An Addendum to

Her vision, our mission

KAMEHAMEHA SCHOOLS
ANNUAL REPORT

KAMEHAMEHA SCHOOLS & SUBSIDIARIES
Consolidated Financial Statements
& Supplemental Schedules

JUNE 30, 2003 & 2002

KAMEHAMEHA SCHOOLS
AND SUBSIDIARIES

Consolidated Financial Statements and Supplemental Schedules

June 30, 2003 and 2002

(With Independent Auditors' Report Thereon)

KAMEHAMEHA SCHOOLS
AND SUBSIDIARIES

Consolidated Financial Statements and Supplemental Schedules

June 30, 2003 and 2002

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Independent Auditors' Report

The Board of Trustees
Kamehameha Schools:

We have audited the accompanying consolidated balance sheets of Kamehameha Schools and subsidiaries as of June 30, 2003 and 2002, and the related consolidated statements of activities and cash flows for the 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 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, 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, 2003 and 2002, and the changes 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 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 has been subjected to the auditing procedures applied in the audits 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.

KPMG LLP

September 17, 2003

KAMEHAMEHA SCHOOLS
AND SUBSIDIARIES

Consolidated Balance Sheets

June 30, 2003 and 2002

(In thousands)

Assets		**2003**	**2002**
Cash and cash equivalents	$	168,068	21,249
Marketable debt and equity securities (notes 2 and 11)		3,406,019	3,042,847
Privately placed debt and equity securities (note 3)		306,790	420,377
Assets held for sale from discontinued activities, net (note 4)		1,288	102,478
Receivables, net (note 5)		22,937	29,554
Property and equipment, net (note 6)		706,315	580,287
Real estate held for development and sale (note 7)		14,846	84,433
Deferred charges and other		38,637	31,115
Total assets	$	4,664,900	4,312,340
Liabilities and Net Assets			
Notes payable (note 8)	$	209,592	161,276
Accounts payable and accrued expenses		85,508	85,928
Income taxes payable (note 9)		28,141	30,610
Accrued pension liability (note 10)		42,641	36,543
Accrued postretirement benefits (note 10)		20,226	19,327
Deferred compensation payable (note 11)		8,952	9,628
Deferred income and other		17,274	20,497
Total liabilities		412,334	363,809
Net assets – unrestricted		4,252,566	3,948,531
Commitments and contingencies (notes 3, 4, 8, 10, 11, and 15)			
Total liabilities and net assets	$	4,664,900	4,312,340

See accompanying notes to consolidated financial statements.

KAMEHAMEHA SCHOOLS
AND SUBSIDIARIES

Consolidated Statements of Activities

Years ended June 30, 2003 and 2002

(In thousands)

		2003	2002
Revenues, gains, and other support:			
Tuition and fees	$	9,918	9,033
Less financial aid		(5,413)	(5,615)
Net tuition and fees		4,505	3,418
Net gain on property sales (notes 7 and 12)		218,222	25,663
Rental (note 15)		140,467	138,559
Investment income (note 3)		77,840	109,845
Net realized and unrealized gains (losses) on investments (note 3)		69,963	(135,915)
Federal grants and contracts		—	1,365
Other, including discontinued activities, net (notes 4, 9, and 13)		33,360	11,048
Total revenues, gains, and other support		544,357	153,983
Expenses:			
Educational programs		135,907	115,079
Management and general:			
Rental		57,566	52,372
Other (notes 8, 9, and 15)		46,849	75,305
Total expenses		240,322	242,756
Change in net assets		304,035	(88,773)
Net assets at beginning of year		3,948,531	4,037,304
Net assets at end of year	$	4,252,566	3,948,531

See accompanying notes to consolidated financial statements.

KAMEHAMEHA SCHOOLS
AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended June 30, 2003 and 2002

(In thousands)

		2003	2002
Cash flows from operating activities:			
Change in net assets	$	304,035	(88,773)
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Net realized and unrealized losses (gains) on investments		(69,963)	135,915
Net gain on property sales		(218,222)	(31,479)
Gain on sale of discontinued activities		(59,876)	—
Impairment loss on property and equipment and real estate held for development and sale		—	5,816
Depreciation, amortization, and depletion		27,963	23,562
Losses (earnings) in investee companies		11,021	(9,530)
Changes in operating assets and liabilities:			
Decrease in assets held for sale from discontinued activities, net		33,427	8,323
Decrease in receivables, net		6,617	33,491
Increase in real estate held for development and sale		(4,272)	(7,374)
Increase in deferred charges and other		(7,522)	(2,519)
Increase in accounts payable, accrued expenses, and other liabilities		2,678	37,519
Decrease in income taxes payable		(2,469)	(66,630)
Other		(512)	1,854
Net cash provided by operating activities		22,905	40,175
Cash flows from investing activities:			
Proceeds from property sales		292,855	55,161
Proceeds from sales of investments		9,431,895	10,322,929
Proceeds from sale of discontinued activities		127,639	—
Purchases of investments		(9,622,026)	(10,402,517)
Purchases of property and equipment		(154,765)	(134,051)
Purchases of investments and property and equipment from discontinued activities		—	(16,532)
Net cash provided by (used in) investing activities		75,598	(175,010)
Cash flows from financing activities:			
Proceeds from borrowings		71,716	20,000
Repayment of borrowings		(23,400)	—
Net cash provided by financing activities		48,316	20,000
Net increase (decrease) in cash and cash equivalents		146,819	(114,835)
Cash and cash equivalents at beginning of year		21,249	136,084
Cash and cash equivalents at end of year	$	168,068	21,249
Supplemental disclosure of cash flow information:			
Income taxes paid	$	13,452	57,599
Interest paid		6,622	26,327
Supplemental disclosure of noncash investing activities:			
Transfer of property and equipment to real estate held for development and sale, net		—	38,272

See accompanying notes to consolidated financial statements.

(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 lands 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 enrichment 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, 2003, served students from kindergarten through grade 9. These two campuses will expand over the next three years to include grades 10 through 12. The Schools are also engaged in summer programs, educational partnerships, and other programs that are outreach related and 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.

(b) Principles of Consolidation

The consolidated financial statements as of June 30, 2003 include the accounts of:

- The Schools;
- Ke Ali'i Pauahi Foundation (KAPF);
- 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; Lake Manassas Limited Liability Company; Treyburn Limited Liability Company; RTJ Limited Liability Company; and Paradise Petroleum, Inc. dba Ali'i Petroleum;
  - In addition to those entities described above, PMC's consolidated financial statements as of June 30, 2002 included the accounts of KUKUI, INC. and its wholly owned subsidiary KUKUI Operating Company. KUKUI, INC. was engaged primarily in the acquisition, development, production, exploration for, and the sale of oil and natural gas. In May 2002, the board of directors of PMC approved a plan to dispose of the assets and liabilities of KUKUI, INC. On February 3, 2003, the stock of KUKUI, INC. was sold by PMC to a third party for approximately $128 million.

– P&C Insurance Company, Inc.; and

– Kamehameha Investment Corporation and its wholly owned subsidiaries – Keauhou Community Services, Inc.; Paki, Inc.; Keauhou Resort Development Corporation 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 fundraising, scholarship, and development activities for 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, and own and operate a hotel and a golf course. In addition, P&C Insurance Company, Inc., a subsidiary, is a captive insurance company that provides property and liability coverage for the Schools and its affiliates.

Subsequent to June 30, 2003, the Schools approved a plan to outsource the property management functions to third-party vendors for certain of its commercial properties. This plan is not expected to have a significant impact on the Schools. Management will continue to look at strategies to improve operational efficiencies and effectiveness.

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 $166.6 million and $19.6 million at June 30, 2003 and 2002, respectively.

(e) Investments

Marketable Debt and Equity Securities – The Schools

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, held-to-maturity, or available-for-sale. 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 included in net assets. Realized gains and losses from the sale of available-for-sale securities are determined on a specific-identification basis.

At June 30, 2003 and 2002, 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) Receivables

Notes receivable consist primarily of receivables from the sale of residential leasehold lots to lessees under the single-family and multifamily 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 5- to 15-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, 2003 and 2002. 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.

(g) 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.

(h) Assets Held for Sale from Discontinued Activities, Net

BHC used 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 were capitalized. Such capitalized costs and estimated future development and dismantlement costs were amortized on a unit-of-production method based on proven 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 the 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 properties, received tax credit payments from the purchaser based on the amount of natural gas produced, and received net profits interest carved out of the working interest equal to the cash flows from the production of the properties until certain events, as defined in the agreement, occur. BHC received all cash flows from the existing wells until December 31, 2002, at which time BHC exercised its option to reacquire these properties for the current fair market value of $6.0 million. BHC received tax credit payments of approximately $4.5 million and $8.0 million for the years ended June 30, 2003 and 2002, respectively, and net profits interest of approximately $4.1 million and $4.2 million for the years ended June 30, 2003 and 2002, respectively. These amounts are included in other revenues, including discontinued activities, net, in the accompanying consolidated statements of activities.

In May 2002, a plan to dispose of the oil and gas properties was approved. Unevaluated properties and associated costs not currently amortized and included in assets held for sale from discontinued activities, net, in the accompanying consolidated balance sheets amounted to approximately nil and $3.1 million at June 30, 2003 and 2002, respectively. The properties represented by these costs were undergoing exploration or development activities, or are properties on which such activities were expected to commence in the future.

Oil and gas properties are located primarily in Colorado, New Mexico, and Alabama. Depletion and depreciation expense amounted to nil and $9.3 million for the years ended June 30, 2003 and 2002, respectively, and are included in other revenues, including discontinued activities, net, in the accompanying consolidated statements of activities. In February 2003, BHC sold a substantial portion of its oil and gas operations, as discussed in note 4.

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(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. In accordance with Statement of Financial Accounting Standards (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.

Profit 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 is 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) of the Internal Revenue Code. The plans cover substantially all the Schools' and BHC's employees after satisfying service requirements. Participating employees may defer up to 20% and 50% (subject to certain limitations) of their pretax earnings for Section 403(b) and Section 401(k) plans, respectively. Effective July 1, 2002, the Schools commenced employer contributions up to a maximum of 3% of pretax 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 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 is also exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code and qualifies as a supporting organization as described in Section 509(a)(3) of the Internal Revenue Code. 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 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

The preparation of the consolidated financial statements requires management of the Schools to make a number of estimates and assumptions relating to the reported amount of assets and liabilities and the 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. Significant items subject to such estimates and assumptions include the carrying amounts of property, equipment, and real estate held for development and sale; valuation allowances for receivables, investments, and deferred income tax assets; valuation of derivative instruments; and assets and obligations related to employee benefits. Actual results could differ from those estimates.

(Continued)

(o) Impairment of Long-Lived Assets

SFAS No. 144 provides a single accounting model for long-lived assets to be disposed of. SFAS No. 144 also changes the criteria for classifying an asset as held for sale; and broadens the scope of businesses to be disposed of that qualify for reporting as discontinued operations and changes the timing of recognizing losses on such operations. The Schools adopted SFAS No. 144 on July 1, 2002. The adoption of SFAS No. 144 did not affect the Schools' consolidated financial statements.

In accordance with SFAS No. 144, long-lived assets, such as property and equipment, are 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 estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the consolidated balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the consolidated balance sheet.

Prior to the adoption of SFAS No. 144, the Schools accounted for long-lived assets in accordance with SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*.

(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 2002 to conform to classifications adopted in 2003. Such reclassifications had no effect on previously reported changes in net assets.

(2) Marketable Debt and Equity Securities

Marketable debt and equity securities at June 30, 2003 and 2002 consisted of the following (in thousands):

		Fair value	
		2003	2002
Common and preferred stocks	$	1,356,522	1,072,316
Corporate debt securities		390,845	666,537
Government assets and mortgaged backed securities		557,218	353,732
Short-term investments		203,456	182,287
Mutual and commingled funds		897,978	767,975
	$	3,406,019	3,042,847

Common and preferred stocks, corporate debt securities, and short-term investments are with corporations and mutual funds involved in various industries located throughout the United States and internationally.

As of June 30, 2003 and 2002, there were no individual investments representing more than 10% of total marketable securities. As of June 30, 2001, the Schools owned approximately 5.5 million shares in a major New York investment banking firm, which represented more than 10% of total marketable securities. The 5.5 million shares were sold in January 2002.

(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, 2003 and 2002 (in thousands):

		2003		2002	
		Carrying amount	Fair value	Carrying amount	Fair value
Equity investments	$	262,268	339,219	378,524	546,473
Direct financing lease		36,256	36,256	35,744	35,744
Loans and subordinated debentures		8,266	8,299	6,109	6,109
	$	306,790	383,774	420,377	588,326

(a) Equity Investments

Equity investments (accounted for on both the equity and cost methods) 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 apartments, retail shopping centers, 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, 2003 and 2002 is as follows (in thousands):

		2003	2002
Assets	$	1,300,121	3,148,018
Liabilities		416,194	1,396,948
Equity	$	883,927	1,751,070
Revenues	$	45,819	1,351,367
Expenses		172,725	1,402,418
Net loss	$	(126,906)	(51,051)

The Schools' equity in earnings (losses) of investments amounted to $(11.0) million and $9.5 million for the years ended June 30, 2003 and 2002, respectively. These amounts are included in investment income in the accompanying consolidated statements of activities.

(b) 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, 2003, the total minimum lease payments to be received and unearned finance charges were $77.8 million and $41.5 million, respectively. At June 30, 2002, the total minimum lease payments to be received and unearned finance charges were $78.9 million and $43.1 million, respectively. Future minimum annual lease payments amount to $1.1 million from 2004 to 2006, $1.6 million in 2007 and 2008, and $71.3 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. There was no percentage rent for the years ended June 30, 2003 and 2002. The lessee has the option to purchase the golf club facilities either at the conclusion of the lease term or anytime during the lease term based on amounts specified in the lease agreement.

(c) Loans and Subordinated Debentures

Loans provide for principal and interest payments over various dates through October 2004 with interest at 8.0% to 25.0% per annum. Subordinated debentures provide for interest rates of 6.5% per annum and mature over periods up to five years.

(d) Net Realized and Unrealized Gains (Losses) on Investments

Net realized and unrealized gains (losses) on investments for the years ended June 30, 2003 and 2002, by investment type, is as follows (in thousands):

		2003	2002
Marketable securities, other	$	88,407	(228,938)
Equity investments		(18,444)	(638)
Investment banking firm		—	101,662
Other		—	(8,001)
	$	69,963	(135,915)

(e) Investment Income

Investment income for the years ended June 30, 2003 and 2002, by investment type, is as follows (in thousands):

		2003	2002
Marketable securities, other	$	80,017	87,523
Equity investments		(9,419)	12,854
Loans and subordinated debentures		4,760	4,812
Investment banking firm		—	1,309
Other		2,482	3,347
	$	77,840	109,845

(4) Assets Held for Sale from Discontinued Activities, Net

In May 2002, BHC approved a plan to sell its oil and gas activities within an estimated 9- to 12-month period. In February 2003, KUKUI, INC., which comprised a significant portion of its oil and gas activities, was sold for $127.6 million, resulting in a gain of $59.9 million. Paradise Petroleum, a subsidiary of KUKUI, INC., was not included in the sale and became a wholly owned subsidiary of BHC. BHC continues its efforts to sell the assets of Paradise Petroleum. Accordingly, the results of the oil and gas activities, including the gain on sale of KUKUI, INC., net of related income taxes, are included as other revenues, including discontinued activities, net, in the accompanying consolidated statements of activities. For all periods presented, assets net of liabilities and cash flows related to the discontinued activities have been reported separately in the accompanying consolidated balance sheets and consolidated statements of cash flows. See note 13.

The assets and liabilities of the discontinued activities at June 30, 2003 and 2002 consisted of the following (in thousands):

		2003	2002
Cash and cash equivalents	$	617	36,143
Marketable debt and equity securities		—	3,978
Receivables and other, net		6	9,098
Property and equipment		666	56,310
Other assets		3	1,594
Total assets		1,292	107,123
Accounts payable and accrued expenses		(4)	(4,527)
Other liabilities		—	(118)
Total liabilities		(4)	(4,645)
Assets held for sale from discontinued activities, net	$	1,288	102,478

(5) Receivables, Net

Receivables at June 30, 2003 and 2002 consisted of the following (in thousands):

		2003	2002
Note agreements	$	47,297	67,367
Less deferred profit on note agreements		(41,165)	(57,885)
		6,132	9,482
Tenant and tuition		12,784	20,732
Interest		8,657	11,660
Trade		6,807	3,634
Other		805	221
		35,185	45,729
Less allowance for doubtful accounts		(12,248)	(16,175)
	$	22,937	29,554

(6) Property and Equipment, Net

Property and equipment at June 30, 2003 and 2002 consisted of the following (in thousands):

		2003	2002
Educational property and equipment:			
Land	$	16,067	16,067
Buildings, improvements, and equipment		409,795	270,401
Less accumulated depreciation		(89,811)	(83,855)
		336,051	202,613
All other property and equipment:			
Land and land improvements		85,658	82,042
Buildings, improvements, and equipment		317,979	310,569
Less accumulated depreciation, amortization, and depletion		(163,145)	(152,937)
		240,492	239,674
Construction in progress		129,772	138,000
	$	706,315	580,287

The provision for depreciation, amortization, and depletion amounted to approximately $28.0 million and $23.6 million for the years ended June 30, 2003 and 2002, respectively.

During the year ended June 30, 2002, the book values of certain properties, buildings, and improvements were impaired. The properties were adjusted to fair value, which resulted in impairment losses of approximately $4.8 million. No impairment losses were recorded in the year ended June 30, 2003.

(7) 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, 2002, 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 loss for the year ended June 30, 2002 was $1.0 million. No impairment loss was recorded in the year ended June 30, 2003.

During 2002, the Schools approved plans to sell certain real estate assets. These assets, with a carrying amount of $60.5 million, were transferred from property and equipment to real estate held for development and sale in the accompanying consolidated balance sheets. As of June 30, 2002, the fair value less costs to sell exceeded the carrying amount of these assets. During 2003, the Schools completed the sale of these assets and recorded a gain on sale of approximately $103.8 million for the year ended June 30, 2003, which is included in the accompanying consolidated statements of activities.

(8) Notes Payable

At June 30, 2003 and 2002, notes payable consisted of the following (columns in thousands):

	2003	2002
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 minimum endowment value and a certain liquidity ratio.	$ 118,575	118,575
Senior promissory notes payable under a $150.0 million private shelf facility. The note agreement contains certain restrictions and requires maintenance of a minimum endowment value and a certain liquidity ratio:		
Interest rate of 6.80% per annum with annual principal payments of $952,000 beginning March 1, 2007, with final payment on March 1, 2027.	20,000	20,000
Interest rate of 4.88% per annum with annual principal payments of $3,333,000 beginning June 10, 2008, with the final payment on June 10, 2028.	70,000	—
Note payable to a bank under a $6.0 million construction loan agreement which matures on February 1, 2005. Interest fluctuates based on the bank's prime rate of interest plus 1% (5.00% at June 30, 2003). The note is secured by all property, as defined, of a certain real estate development project.	1,017	—
Note payable to banks under a $37.0 million revolving credit agreement which was paid off on September 20, 2002. Interest rate was 2.31% on June 30, 2002. Interest options included the bank's prime rate, a certificate of deposit rate plus 37.5 basis points, or floating LIBOR plus 25 basis points.	—	22,701
	$ 209,592	161,276

In 2003, BHC entered into a revolving credit agreement with a commercial bank that permits BHC to borrow up to $3.0 million, bearing interest at the bank's prime rate (4% at June 30, 2003). The line of credit matures on April 1, 2004 and is secured by all contracts and personal property, as defined, of certain real estate. There are no borrowings outstanding on the line of credit at June 30, 2003.

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

Year ending June 30:		
2004	$	11,860
2005		12,877
2006		11,860
2007		12,812
2008		16,146
Thereafter		144,037
	$	209,592

Interest expense, net of amounts capitalized of approximately $3.4 million and $0.5 million for the years ended June 30, 2003 and 2002, respectively, is as follows (in thousands):

		2003	**2002**
The Schools	$	6,418	8,323
BHC		132	1,165
	$	6,550	9,488

(9) Income Taxes

Total income tax expense amounted to $9.7 million and $5.9 million for the years ended June 30, 2003 and 2002, respectively. Of the total income tax expense of $9.7 million for the year ended June 30, 2003, an income tax benefit of $(24) million was from continuing activities and $33.7 million was from discontinued activities. The income tax (benefit) expense of $(24) million and $5.9 million for the years ended June 30, 2003 and 2002, respectively, are included in other management and general expenses in the accompanying consolidated statements of activities. The income tax expense of $33.7 million from discontinued activities for the year ended June 30, 2003 is included in other revenues, including discontinued activities, net, in the accompanying 2003 consolidated statements of activities.

(Continued)

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, 2003 and 2002 are presented below (in thousands):

		2003	2002
Deferred tax assets:			
Difference in basis of investments and real estate	$	6,465	12,063
State tax provisions		1,972	1,962
Deferred income		1,303	1,276
Net operating loss carryforwards		—	15,999
Other		5,977	5,523
Valuation allowance		(14,177)	(27,178)
		1,540	9,645
Deferred tax liabilities:			
Depreciation		(1,441)	(1,376)
Investment basis difference and other		(99)	(8,269)
		(1,540)	(9,645)
Net deferred taxes	$	—	—

The valuation allowance for deferred tax assets as of July 1, 2002 and 2001 was $27.2 million and $17.3 million, respectively. The total valuation allowance decreased by $13.0 million and increased by $9.9 million for the years ended June 30, 2003 and 2002, 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.

IRS 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. In March 1999, the IRS began an audit of Kamehameha Activities Association (KAA) for the years ended June 30, 1997 and 1998. KAA, formerly a subsidiary of the Schools, merged with KAPF effective June 28, 2002, with KAPF as the surviving entity. 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 removal 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 were 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 1999 and paid in the year ended June 30, 2001.

In fiscal year 2002, the Schools and its related entities signed closing agreements with the IRS that resolved all outstanding tax issues relating to the taxable year ended July 31, 1998 for PHC, the taxable years ended through June 30, 1999 for KAA, and the taxable years ended through June 30, 2000 for the Schools. Under the agreements, KAA paid the IRS approximately $17 million (plus interest) and the for-profit subsidiaries paid $55.6 million in taxes (plus interest), which were accrued in the consolidated financial statements for the year ended June 30, 2001. The closing agreements also resulted in the transfer of the majority of KAA's assets to the Schools and the subsequent merger of KAA into KAPF, with KAPF as the surviving entity.

(10) 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, 2003 and 2002 is as follows (in thousands):

		2003		2002	
		Pension	Post retirement	Pension	Post retirement
Benefit obligations	$	186,974	21,545	145,448	15,014
Fair value of plan assets		105,293	—	106,315	—
Funded status	$	(81,681)	(21,545)	(39,133)	(15,014)
Accrued benefit cost recognized in the consolidated balance sheets	$	42,641	20,226	36,543	19,327

The amounts of net periodic benefit cost, contributions, and benefits paid for the years ended June 30, 2003 and 2002 are as follows (in thousands):

		2003		2002	
		Pension	Post retirement	Pension	Post retirement
Benefit cost	$	6,098	1,500	4,145	972
Employer contribution		—	601	—	513
Benefits paid		4,536	601	3,650	513

The assumptions used in the measurement of the Schools' benefit obligation for the years ended June 30, 2003 and 2002 are as follows:

	2003		2002	
	Pension	Post retirement	Pension	Post retirement
Discount rate	6.00%	6.00%	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% and 15% annual rate of increase in the per capita cost of covered medical and drug benefits, respectively, was assumed for 2003. The rate was assumed to decrease gradually to 4.5% by the year 2011 and remain at that level thereafter.

Effective July 1, 2002, the Schools also sponsor a 401(k) retirement savings plan covering substantially all eligible employees. The Schools make 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 year ended June 30, 2003 amounted to approximately $1.6 million.

(11) 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 marketable debt and equity securities in the consolidated balance sheets.

(12) Net Gain on Property Sales

Net gain on property sales for the years ended June 30, 2003 and 2002 consisted of the following (in thousands):

		2003	2002
Property sales	$	292,855	55,161
Less cost of property sales		(74,633)	(23,682)
Net property sales		218,222	31,479
Impairment loss on property and equipment and real estate held for development and sale (notes 6 and 7)		—	(5,816)
	$	218,222	25,663

(13) Other Revenues, Including Discontinued Activities, Net

Other revenues, including discontinued activities, net, for the years ended June 30, 2003 and 2002 consisted of the following (in thousands):

		2003	2002
Continuing activities:			
Hotel operations	$	2,158	2,501
Less cost of hotel operations		(2,903)	(3,150)
Net hotel operations		(745)	(649)
Golf course operations		3,059	2,340
Less cost of golf course operations		(3,793)	(3,356)
Net golf course operations		(734)	(1,016)
Other		2,066	4,276
Other income, net from continuing activities		587	2,611
Discontinued activities (note 4):			
Oil and gas operations		21,218	29,316
Less cost of oil and gas operations		(14,663)	(20,879)
Net oil and gas operations		6,555	8,437
Gain on sale of discontinued activities		59,876	—
Income tax expense from discontinued activities		(33,658)	—
Other income from discontinued activities		32,773	8,437
Other revenues, net	$	33,360	11,048

(Continued)

(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, 2003 and 2002 (in thousands). The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties.

	2003		2002	
	Carrying amount	**Fair value**	**Carrying amount**	**Fair value**
Cash and cash equivalents	$ 168,068	168,068	21,249	21,249
Marketable debt and equity securities	3,406,019	3,406,019	3,042,847	3,042,847
Privately placed debt and equity securities	306,790	383,774	420,377	588,326
Receivables, net	22,937	44,021	29,554	55,465
Notes payable	209,592	229,508	161,276	160,693
Accounts payable and accrued expenses	85,508	85,508	85,928	85,928
Income taxes payable	28,141	28,141	30,610	30,610

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

Cash and cash equivalents, accounts payable and accrued expenses, and income taxes payable: 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 securities: 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, net: 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.

 (Continued)

(15) Commitments and Contingencies

(a) Rental Income

The majority of land and buildings are generally leased under long-term lease arrangements. At June 30, 2003, future rental income from these leases based on present effective minimum rentals is summarized as follows (in thousands):

Year ending June 30:		
2004	$	83,200
2005		73,666
2006		66,720
2007		59,275
2008		51,630
Thereafter		651,664
	$	986,155

Percentage rental income, based on stipulated percentages of gross lessees' sales, amounted to approximately \$12.5 million and \$11.4 million for the years ended June 30, 2003 and 2002, respectively.

(b) Capital Commitments

At June 30, 2003 and 2002, the Schools were committed under agreements with certain partnerships and corporations to invest an additional \$60 million and \$76 million, respectively.

At June 30, 2003 and 2002, open construction, renovation, and major repair contracts amounted to approximately \$49 million and \$71 million, respectively.

During September 2003, the Schools entered into contracts for construction on the Maui and Hawaii campuses of approximately \$29 million and \$18 million, respectively.

(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.

(Continued)

(d) 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 monthly 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, 2003 and 2002, total Trustee compensation amounted to $479,500 and $525,000, respectively.

Schedule 1

KAMEHAMEHA SCHOOLS
AND SUBSIDIARIES

Schedules of Trust Spending

Years ended June 30, 2003, 2002, 2001, and 2000

(In thousands)

	2003	2002	2001	2000
Trust spending, net:				
Campus-based programs:				
Kapalama	$ 71,663	70,661	72,081	66,955
Maui	12,845	5,266	3,721	3,193
Hawaii	12,697	5,300	2,407	1,826
Outreach-based programs:				
Extension education and summer programs	5,218	4,795	5,435	3,386
Early childhood education	17,516	17,060	14,552	12,787
Virtual campus	503	—	—	—
Financial aid/scholarships	16,412	16,726	16,852	16,634
Ke Ali'i Pauahi Foundation	1,984	3,322	—	—
Other program expenditures	7,457	2,681	4,828	6,283
Base spending (before Pauahi's Legacy Lives) (Expansion))	146,295	125,811	119,876	111,064
Pauahi's Legacy Lives (Expansion) (net) (includes $280K of funding for Ho'okako'o, a not-for-profit organization.)	7,391	—	—	—
Base spending	153,686	125,811	119,876	111,064
Less: Tuition, fees, and other education income (net)	(4,518)	(4,128)	(3,109)	(3,047)
Less: Net income from agriculture and conservation lands	—	—	—	(154)
Base distributions	149,168	121,683	116,767	107,863
Major repairs	5,837	3,907	3,862	1,737
Capital projects	127,101	116,256	50,077	23,153
Interest on debt	1,360	—	—	—
Debt financing of capital projects	(70,000)	(20,000)	—	—
Total trust spending before reserve activity	213,466	221,846	170,706	132,753
Reserve activity – operating, net	6,000	1,000	35,400	—
Total trust spending	$ 219,466	222,846	206,106	132,753
Average market value of Endowment	$ 5,392,443	5,210,717	4,996,812	4,812,799
Trust spending rate before reserve activity	4.0%	4.3%	3.4%	2.8%
Trust spending rate	4.1%	4.3%	4.1%	2.8%

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

KAMEHAMEHA SCHOOLS
AND SUBSIDIARIES

Notes to Schedules of Trust Spending

Years ended June 30, 2003, 2002, 2001, and 2000

(1) Background and Purpose

In August 1999, the Schools adopted a spending policy that governs annual trust spending from the Endowment to support its educational purpose. The spending policy targets annual trust spending at 4% of the average market 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 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, 2003, 2002, 2001, and 2000.

(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-based program costs represent direct and indirect costs of providing these programs. Ke Ali'i Pauahi Foundation expenditures represent the direct and indirect costs of providing scholarships and other education related programs through January 2003 at which time these functions returned to the Schools. 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, which represents the portion of the finance, operations, and legal services cost that are in support of 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. Pauahi's Legacy Lives expenditures represent direct and indirect costs of the Schools' expansion programs. Major repairs, capital projects, and interest on debt, net of related debt financing, 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.

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. 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.

(3) 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 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, 2003, 2002, 2001, and 2000 are based on the estimated average market values over the last five fiscal years utilizing the respective year-end and/or quarter-end values. 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 consolidated financial statements for these fiscal years, net of any associated debt and certain applicable prior period adjustments.

Schedule 2

KAMEHAMEHA SCHOOLS
AND SUBSIDIARIES

Schedules of Total Return

As of and for the years ended June 30, 2003, 2002, 2001, and 2000

Asset Class and Benchmarks	June 30, 2003 Market value (in thousands)	June 30, 2003 Total return %	June 30, 2002 Market value (in thousands)	June 30, 2002 Total return %	June 30, 2001 Market value (in thousands)	June 30, 2001 Total return %	June 30, 2000 Market value (in thousands)	June 30, 2000 Total return %	For the four years ended June 30, 2003 Annualized Total return %
Hawaii Real Estate:	$ 1,625,893	10.2	$ 1,550,268	(2.1)	$ 1,690,295	(1.8)	$ 1,881,977	9.0	3.5
CPI+5%		7.2		6.2		8.3		8.9	7.7
U.S. Equity:	1,598,226	(1.1)	1,213,532	(10.0)	1,363,433	(2.5)	2,010,796	26.4	2.3
Russell 3000		0.8		(17.3)		(13.9)		9.6	(5.8)
Non-U.S. Equity:	574,934	(4.9)	500,620	(2.5)	467,929	(13.1)	127,346	24.7	0.1
MSCI EAFE / Emerging Markets Free Indices		(5.1)		(8.3)		(24.0)		16.0	(6.4)
Fixed Income:	1,371,674	11.6	1,281,282	7.6	1,288,761	8.5	871,237	6.0	8.0
Lehman Brothers Aggregate/ Three-Month U.S. Treasury Bill		9.8		8.2		—		—	8.4
Lehman Brothers Aggregate		—		—		11.2		4.6	8.7
Alternative Investments:									
Venture & Private Equity:	146,789	(29.0)	204,985	(19.6)	285,394	(0.8)	283,166	23.4	(8.6)
CPI+10%		12.3		11.3		13.5		14.1	12.8
Absolute Return:	13,925	12.8	32,148	6.7	36,256	5.6	33,992	8.3	8.3
CPI+8%		10.3		9.3		11.4		12.0	10.7
Energy:	1,288	43.6	94,639	0.7	93,985	59.6	52,964	24.8	39.9
CPI+5%		7.2		6.2		8.3		8.9	7.7
Real Estate (Mainland):	205,581	(2.2)	550,927	16.6	526,059	31.8	391,284	6.8	12.6
NCREIF Total Property Index		7.7		5.6		11.2		14.8	9.1
Total Portfolio	$ 5,538,310	5.7	$ 5,428,401	(0.7)	$ 5,752,112	4.8	$ 5,652,762	14.7	5.9
Blended Portfolio		5.4		(1.4)		(0.9)		9.4	3.0
Cambridge Associates Large Endowment Fund Median		4.0		(4.3)		(2.4)		9.7	5.3
CPI+5%		7.2		6.2		8.3		8.9	7.7

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

(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 and other third-party managers to generate space rents. Improved commercial properties are comprised of shopping centers, office buildings, and warehouse facilities.

(b) U.S. Equity

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

(c) Non-U.S. Equity

Non-U.S. equity is 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 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, and bankers' 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

As of June 30, 2003, energy is comprised of a few gas stations located in Texas. Prior to June 30, 2003, energy was comprised of coal seam methane gas well operations located primarily in Colorado, New Mexico, and Alabama, as well as a few gas stations in Texas.

(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 multifamily) is estimated by internal appraisals using a discounted cash flow method for leased properties and sales comparison approach for unleased properties. 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 time that the appraisals were performed.

Commercial properties are divided into two primary categories – leased and unleased. As of June 30, 2003, commercial properties were externally appraised. The market value of leased properties was typically estimated by the external appraisers using a discounted cash flow methodology, while the value of unleased properties was typically estimated using a sales comparison approach. Prior to June 30, 2003, for the properties that were internally appraised, the market value of leased properties was estimated by discounting future net cash flows at an appropriate discount rate over a ten-year period and the current tax-assessed values was used to approximate the market value of unleased commercial properties.

The current tax-assessed value is generally 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 market value of any associated debt.

(b) U.S. Equity

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

(c) Non-U.S. Equity

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

(d) Fixed Income

The market value of marketable debt securities is 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.

(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, carrying value of a direct financing lease, and carrying value of operating assets reduced by liabilities.

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.

(Continued)

(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/Emerging Markets Free Indices
Fixed income	Lehman Brothers Aggregate/Three-Month Treasury Bill 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	Blended Portfolio Cambridge Associates Large Endowment Fund Median Consumer Price Index plus 5%

The MSCI EAFE/Emerging Markets Free Indices is a weighted benchmark based upon the asset class targets set forth in the Schools' approved investment policy. The Lehman Brothers Aggregate/ Three-Month Treasury Bill is weighted by the percentage of fixed income and cash management fund year-end fair market value, if applicable. The Blended Portfolio benchmark is weighted by the percentage of Hawaii Real Estate year-end fair market values and the aggregate year-end fair market values of all other asset classes combined.