

Independent Auditors' Report

The Trustees
Kamehameha Schools:

We have audited the accompanying consolidated balance sheets of Kamehameha Schools and subsidiaries as of June 30, 2001 and 2000, and the related consolidated statements of activities and cash flows for years then ended. These consolidated financial statements are the responsibility of Kamehameha Schools management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the 2000 consolidated financial statements of Bishop Holdings Corporation, a wholly owned subsidiary, which statements reflect total assets constituting 8% and revenues constituting 8% of the related 2000 consolidated totals. Those statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amount included for Kamehameha Schools, is based solely on the reports of the other auditors.

We conducted our audits 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. 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 audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kamehameha Schools and subsidiaries as of June 30, 2001 and 2000, and the change in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were made for the purpose of forming an opinion on the basic 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 basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, based on our audits and with respect to the 2000 amounts related to Bishop Holdings Corporation and the reports of other auditors, is fairly stated in all material respects, in relation to the basic financial statements taken as a whole.

KPMG LLP

October 26, 2001



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KAMEHAMEHA SCHOOLS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

JUNE 30, 2001 AND 2000
(IN THOUSANDS)

	2001	2000
ASSETS		
CASH AND CASH EQUIVALENTS	\$ 170,887	473,608
MARKETABLE DEBT AND EQUITY SECURITIES (NOTES 2 AND 10)	3,022,067	1,789,711
PRIVATELY PLACED DEBT AND EQUITY SECURITIES (NOTE 3)	487,396	767,680
RECEIVABLES, NET (NOTE 4)	75,910	69,583
PROPERTY AND EQUIPMENT, NET (NOTE 5)	566,648	570,342
REAL ESTATE HELD FOR DEVELOPMENT AND SALE (NOTE 6)	61,186	56,033
DEFERRED CHARGES AND OTHER (NOTES 8 AND 13)	<u>31,156</u>	<u>35,323</u>
TOTAL ASSETS	<u>\$ 4,415,250</u>	<u>3,762,280</u>
LIABILITIES AND NET ASSETS		
NOTES PAYABLE (NOTE 7)	\$ 141,276	252,844
ACCOUNTS PAYABLE AND ACCRUED EXPENSES	54,194	37,131
INCOME TAXES PAYABLE (NOTE 8)	97,240	48,196
ACCRUED PENSION LIABILITY (NOTE 9)	32,475	29,529
ACCRUED POSTRETIREMENT BENEFITS (NOTE 9)	18,868	18,767
DEFERRED COMPENSATION PAYABLE (NOTE 10)	12,345	13,965
DEFERRED INCOME AND OTHER	<u>21,548</u>	<u>15,003</u>
TOTAL LIABILITIES	377,946	415,435
 NET ASSETS – UNRESTRICTED	 <u>4,037,304</u>	 <u>3,346,845</u>
 COMMITMENTS AND CONTINGENCIES (NOTES 6, 7, 8, 9, 10, 13 AND 15)		
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 4,415,250</u>	<u>3,762,280</u>

See accompanying notes to consolidated financial statements.

KAMEHAMEHA SCHOOLS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF ACTIVITIES

YEARS ENDED JUNE 30, 2001 AND 2000
(IN THOUSANDS)

	2001	2000
REVENUES, GAINS AND OTHER SUPPORT:		
TUITION AND FEES	\$ 7,754	7,863
LESS FINANCIAL AID	<u>(5,441)</u>	<u>(5,475)</u>
NET TUITION AND FEES	2,313	2,388
NET REALIZED AND UNREALIZED GAINS ON INVESTMENTS (NOTE 3)	654,011	651,621
INVESTMENT INCOME (NOTE 3)	118,574	134,661
RENTAL	138,622	136,683
NET GAIN (LOSS) ON PROPERTY SALES (NOTE 11)	58,896	(581)
FEDERAL GRANTS AND CONTRACTS	2,696	2,743
OTHER, NET (NOTES 12 AND 15)	<u>36,728</u>	<u>8,790</u>
TOTAL REVENUES, GAINS AND OTHER SUPPORT	<u>1,011,840</u>	<u>936,305</u>
EXPENSES:		
EDUCATIONAL PROGRAMS	109,143	99,289
MANAGEMENT AND GENERAL:		
RENTAL	56,032	55,552
OTHER (NOTE 8)	<u>156,206</u>	<u>66,657</u>
TOTAL EXPENSES	<u>321,381</u>	<u>221,498</u>
INCREASE IN NET ASSETS	690,459	714,807
NET ASSETS AT BEGINNING OF YEAR	<u>3,346,845</u>	<u>2,632,038</u>
NET ASSETS AT END OF YEAR	<u>\$ 4,037,304</u>	<u>3,346,845</u>

See accompanying notes to consolidated financial statements.

KAMEHAMEHA SCHOOLS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED JUNE 30, 2001 AND 2000 (IN THOUSANDS)

	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:		
INCREASE IN NET ASSETS	\$ 690,459	714,807
ADJUSTMENTS TO RECONCILE INCREASE IN NET ASSETS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
NET REALIZED AND UNREALIZED GAINS ON INVESTMENTS	(654,011)	(651,621)
GAINS ON PROPERTY SALES	(95,896)	(45,395)
IMPAIRMENT LOSS ON PROPERTY AND EQUIPMENT AND REAL ESTATE HELD FOR SALE	49,937	48,831
DEPRECIATION, AMORTIZATION AND DEPLETION	37,899	34,132
LOSSES (EARNINGS) IN INVESTEE COMPANIES	13,056	(50,804)
EARNED FINANCE CHARGES NOT RECEIVED	(809)	(774)
AMORTIZATION OF DISCOUNT ON NOTES PAYABLE	1,493	451
CHANGE IN OPERATING ASSETS AND LIABILITIES:		
INCREASE IN RECEIVABLES	(6,327)	(32,381)
DECREASE (INCREASE) IN DEFERRED CHARGES AND OTHER	4,167	(6,835)
DECREASE (INCREASE) IN REAL ESTATE HELD FOR DEVELOPMENT AND SALE	(11,533)	710
INCREASE IN ACCOUNTS PAYABLE, ACCRUED EXPENSES AND OTHER LIABILITIES	25,035	1,569
INCREASE IN INCOME TAXES PAYABLE	<u>49,044</u>	<u>25,447</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>102,514</u>	<u>38,137</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
PROCEEDS FROM PROPERTY SALES	97,674	48,348
PROCEEDS FROM SALES OF INVESTMENTS	4,403,008	2,253,874
PURCHASES OF INVESTMENTS	(4,713,316)	(2,294,564)
PURCHASES OF PROPERTY AND EQUIPMENT	<u>(79,540)</u>	<u>(60,813)</u>
NET CASH USED IN INVESTMENT ACTIVITIES	<u>(292,174)</u>	<u>(53,155)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
PROCEEDS FROM BORROWINGS	748,494	520,969
REPAYMENT OF BORROWINGS	<u>(861,555)</u>	<u>(525,370)</u>
NET CASH USED IN FINANCING ACTIVITIES	<u>(113,061)</u>	<u>(4,401)</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(302,721)	(19,419)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>473,608</u>	<u>493,027</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 170,887</u>	<u>473,608</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
INCOME TAXES PAID	<u>\$ 22,158</u>	<u>23,585</u>
INTEREST PAID	<u>\$ 23,669</u>	<u>20,537</u>

See accompanying notes to consolidated financial statements.

KAMEHAMEHA SCHOOLS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2001 AND 2000

(1) Summary of Significant Accounting Policies and Practices

(a) *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 jurisdiction of the First Circuit Court of the State of Hawaii (the Court). The primary assets of the Schools are land and properties located in the State of Hawaii and debt and equity investments.

The Schools provide a variety of educational services for students of Hawaiian ancestry including early education (preschool), campus-based programs and other extension and summer school programs. Early education programs are conducted in various facilities throughout the State of Hawaii. The campus-based programs include campuses on the islands of Oahu, Maui and Hawaii. The Oahu Campus is a kindergarten through grade 12 program. The Maui and Hawaii campuses are in their development stages and, as of June 30, 2001, served students from kindergarten through grade 8. These two campuses will expand over the next four years to include grades 9 through 12. The Schools are also engaged in summer programs, educational partnerships and other programs that are outreach related intended to provide educational opportunities to a greater population of Hawaiian people. In addition, the Schools provide a significant amount of scholarships for post-secondary education.

(b) *Principles of Consolidation*

The consolidated financial statements include the accounts of:

- The Schools;
- Ke Alii Pauahi Foundation (KAPF);
- Kamehameha Activities Association (KAA) and KAA's wholly owned subsidiary, Bishop Holdings Corporation (BHC) whose consolidated financial statements include the accounts of:
 - Pauahi Management Corporation (PMC) and its wholly owned subsidiaries - KDP, Limited; KBH, Inc.; VCI, Inc.; Horton Grove Limited Liability Company; Shelter Bay Limited Liability Company; Lake Manassas Limited Liability Company; Gwinnett Associates Limited Liability Company; Treyburn Limited Liability Company; RTJ Limited Liability Company; and KUKUI, Inc. and its wholly owned subsidiaries - KUKUI Operating Company and Paradise Petroleum, Inc. dba Alii Petroleum;
 - P&C Insurance Company, Inc.; and
 - Kamehameha Investment Corporation and its wholly owned subsidiaries - Keauhou Community Services, Inc.; Paki, Inc.; and its investment in Keauhou Kona Resort Company.

KAPF is a charitable organization whose exclusive purpose as a supporting organization is to actively engage in a fund-raising program and administer and operate the scholarship and financial aid programs for the Schools, KAA and KAPF.

KAA is also a charitable organization whose exclusive purpose as a supporting organization is to provide funds to the Schools for its educational programs and to advance the mission, vision and goals of the Schools.

BHC is a taxable holding corporation with subsidiaries involved in property investment and management. The subsidiaries develop and sell real estate, maintain investments in equity and debt instruments, manage commercial properties on behalf of the Schools, operate oil and gas properties, and own and operate a hotel. In addition, a subsidiary is a captive insurance company that provides property and liability coverage for the Schools and its affiliates.

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

(c) *Basis of Financial Statement Presentation*

The Schools' consolidated financial statements have been prepared on the accrual basis of accounting, and are presented in conformity with accounting principles generally accepted in the United States of America. Net assets, revenues, gains and other support and expenses are classified based on the existence or absence of donor-imposed restrictions. All net assets of the Schools and changes therein are classified and reported as unrestricted net assets.

(d) Cash Equivalents

Cash equivalents consist of a liquid asset account offered by an investment bank and commercial paper with initial terms of less than three months. For purposes of the Consolidated Statements of Cash Flows, the Schools consider all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. The net cash balances maintained in excess of available depository insurance limits amounted to approximately \$169.0 million and \$472.1 million at June 30, 2001 and 2000, respectively.

(e) Investments

Marketable Debt and Equity Securities – The Schools and KAA

Debt and equity securities with readily determinable fair values are reported at fair value with unrealized gains and losses included in the Consolidated Statements of Activities. Fair value is based on quoted market prices and, if applicable, discounted for restrictions on the sale of shares.

Marketable Debt and Equity Securities – BHC

Debt and equity securities are classified in one of three categories: trading, available-for-sale, or held-to-maturity. Trading securities are bought and held principally for the purpose of selling them in the near term. Held-to-maturity securities are those securities in which BHC has the ability and intent to hold the security until maturity. All securities not included in trading or held-to-maturity are classified as available-for-sale.

Trading and available-for-sale securities are recorded at fair value. Held-to-maturity securities are recorded at amortized cost, adjusted for the amortization or accretion of premiums or discounts. Unrealized and realized gains and losses on trading securities are included in earnings. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported in other comprehensive income as a separate component of net assets. Realized gains and losses from the sale of available-for-sale securities are determined on a specific identification basis.

At June 30, 2001 and 2000, debt and equity securities were classified as available-for-sale and were reported at amounts which approximate fair value.

Privately Placed Debt and Equity Securities

Investments in which the Schools own 20% to 50% of the equity interest (5% to 50% for partnership investments) are accounted for primarily on the equity method. Certain limited partnership investments for which the Schools have in excess of 50% interest, but do not have control, are also accounted for on the equity method. Other investments in which the Schools have no significant influence are accounted for at cost.

A decline in the fair value of any held-to-maturity, privately placed debt or equity securities below cost that is deemed to be other than temporary results in a reduction in carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. Premiums and discounts are amortized or accreted over the life of the related held-to-maturity security as an adjustment to yield using the effective interest method. Dividend and interest income are recognized when earned.

(f) Derivative Financial Instruments

At times, BHC enters into various commodity price hedging contracts with respect to its oil and gas production. While the use of these hedging agreements limits the downside risk of adverse price movements, they may also limit future revenue from favorable price movements. The use of hedging transactions also involves the risk that the counterparties will be unable to meet the financial terms of such transactions. The derivative financial instruments held by BHC are principally held for purposes other than trading.

Effective July 1, 2000, BHC adopted the Financial Accounting Standards Board's Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, an amendment of SFAS No. 133. These statements establish accounting and reporting standards requiring that derivative instruments, including certain derivative instruments embedded in other contracts, be recorded on the Consolidated Balance Sheets at fair value as either assets or liabilities. The accounting for changes in the fair value of a derivative instrument depends on the intended use and designation of the derivative at its inception. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results of the hedged item in earnings, and requires BHC to formally document, designate and assess the effectiveness of the hedge transaction to receive hedge accounting. For derivatives designated as cash flow hedges, changes in fair value, to the extent the hedge is effective, are

recognized in other comprehensive income as a separate component of net assets until the hedged item is recognized in earnings. Overall hedge effectiveness is measured at least quarterly. Any changes in the fair value of the derivative instrument resulting from hedge ineffectiveness, as defined by SFAS No. 133 and measured based on the cumulative changes in the fair value of the derivative instrument and the cumulative changes in the estimated future cash flows of the hedged item, are recognized immediately in earnings. BHC has designated all of its commodity hedges as cash flow hedges.

(g) *Receivables*

Notes receivable consist primarily of receivables from the sale of residential leasehold lots to lessees under the single-family and multi-family residential land sales program, mortgage agreements from the sale of real estate to developers and interest earned. The residential leasehold interests were sold under various collateralized financing arrangements with five to fifteen year terms and monthly payments of both principal and interest or interest only. Annual interest rates range from 5% to 11% with a weighted average interest rate of approximately 7% at June 30, 2001 and 2000, respectively. The sale of leasehold lots under the financing arrangements is accounted for using the cost recovery method whereby no profit is recognized until cash payments are received.

(h) *Property and Equipment*

Property and equipment are stated at cost. Depreciation on property and equipment is calculated on the straight-line method over the estimated useful lives of the assets.

BHC uses the full cost method of accounting for oil and gas properties. Under this method of accounting, all costs incurred in the acquisition, exploration and development of oil and gas properties are capitalized. Such capitalized costs and estimated future development and dismantlement costs are amortized on a unit-of-production method based on proved reserves. Net capitalized costs of oil and gas properties are limited to the lower of unamortized costs or the cost center ceiling, defined as the sum of the present value (10% discount rate) of estimated future net revenues from proved reserves, based on year-end oil and gas prices; plus the cost of properties not being amortized, if any; plus the lower of cost or estimated fair value of unevaluated properties, if any; less related income tax effects.

In September 1998, BHC sold substantially all of its interest in its coal bed methane wells as it relates to gas produced from the existing well bores. The terms of the sale were designed to allow the purchaser to be considered an owner of an economic interest in the gas produced for purposes of tax benefits that may be available under the Internal Revenue Code. BHC received a down payment of \$1.7 million which reduced the basis in the property, receives tax credit payments from the purchaser based on the amount of natural gas sold, and receives a net profit interest carved out of the working interest equal to the cash flows from the properties until certain events, as defined in the agreements, occur. Such events should allow BHC to receive all of the cash flows from the existing wells until January 1, 2003, at which time BHC has an option to reacquire the properties at the then fair market value. In fiscal 2001 and 2000, BHC received annual tax credit payments of \$8.3 million. BHC also received net profit interest payments of \$21.0 million and \$7.6 million for the years ended June 30, 2001 and 2000, respectively. These amounts are reported as Other revenues, net in the Consolidated Statements of Activities.

Unevaluated properties and associated costs not currently amortized and included in oil and gas properties amounted to \$3.9 million and \$2.5 million at June 30, 2001 and 2000, respectively. The properties represented by these costs were undergoing exploration or development activities, or are properties on which such activities are expected to commence in the future. BHC believes that these unevaluated properties will be substantially evaluated and therefore subject to amortization in 12 to 24 months.

BHC's oil and gas properties coal seam methane gas wells are located primarily in Colorado, New Mexico and Alabama. Depletion expense amounted to \$11.1 million and \$8.9 million for the years ended June 30, 2001 and 2000, respectively.

(i) *Real Estate Held for Development and Sale*

Real estate assets held for development and sale are stated at cost net of any write-downs. Cost includes land acquisition and holding costs, site development, construction and other project related costs. Land improvements are allocated to land parcels, based on their relative sales values. Improvements allocated to land are charged to expense when land is sold. Improvements allocated to leased lands are amortized over the service lives of the improvements or lease term, whichever is shorter. Improvements that have been or will be donated to governmental units are amortized over the term of the leases benefited by those improvements. General improvement costs, unless specifically identified to benefit a particular land parcel, are allocated to undeveloped land.

Profits on sales of real estate is recognized when title has passed, minimum down payment criterion are 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, 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.

(j) *Vacation*

Professional teaching employees are employed under one-year contracts for school years ending in mid-August. School years comprise a "teaching period" from mid-August to mid-June and a "professional improvement period" for the balance of the year.

Vacations for these employees are provided during the professional improvement period. Substantially all the Schools' employees, except for professional teaching employees, earn vacation benefits and are entitled to receive payments for unused vacation benefits based upon their regular salary at the time of their termination of employment.

(k) *Employee Benefits and Postretirement Plans*

The Schools have a defined benefit pension plan covering substantially all of its employees. The benefits are based on years of service and the employee's compensation. The cost of this program is being funded currently.

The Schools also sponsor a defined benefit health care plan for substantially all retirees and employees. The Schools measure the costs of its obligation based on its best estimate. The net periodic costs are recognized as employees render the services necessary to earn the postretirement benefits.

The Schools and BHC have employee savings and profit sharing plans under Section 403(b) and Section 401(k), respectively, of the Internal Revenue Code. The plans cover substantially all the Schools' and BHC employees after satisfying service requirements. Under these plans, participating employees may defer up to 20% and 15% of their pretax earnings, respectively, for Section 403(b) and Section 401(k).

There were no employer contributions for fiscal years 2001 and 2000. Effective July 1, 2002, the Schools will commence employer contributions up to a maximum of 3% of employee earnings.

(l) *Deferred Income*

Deferred income consists primarily of prepaid lease rents, which are deferred and recognized as income ratably over the fixed term of the respective leases.

(m) *Income Taxes*

In a ruling dated February 9, 1939, and as reaffirmed in 1969, 1986 and 2000, the Internal Revenue Service (IRS) determined that the Schools were exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code and organized and operated for educational purposes within the meaning of Section 170(b)(1)(A)(ii) of the Internal Revenue Code. KAPF and KAA are also exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code and qualify as supporting organizations described in Section 509(a)(3) of the Internal Revenue Code. To the extent that the Schools, KAPF and KAA 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 future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss 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. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

(n) *Use of Estimates*

Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ from those estimates.

- (o) **Impairment of Long Lived Assets and Long Lived Assets to Be Disposed Of**
SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of*, requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.
- (p) **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.
- (q) **Reclassifications**
Certain amounts in the accompanying consolidated financial statements have been reclassified in 2000 to conform to classifications adopted in 2001.

(2) Marketable Debt and Equity Securities

Marketable debt and equity securities at June 30, 2001 and 2000 consisted of the following (in thousands):

	FAIR VALUE	
	2001	2000
COMMON AND PREFERRED STOCK:		
INVESTMENT BANKING FIRM (NOTE3)	\$ 397,848	1,101,038
OTHER	988,314	125,501
CORPORATE DEBT SECURITIES	725,384	185,741
SHORT-TERM CORPORATE OBLIGATIONS	2,358	130,861
GOVERNMENT SECURITIES	326,967	133,458
MUTUAL FUNDS	576,435	87,265
OTHER	4,761	25,847
	<u>\$ 3,022,067</u>	<u>1,789,711</u>

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Short-term corporate obligations, corporate debt securities, and common and preferred stock investments are with corporations and mutual funds involved in various industries located throughout the United States and internationally. The only individual investment as of June 30, 2001 and 2000 representing more than 10% of total marketable securities is the Schools' investment in the investment banking firm discussed in note 3.

(3) Privately Placed Debt and Equity Securities

The following schedule summarizes the carrying amount and fair value of the components of privately placed debt and equity securities at June 30, 2001 and 2000 (in thousands):

	2001		2000	
	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
EQUITY INVESTMENTS	\$ 437,610	608,908	530,773	587,515
DIRECT FINANCING LEASE	35,255	35,255	34,446	34,446
LOANS AND SUBORDINATED DEBENTURES	14,531	14,826	27,736	28,073
INVESTMENT BANKING FIRM, AT COST	—	—	174,725	777,031
	<u>\$ 487,396</u>	<u>658,989</u>	<u>767,680</u>	<u>1,427,065</u>

(a) **Equity Investments**

Equity investments (accounted for on both the equity and cost method) include interests in partnerships, corporations and real estate investment trusts. These entities are involved in a diversified mix of real estate, retail and financial activities in various geographical locations. The objectives of these companies include but are not limited to the following:

- Own luxury apartments, retail shopping center and office buildings;
- Develop senior living communities;
- Acquire distressed real estate assets for either foreclosure or restructuring; and
- Invest in:
 - Equity securities in various industries, including insurance, financial services and healthcare;
 - Currently under-managed companies in need of sophisticated financial assistance;
 - Equity securities in connection with leveraged acquisitions;
 - Medium- and long-term investments in distressed fixed income securities, primarily in Asia; and
 - Equity, equity-related and debt securities acquired through privately negotiated transactions.

Combined and condensed unaudited financial information (most recent available) for the investee companies that are accounted for on the equity method as of June 30, 2001 and 2000 is as follows (in thousands):

	2001	2000
ASSETS	\$ 3,254,983	6,681,524
LIABILITIES	<u>1,305,358</u>	<u>4,660,305</u>
EQUITY	<u>\$ 1,949,625</u>	<u>2,021,219</u>
REVENUES	\$ 366,640	1,526,651
EXPENSES	<u>366,203</u>	<u>1,288,345</u>
NET INCOME	<u>\$ 437</u>	<u>238,306</u>

The Schools' equity in losses of investments amounted to \$13.1 million for the year ended June 30, 2001. The Schools equity in income of investments amounted to \$50.8 million for the year ended June 30, 2000. These amounts are included in Investment income in the Consolidated Statements of Activities.

(b) **Investment Banking Firm**

At June 30, 2001 and 2000, the Schools owned approximately 5.5 million and 22 million shares, respectively, in a major New York investment banking firm (the Firm). The Schools' shares may be sold over a period of three years commencing in May 2000. In fiscal 2001, the Schools sold approximately 16.5 million shares of its common stock in the Firm at prices ranging between \$90 to \$109 per share.

Shares available for sale within a one-year period from the respective balance sheet date are considered marketable and reflected in Marketable debt and equity securities and carried at fair value. The remaining portion of the shares are reflected in Privately placed debt and equity investments and reflected at cost. The fair value of the Firm has been estimated using quoted market prices discounted for the time restrictions on sale.

The Firm is a U.S. registered broker dealer that is involved in securities underwriting and distribution; trading of corporate debt and equity securities, U.S. government and agency securities, non-U.S. sovereign debt and mortgage and municipal securities; execution of swaps and other derivative financial instruments; mergers and acquisitions; financial advisory services for restructurings, private placements and lease and project financing; real estate brokerage and finance; stock brokerage and research; asset management and the trading of currencies. The Firm provides its services worldwide to a substantial and diversified client base, which includes corporations, financial institutions, governments and individual investors. Investment banking has inherent risks associated with such items as market, interest rate, currency and credit risk.

(c) **Loans and Subordinated Debentures**

Loans provide for principal and interest payments over the next fiscal year with interest at 6.5% per annum. Subordinated debentures provide for interest rates of 6.5% to 12% per annum and mature over periods up to seven years. Certain debt investments are collateralized by real property.

(d) **Direct Financing Lease**

BHC holds a 40-year lease for a golf course facility located in Virginia. The lease is accounted for as a direct financing lease. At June 30, 2001, the total minimum lease payments to be received and unearned finance charges were \$80.0 million and \$44.7 million, respectively. At June 30, 2000, the total minimum lease payments to be received and unearned finance charges were \$80.7 million and \$46.3 million, respectively. Future minimum annual lease payments amount to \$1.1 million from 2002 to 2006 and \$74.5 million in the aggregate thereafter. In addition to fixed minimum rentals, the lease agreement provides for percentage rent based on adjusted gross revenue of the golf course. The golf club has the option to purchase the golf club facilities either at the conclusion of the lease term or any time during the term of the lease based on amounts specified in the lease agreement.

(e) **Net Realized and Unrealized Gains (Losses) on Investments**

Net realized and unrealized gains (losses) on investments for the years ended June 30, 2001 and 2000, by investment type, are as follows (in thousands):

	2001	2000
MARKETABLE SECURITIES, OTHER	\$ (55,450)	7,601
EQUITY INVESTMENTS	(3,246)	39,191
INVESTMENT BANKING FIRM	712,123	602,390
OTHER	584	2,439
	<u>\$ 654,011</u>	<u>651,621</u>

(f) **Investment Income**

Investment income for the years ended June 30, 2001 and 2000, by investment type, is as follows (in thousands):

	2001	2000
CASH EQUIVALENTS	\$ 25,899	37,053
MARKETABLE SECURITIES, OTHER	88,221	18,635
EQUITY INVESTMENTS	(8,399)	55,583
INVESTMENT BANKING FIRM	6,413	10,861
LOANS AND SUBORDINATED DEBENTURES	2,676	6,720
MORTGAGE NOTES	3,528	3,172
OTHER	236	2,637
	<u>\$ 118,574</u>	<u>134,661</u>

(4) **Receivables**

Receivables at June 30, 2001 and 2000 consisted of the following (in thousands):

	2001	2000
NOTE AGREEMENTS	\$ 80,570	82,478
LESS DEFERRED PROFIT ON NOTE AGREEMENTS	(70,500)	(69,744)
	10,070	12,734
INCOME TAXES	31,063	31,566
TENANT AND TUITION	19,020	13,415
INTEREST	13,169	10,925
TRADE	12,682	9,659
OTHER	1,749	1,979
	87,753	80,278
LESS ALLOWANCE FOR DOUBTFUL ACCOUNTS	(11,843)	(10,695)
	<u>\$ 75,910</u>	<u>69,583</u>

(5) Property and Equipment

Property and equipment at June 30, 2001 and 2000 consisted of the following (in thousands):

	2001	2000
EDUCATIONAL PROPERTY AND EQUIPMENT:		
LAND	\$ 12,458	9,656
BUILDINGS, IMPROVEMENTS AND EQUIPMENT	216,679	158,485
LESS ACCUMULATED DEPRECIATION	<u>(73,598)</u>	<u>(65,192)</u>
	<u>155,539</u>	<u>102,949</u>
ALL OTHER PROPERTY AND EQUIPMENT:		
LAND AND LAND IMPROVEMENTS	123,169	129,663
BUILDINGS, IMPROVEMENTS AND EQUIPMENT	320,979	358,951
OIL AND GAS PROPERTIES	91,521	77,378
LESS ACCUMULATED DEPRECIATION, AMORTIZATION AND DEPLETION	<u>(190,484)</u>	<u>(173,095)</u>
	<u>345,185</u>	<u>392,897</u>
CONSTRUCTION IN PROGRESS	<u>65,924</u>	<u>74,496</u>
	<u>\$ 566,648</u>	<u>570,342</u>

The provision for depreciation and depletion amounted to approximately \$57.9 million and \$34.1 million for the years ended June 30, 2001 and 2000, respectively.

In addition, the Schools determined that the book values of certain properties, buildings and improvements were impaired. As such, the properties were adjusted to fair value, which resulted in impairment losses of approximately \$43.4 million and \$22.6 million for the years ended June 30, 2001 and 2000, respectively.

In May 2000, BHC entered into an agreement to sell its interest in the Keauhou Kona Surf and Racquet Club (KSR) to the KSR Association of Apartment Owners for \$11.5 million. The sale of KSR closed in September 2000.

(6) Real Estate Held for Development and Sale

BHC is involved in the development and sale of several real estate projects throughout the United States. At June 30, 2001 and 2000, the carrying amount of certain real estate held for sale exceeded their fair value less costs to sell resulting in impairment losses. The fair value of the real estate was determined based on discounted cash flow analyses prepared by independent appraisers and management. The impairment losses for the years ended June 30, 2001 and 2000 was \$6.5 million and \$26.2 million, respectively.

In August 2001, BHC completed a bulk sale of one of its projects. The sales price for the project totaled \$13.3 million of which \$12.5 million was received upon closing after selling and other closing costs. Under the terms of the agreement, BHC is also obligated to complete construction on a certain roadway and filtration pond at an estimated cost of approximately \$106,000.

(7) Notes Payable

At June 30, 2001 and 2000, notes payable consisted of the following (columns in thousands):

	2001	2000
Senior promissory notes payable at the rate of 6.89% per annum with annual principal payments of \$11.9 million beginning June 22, 2004 with the final payment on June 22, 2013. The note agreement contains certain restrictions on assumption of additional debt and requires maintenance of a certain interest coverage ratio, among other restrictions.	\$ 118,575	118,575
Notes payable under a \$200.0 million commercial paper program, due on various dates from August 29 to February 12, 2001 with interest at the rates ranging from 6.35% to 6.77%. The notes were paid down in May 2001. In connection with this program, the Schools maintain a back-up liquidity facility with a consortium of banks. The facility requires the maintenance of a minimum liquidity balance, based on a proportion of commercial paper outstanding. The facility expires in November 2001.	—	95,257
Note payable to banks under a \$37.0 million revolving credit agreement with principal due on September 30, 2002. Interest rate (4.25% on June 30, 2001 and 7.19% to 7.31% on June 30, 2000, respectively) options include the bank's prime rate, a certificate of deposit rate plus 37.5 basis points, or floating LIBOR rate plus 25 basis points	22,701	32,700
Notes payable under \$13.0 million credit term loan due July 2, 2001; interest (7.21% at June 30, 2000) payable quarterly or more frequently depending on the interest rate options based on the bank's prime rate, a certificate of deposit rate plus 77.5 basis points, or eurodollar rate plus 43 basis points. The notes were paid in full in March 2001.	—	5,704
Note payable under a \$6.5 million revolving credit agreement with interest (9.5%) due monthly and principal due March 2, 2002. The note was paid in full in 2001.	—	573
Other, paid in full in 2001.	—	35
	<u>\$ 141,276</u>	<u>252,844</u>

BHC has a \$50 million bank revolving line of credit with interest at 1.5% over the LIBOR rate. The line of credit facility expires on March 1, 2002. Drawings on the line are secured by oil and gas properties. There were no drawings on the line at June 30, 2001 and 2000.

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

YEAR ENDING JUNE 30:	
2002	\$ —
2003	22,701
2004	11,860
2005	11,860
2006	11,860
THEREAFTER	82,995
	<u>\$ 141,276</u>

Interest expense for the years ended June 30, 2001 and 2000 is as follows (in thousands):

	2001	2000
THE SCHOOLS	\$ 13,441	14,930
BHC	2,417	3,131
	<u>\$ 15,858</u>	<u>18,061</u>

(8) Income Taxes

Total income tax expense amounted to \$82.6 million for the year ended June 30, 2001. Total income tax benefit amounted to \$4.4 million for the year ended June 30, 2000. These amounts are included in Management and general expenses in the Consolidated Statements of Activities. For the year ended June 30, 2001, the components of income tax expense include current and deferred income tax expense of \$79.6 million and \$3.0 million, respectively. For the year ended June 30, 2000, the components of income tax benefit include current and deferred income tax benefit of \$5.4 million and \$1.0 million, respectively.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of June 30, 2001 and 2000 are presented below (in thousands):

	2001	2000
DEFERRED TAX ASSETS:		
DIFFERENCE IN BASIS OF INVESTMENTS AND REAL ESTATE	\$ 6,499	13,202
NET OPERATING LOSS CARRYFORWARDS	8,059	5,606
DEFERRED INCOME	1,376	4,924
ACCRUED INTEREST	2,730	2,730
OTHER	999	2,402
VALUATION ALLOWANCE	(17,261)	(24,749)
	<u>2,402</u>	<u>4,115</u>
DEFERRED TAX LIABILITIES:		
DEPRECIATION	(1,206)	(1,103)
INVESTMENT BASIS DIFFERENCE AND OTHER	(1,196)	—
	<u>(2,402)</u>	<u>(1,103)</u>
NET DEFERRED TAX ASSET	\$ —	<u>3,012</u>

The valuation allowance for deferred tax assets as of July 1, 2000 and 1999 was \$24.7 million and \$25.5 million, respectively. Total valuation allowance decreased by \$7.5 million and \$760,000 for the years ended June 30, 2001 and 2000, 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 not 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 not realize the benefits of these deductible differences. The amount of the 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.

Internal Revenue Service Audit

In 1995, the IRS began an audit of the Schools and Pauahi Holding Company (PHC), the Schools' former wholly owned taxable subsidiary, for the years ended June 30, 1992 to 1994. It was later expanded to include the years ended June 30, 1995 to 1998 and month ended July 31, 1998. In March 1999, the IRS began an audit of KAA for the years ended June 30, 1997 and 1998. This audit was later expanded to include the year ended June 30, 1999.

In January 1999, the IRS had proposed revocation of the Schools' tax-exempt status. Through settlement negotiation and the execution of a closing agreement in February 2000, which included the permanent removal and/or resignation of the five former Trustees, a settlement payment (including interest) of \$14.0 million, and other conditions that require special filings to be made to the IRS annually through February 2005, the Schools was able to preserve its tax-exempt status.

PHC executed a closing agreement with the IRS in December 2000 to settle tax matters through June 30, 1998. The agreement resulted in a settlement payment (including interest) of \$29.8 million that was accrued in the 1999 consolidated financial statements and paid in the year ended June 30, 2001.

The IRS continues to audit the nontaxable treatment of a reorganization that occurred between KAA and other related entities in July 1998. KAA is currently in discussions with the IRS. As of June 30, 2001, an estimate of the expected results from these discussions has been included in the income tax expense discussed above.

(9) Pension and Other Postretirement Benefits

The Schools have a defined benefit pension plan covering substantially all of its employees. The benefits are based on years of service and the employee's compensation. The Schools make annual contributions to the plan equal to the maximum amount that can be deducted for income tax purposes.

In addition to the Schools' defined benefit pension plan, the Schools sponsor a defined benefit health care plan that provides postretirement medical benefits to full-time employees who meet minimum age and service requirements. The Schools have the right to modify the terms of these benefits. The funded status of the plans as of June 30, 2001 and 2000 are as follows (in thousands):

	2001		2000	
	PENSION	POST RETIREMENT	PENSION	POST RETIREMENT
BENEFIT OBLIGATION	\$ 133,244	12,788	125,897	10,318
FAIR VALUE OF PLAN ASSETS	118,386	—	130,386	—
FUNDED STATUS	\$ (14,858)	(12,788)	4,489	(10,318)
ACCRUED BENEFIT COST RECOGNIZED IN THE CONSOLIDATED BALANCE SHEETS	\$ (32,475)	(18,868)	(29,529)	(18,767)

The amount of contributions, benefits paid and net periodic benefit cost for the years ended June 30, 2001 and 2000 are as follows (in thousands):

	2001		2000	
	PENSION	POST RETIREMENT	PENSION	POST RETIREMENT
BENEFIT COST	\$ 2,946	574	4,717	177
EMPLOYER CONTRIBUTION	—	473	—	464
BENEFITS PAID	3,153	473	3,064	464

The assumptions used in the measurement of the Schools' benefit obligation for the years ended June 30, 2001 and 2000 are as follows (in thousands):

	2001		2000	
	PENSION	POST RETIREMENT	PENSION	POST RETIREMENT
DISCOUNT RATE	7.00%	7.00%	7.00%	7.00%
EXPECTED RETURN ON PLAN ASSETS	8.00%	N/A	8.00%	N/A
RATE OF COMPENSATION INCREASE	5.30%	N/A	5.30%	N/A

For measurement purposes, a 10%, 15% and 9% annual rate of increase in the per capita cost of covered medical, drug and dental benefits, respectively, were assumed for 2001. The rate was assumed to decrease gradually to 4.5% by the year 2009 and remain at that level thereafter.

(10) 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. This liability has been fully funded and investments are included in Marketable debt and equity securities.

(11) Net Gain (Loss) on Property Sales

Net gain (loss) on property sales for the years ended June 30, 2001 and 2000 consisted of the following (in thousands):

	2001	2000
PROPERTY SALES	\$ 120,464	65,664
LESS COST OF PROPERTY SALES	<u>(11,631)</u>	<u>(17,414)</u>
NET PROPERTY SALES	108,833	48,250
IMPAIRMENT LOSS ON PROPERTY AND EQUIPMENT AND REAL ESTATE HELD FOR DEVELOPMENT AND SALE (NOTES 5 AND 6)	<u>(49,937)</u>	<u>(48,831)</u>
	\$ 58,896	(581)

(12) Other Revenues, Net

Other revenues, net for the years ended June 30, 2001 and 2000 consisted of the following (in thousands):

	2001	2000
OIL AND GAS OPERATIONS	\$ 48,059	30,523
LESS COST OF OIL AND GAS OPERATIONS	<u>(25,970)</u>	<u>(20,469)</u>
NET OIL AND GAS OPERATIONS	22,089	10,054
HOTEL OPERATIONS	3,013	3,025
LESS COST OF HOTEL OPERATIONS	<u>(3,666)</u>	<u>(3,839)</u>
NET HOTEL OPERATIONS	(653)	(814)
OTHER (NOTE 15)	<u>15,292</u>	<u>(450)</u>
	\$ 36,728	8,790

(13) Derivative Financial Instruments

BHC uses derivative contracts to reduce the effect of fluctuations in natural gas prices. These instruments are effective in minimizing such risks by creating essentially equal and offsetting market exposure. The derivative financial instruments held by BHC are principally held for purposes other than trading. If BHC did not use derivative investments, its exposure to market risk would be higher.

During fiscal 2001, approximately 26.7% of BHC's equivalent production was subject to hedge positions. As of June 30, 2001, BHC had entered into the following natural gas costless collars:

PERIOD	TOTAL MMBTU	DAILY MMBTU	US \$ EPNG SAN JUAN INDEX PRICE	
			FLOOR	CAP
NOVEMBER 2001 – MARCH 2002	450,000	3,000	\$ 4.00	6.60

PERIOD	TOTAL MMBTU	DAILY MMBTU	US \$ SONAT LOUISIANA INDEX PRICE	
			FLOOR	CAP
NOVEMBER 2001 – MARCH 2002	300,000	2,000	\$ 4.00	7.10

The fair value of BHC's hedging contracts was approximately \$585,000 at June 30, 2001 and was included in Deferred charges and other assets in the Consolidated Balance Sheets.

During 2000, approximately 21% of the Company's equivalent production was subject to hedge positions. At June 30, 2000, the Company had entered into the following commodity price hedging contracts:

PERIOD	VOLUME IN MMBTU PER DAY	SWAP CONTRACT PRICE PER MMBTU	FAIR VALUE*
NOVEMBER 1999 – OCTOBER 2000	5,000	\$ 2.61	(977,212)
MARCH 2000 – FEBRUARY 2001	5,000	2.48	(2,061,990)
APRIL 2000 – MARCH 2001	3,000	2.63	(1,138,551)

*Fair value is calculated using prices derived from NYMEX futures existing at June 30, 2000.

(14) Fair Value of Financial Instruments

The following table presents the carrying amounts and estimated fair values of the Schools' financial instruments at June 30, 2001 and 2000 (in thousands). Note 13 presents the estimated fair values of derivative financial instruments. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties.

	2001		2000	
	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
CASH AND CASH EQUIVALENTS	\$ 170,887	170,887	473,608	473,608
MARKETABLE DEBT AND EQUITY SECURITIES	3,022,067	3,022,067	1,789,711	1,789,711
PRIVATELY PLACED DEBT AND EQUITY INVESTMENTS	487,396	658,989	767,680	1,427,065
RECEIVABLES	75,910	106,857	69,583	106,858
NOTES PAYABLE	141,276	137,131	252,844	217,039
ACCOUNTS PAYABLE AND ACCRUED EXPENSES	54,194	54,194	37,131	37,131

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

Cash and cash equivalents and accounts payable and accrued expenses: The carrying amounts approximate fair value because of the short maturity of these instruments.

Marketable debt and equity securities: The fair value of marketable debt and equity securities are based on quoted market prices, and if applicable, discounted for time restrictions.

Privately placed debt and equity investments: 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. Financial instruments with determinable cash flows were valued on the basis of their future principal and earnings distributions discounted at prevailing interest rates for similar investments. In addition, shares with quoted market prices with restrictions on the sale of shares were valued at market prices and discounted for time restrictions.

Receivables: The fair value of note agreements and mortgage notes are 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 are 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 carrying value of commercial paper approximates the fair value because of the short maturity of these instruments.

(15) Commitments and Contingencies

(a) Rental Income

The majority of land and buildings are generally leased under long-term lease arrangements. At June 30, 2001, future rental income from these leases based on present effective minimum rentals is summarized as follows (in thousands):

YEAR ENDING JUNE 30:	
2002	\$ 81,608
2003	78,408
2004	72,978
2005	64,381
2006	58,536
THEREAFTER	<u>766,769</u>
	\$ 1,122,680

Percentage rental income, based on stipulated percentages of gross lessees' sales, amounted to approximately \$24.1 million and \$17.3 million for the years ended June 30, 2001 and 2000, respectively.

(b) Capital Commitments

At June 30, 2001 and 2000, the Schools were committed under agreements with certain partnerships and corporations to invest an additional \$99 million and \$152 million, respectively.

The Schools have also provided unsecured repurchase or guarantee agreements for certain liabilities related to certain investments aggregating \$1 million and \$93 million at June 30, 2001 and 2000, respectively.

At June 30, 2001, open construction, renovation and major repair contracts amounted to approximately \$53 million.

(c) Litigation

The Schools, in the normal course of conducting its business, is a defendant or party in a number of civil actions involving real estate and investment management and ownership. Management of the Schools is of the opinion that substantially all of these actions are either adequately covered by liability insurance or agreements with lessees or developers of the Schools' real estate and should not have a material adverse effect on the Schools' consolidated financial position.

(d) Environmental Issues

BHC is in the process of decontaminating the soil and groundwater located at a previously owned property in Ohio. The expected costs of decontamination have been accrued in the consolidated financial statements as of June 30, 2001.

BHC (and/or its subsidiaries) is engaged in the oil and gas production business and may become subject to certain liabilities as they relate to environmental cleanup of well sites or other environmental restoration procedures as they relate to oil and gas operations. In BHC's acquisition of existing wells, BHC may not be aware of what environmental safeguards were taken at the time the wells were drilled or during such time the wells were operated. Should it be determined that a liability exists with respect to any environmental cleanup or restoration, the liability to cure such violation could fall upon BHC. At the present time, management is not aware of any such liabilities.

(e) Trustee Matters

In September 1999, the Court approved monthly compensation of \$15,000 to each of the Interim Trustees for their services from the date of their appointment on May 7, 1999. In January 2000, the Court approved a Compensation Committee's recommendation regarding trustee compensation. Effective February 1, 2000, Trustees received an annual retainer of \$30,000 payable in monthly installments and will receive a meeting fee of \$1,500 per meeting, except for the Chairperson who will receive \$2,000 per meeting. The meeting fee is subject to a maximum of 45 meetings during a 12-month period.

In November 2000, the Court appointed five permanent Trustees who will serve varying terms from one to five years. Two of the five permanent Trustees served as Interim Trustees while three are newly appointed. The appointments were effective on January 1, 2001.

For the years ended June 30, 2001 and 2000, total trustee compensation paid amounted to \$522,500 and \$764,500, respectively.

(f) Attorney General

The Attorney General of the State of Hawaii filed a petition in 1998 to remove and surcharge the Former Trustees. Various allegations were asserted and the parties entered into a global settlement with the Attorney General in September 2000. The global settlement was approved by the Court in October 2000 and resulted in the Schools receiving insurance proceeds of approximately \$14 million, which has been included in Other revenues, net in the 2001 Consolidated Statement of Activities.

KAMEHAMEHA SCHOOLS AND SUBSIDIARIES

SCHEDULE 1

SCHEDULES OF TRUST DISTRIBUTIONS AND SPENDING
 YEARS ENDED JUNE 30, 2001 AND 2000
 (IN THOUSANDS)

	2001	2000
TRUST DISTRIBUTIONS	\$ <u>206,106</u>	<u>132,753</u>
TRUST SPENDING, NET		
CAMPUS-BASED PROGRAMS:		
OAHU	72,081	66,955
MAUI	2,407	1,826
HAWAII	3,721	3,193
OUTREACH-BASED PROGRAMS:		
EXTENSION AND SUMMER PROGRAMS	5,435	3,386
EARLY EDUCATION	14,552	12,787
FINANCIAL AID AND SCHOLARSHIPS	22,126	21,450
OTHER PROGRAM EXPENDITURES	<u>4,828</u>	<u>6,283</u>
BASE SPENDING	125,150	115,880
LESS — TUITION, FEES AND OTHER EDUCATION INCOME	(8,383)	(7,863)
LESS — NET INCOME FROM AGRICULTURE AND CONSERVATION LANDS	<u>—</u>	<u>(154)</u>
BASE DISTRIBUTIONS	116,767	107,863
MAJOR REPAIRS	3,862	1,737
CAPITAL PROJECTS	<u>50,077</u>	<u>23,153</u>
TOTAL TRUST SPENDING BEFORE RESERVE ACTIVITY	170,706	132,753
RESERVE ACTIVITY — OPERATING, NET	<u>35,400</u>	<u>—</u>
TOTAL TRUST SPENDING	<u>206,106</u>	<u>132,753</u>
TRUST DISTRIBUTIONS IN EXCESS OF TRUST SPENDING	\$ <u>—</u>	<u>—</u>
AVERAGE MARKET VALUE OF ENDOWMENT	\$ <u>4,996,812</u>	<u>4,812,799</u>
TRUST SPENDING RATE BEFORE RESERVE ACTIVITY	<u>3.4%</u>	<u>2.8%</u>
TRUST SPENDING RATE	<u>4.1%</u>	<u>2.8%</u>

See accompanying independent auditors' report and notes to the schedules of trust distributions and spending.

KAMEHAMEHA SCHOOLS AND SUBSIDIARIES

NOTES TO SCHEDULES OF TRUST DISTRIBUTIONS AND SPENDING YEARS ENDED JUNE 30, 2001 AND 2000

(1) Background and Purpose

In August 1999, the Schools adopted a spending policy that governs annual trust distributions from the Endowment to support its educational purpose. The spending policy targets annual trust distributions at 4% of the average market value of the Endowment plus the net income (loss) generated from the Schools' agriculture and conservation lands. The spending policy also provides for actual trust distributions to vary annually in a range of 2.5% to 6%.

The schedule is prepared on a cash basis and presents the total distributions made from the Endowment to fund educational programs (trust spending) by major program and activity. It also presents the trust spending rates for the fiscal years ended June 30, 2001 and 2000.

(2) Trust Distributions

Trust distributions represent the amount withdrawn from the Endowment during the fiscal year to fund the Schools' educational programs and activities.

(3) 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-based program costs represent direct and indirect costs of providing these programs. Other program expenditures represent the direct and indirect costs related to certain educational services that benefit the various campus-based and outreach-based programs. Indirect costs represent the portion of the finance, administration and legal services cost that are in support of the Schools' educational programs and purpose. Major repairs and capital projects cost relate to activities that are directly related 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.

For purposes of this schedule, trust spending on educational programs includes major repairs and capital projects, an allocation of indirect costs and the funding of reserves. These costs are not included in educational program expenses on the Consolidated Statements of Activities. Indirect costs represent finance, administration and legal costs allocated to educational programs and activities. These costs are allocated between education and the Schools' endowment activities based on various methods depending on the type of cost including headcount, square footage, and proportion in relation to the total and other estimates based on management's best judgment.

The trust spending rates are determined by dividing the total trust spending before reserve activity and the total trust spending by the average market value of the Endowment.

(4) Endowment and Average Market Value of the Endowment

The Endowment consists of all consolidated investment assets of the Schools except agriculture and conservation lands and reserve funds (the Endowment) as defined in the Schools' investment policy.

The average market value of the Endowment is initially based on the average of the five prior fiscal June 30 year-end market values and over time will be based on the average of the prior 20-quarter market values. Accordingly, the trust spending rates for the years ended June 30, 2001 and 2000, are based on the estimated average market values for the fiscal years ended June 30, 1996 through June 30, 2000 and June 30, 1995 through June 30, 1999, respectively. The market values for these fiscal years were based primarily on tax assessed values and internal and external appraisals, to the extent available, for the Hawaii real estate assets and the fair value of the other Endowment assets as reported in the audited financial statements for these fiscal years, net of any associated debt and certain applicable prior period adjustments.

KAMEHAMEHA SCHOOLS AND SUBSIDIARIES

SCHEDULE 2

SCHEDULES OF TOTAL RETURN
AS OF AND FOR THE YEARS ENDED JUNE 30, 2001 AND 2000

FOR THE
TWO YEARS
ENDED
JUNE 30, 2001
ANNUALIZED

ASSET CLASS AND BENCHMARKS	JUNE 30, 2001		JUNE 30, 2000		TOTAL RETURN %
	MARKET VALUE (IN THOUSANDS)	TOTAL RETURN %	MARKET VALUE (IN THOUSANDS)	TOTAL RETURN %	
HAWAII REAL ESTATE	\$ 1,690,295	(1.78)	\$ 1,881,977	9.03	3.48
CPI+5%		8.30		8.90	8.59
U.S. EQUITY	1,363,433	(2.47)	2,010,796	26.38	11.01
RUSSELL 3000		(13.94)		9.59	(2.88)
NON-U.S. EQUITY	467,929	(13.05)	127,346	24.65	4.11
MSCI EAFE/EMERGING MARKETS FREE INDICES		(24.00)		16.01	(6.10)
FIXED INCOME	1,288,761	8.48	871,237	6.02	6.33
LEHMAN BROTHERS AGGREGATE		11.23		4.56	7.84
ALTERNATIVE INVESTMENTS:					
VENTURE & PRIVATE EQUITY	285,394	(0.82)	283,166	23.40	10.59
CPI+10%		13.45		14.07	13.75
ABSOLUTE RETURN	36,256	5.62	33,992	8.25	6.92
CPI+8%		11.39		12.01	11.69
ENERGY	93,985	59.63	52,964	24.76	62.72
CPI+5%		8.30		8.90	8.59
REAL ESTATE (MAINLAND)	526,059	31.75	391,284	6.79	18.60
NCREIF TOTAL PROPERTY INDEX		11.15		14.78	12.95
TOTAL PORTFOLIO	\$ 5,752,112	4.75	\$ 5,652,762	14.69	9.59
POLICY PORTFOLIO/CPI+5%		(0.89)		9.41	4.13
CAMBRIDGE ASSOCIATES LARGE ENDOWMENT FUND MEDIAN		(2.44)		9.74	3.47
CPI+5%		8.30		8.90	8.59

See accompanying independent auditors' report and notes to the schedules of total return.

KAMEHAMEHA SCHOOLS AND SUBSIDIARIES

NOTES TO SCHEDULES OF TOTAL RETURN AS OF AND FOR THE YEARS ENDED JUNE 30, 2001 AND 2000

(1) Background and Purpose

In August 1999, the Schools adopted an investment policy that establishes long- 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 net real return of 5% (Consumer Price Index + 5%).

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

(a) 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 PMC to generate space rents. Improved commercial properties are comprised of shopping centers, office buildings and warehouse facilities.

(b) U.S. Equity

U.S. equity are comprised of marketable equity securities of U.S. companies.

(c) Non-U.S. Equity

Non-U.S. equity are comprised of marketable equity securities of companies outside the U.S. These primarily include stocks of companies overseas in both developed and emerging markets.

(d) Fixed Income

Fixed income are 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 and banker's acceptances.

(e) Venture and Private Equity

Venture and private equity investments can be defined as high risk, high potential return investments in nonmarketable securities such as equity or equity-linked investments in nonpublic companies, or in companies or parts of companies that are being taken private. These companies range from start-up enterprises to middle-market firms to public firms needing private financing for specific projects. The Schools' venture capital portfolio currently consists primarily of pooled fund investments in limited partnerships.

(f) Absolute Return

Absolute return investments consist of the Schools' ownership interest in funds with investment strategies intended to produce relatively stable, positive returns regardless of the performance of the primary stock and bond markets. These may include the five broad strategies of event arbitrage, market neutral or hedged equity, distressed securities, hedge funds, and multi-strategy funds or fund of funds.

(g) Energy

Energy is comprised of coal seam methane gas well operations located primarily in Colorado, New Mexico and Alabama.

(h) 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) Market Values

Market value of an asset is the amount at which the asset could be exchanged in a current transaction between willing parties. The following methods and assumptions were used to estimate the market value of each asset class:

(a) *Hawaii Real Estate*

The market value of residential real property interests (single-family and condominium) is estimated by internal appraisals using the discounted cash flow method for leased properties and sales comparison approach for unleased properties.

Commercial properties are divided into two primary categories: leased and unleased. The market value of leased properties is estimated by discounting future net cash flows at an appropriate discount rate over a ten-year period. The current tax-assessed value is used to approximate the market value of unleased commercial properties. Most of the commercial properties were appraised internally.

The current tax-assessed value is also used to approximate the market value of real estate held for future development and sale.

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

(b) *U.S. Equity*

The market value of marketable equity securities are based on quoted market prices, and if applicable, discounted for time restrictions.

(c) *Non-U.S. Equity*

The market value of marketable equity securities are based on quoted market prices, and if applicable, discounted for time restrictions.

(d) *Fixed Income*

The market value of marketable debt securities are based on quoted market prices.

(e) *Venture and Private Equity*

Different techniques and many factors were considered in deriving the market value of these investments. Several investments have been valued based on the underlying asset value. In addition, shares with quoted market prices with restrictions on the sale of shares were valued at market prices and discounted for time restrictions.

(f) *Absolute Return*

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

(g) *Energy*

The market value of these assets was deemed to approximate the carrying value. The carrying value is the basis of the assets reduced by the liabilities of KUKUI Operating Company.

(h) *Real Estate (Mainland)*

Several pooled investments with determinable cash flows were valued on the basis of their future principal and earnings distributions discounted at prevailing interest rates for similar investments. Others were valued using the net operating income multiplied by a capitalization rate.

Different techniques were considered in deriving the market value of direct investments. Fair value was based on independent appraisals dated at various points in time since 1993, in-house valuations, carrying value of a direct financing lease and carrying value as impairment was recorded during year.

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

(3) Total Return

Total return is calculated using the Modified BAI Method, a time-weighted rate of return.

(4) Benchmark Indices

The following represents the benchmark indices by asset class as approved in the investment policy:

ASSET CLASS	DESCRIPTION
HAWAII REAL ESTATE	CONSUMER PRICE INDEX PLUS 5%
U.S. EQUITY	RUSSELL 3000
NON-U.S. EQUITY	MSCI EAFE INDEX MSCI EMERGING MARKETS FREE INDEX
FIXED INCOME	LEHMAN BROTHERS AGGREGATE
ALTERNATIVE INVESTMENTS:	
VENTURE AND PRIVATE EQUITY	CONSUMER PRICE INDEX PLUS 10%
ABSOLUTE RETURN	CONSUMER PRICE INDEX PLUS 8%
ENERGY	CONSUMER PRICE INDEX PLUS 5%
REAL ESTATE (MAINLAND)	NATIONAL COUNCIL OF REAL ESTATE INVESTMENT FIDUCIARIES (NCREIF) TOTAL PROPERTY INDEX
TOTAL ENDOWMENT	POLICY PORTFOLIO/CONSUMER PRICE INDEX PLUS 5% CAMBRIDGE ASSOCIATES LARGE ENDOWMENT FUND MEDIAN CONSUMER PRICE INDEX PLUS 5%

The MSCI EAFE/Emerging Markets Free Indices and the Policy Portfolio are weighted benchmarks based upon the asset class targets set forth in the Schools approved investment policy. The Policy Portfolio/Consumer Price Index plus 5% benchmark is weighted by the percentage of Hawaii Real Estate fair market values and the aggregate fair market values of all other asset classes combined.

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