerging Markets Free Index from July 1999 to December 2006; MSCI Emerging markets net from January 2007.

- **U.S. Fixed Income Composite**
  Lehman Aggregate Index from July 1999 to December 2006; U.S. Treasury 6.5 Duration Bond Index from January 2007.

- **Venture and Private Equity Long-Term Objective**
  CPI + 10% from July 1999 to June 2004; CPI + 8.75% from July 2004.