

ARTHUR ANDERSEN

Direct Dial 502-587-3337

August 16, 1999

Ret. Admiral Robert K.U. Kihune, USN
Mr. David Paul Coon
Mr. Francis Keala
Ms. Constance Lau
Mr. Ronald Libkuman
Trustees
Kamehameha Schools Bernice Pauahi Bishop Estate
Kawaihoo Plaza
Honolulu, Hawaii 96801

Arthur Andersen LLP

Louisville Galleria
2300 Meidinger Tower
Louisville KY 40202-3460
502 589 4160

Dear Trustee Kihune, Trustee Coon, Trustee Keala, Trustee Lau and Trustee Libkuman :

At the direction of Miller & Chevalier Chartered, we have calculated the estimated financial impact of the potential loss of recognition of Internal Revenue Code Section 501(c)(3) tax-exempt status for Kamehameha Schools Bernice Pauahi Bishop Estate (KSBE) for the period ended June 30, 1990 through June 30, 1999. As directed, for purposes of calculating the estimate, we have assumed that the tax-exempt status would be revoked based solely on the positions set forth by the Internal Revenue Service (IRS) in the draft Forms 5701, *Notice of Proposed Adjustment(s)* provided to KSBE on January 4, 1999.

The calculations provide an estimate of the following potential financial costs (including applicable interest): federal income, employment and excise taxes, state income, property and general excise and use taxes. Other possible implications such as loss of preferred postal rates, certain purchasing discounts, etc. have not been considered as discussed with Miller & Chevalier due to a lack of information. In addition, we have made no determinations regarding any possible ramifications to the tax-exempt or public charity status for Kamehameha Activities Association (K.A.A.).

For purposes of preparing the calculations, Arthur Andersen has reviewed the IRS draft Forms 5701, *Notice of Proposed Adjustment(s)* as they relate to the tax-exempt status. We also participated in discussions with the IRS regarding the IRS's positions. We utilized information included in the Form 990, Return of Organization Exempt from Income Tax, as filed with the IRS for each year, financial statement information as filed with the

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Probate Court, and information provided directly by KSBE personnel. Further, we have discussed the issues and our approach to the calculations with selected internal KSBE personnel and the organization's external litigation counsel. Based on our research regarding the possible loss of tax-exempt status, the circumstances surrounding this case, and the information obtained from the activities discussed above, we estimate that loss of tax-exempt status could result in a financial cost to KSBE in excess of \$750,000,000 calculated as described above.

If you have any further questions regarding this matter, please contact me.

Very truly yours,

ARTHUR ANDERSEN LLP

By 
Diane Cornwell

SMH