OVERVIEW

Financial Audit of the Hawaii Public Employees Health Fund

Report No. 99-18, April 1999

Summary

The Office of the Auditor and the certified public accounting firm of Deloitte & Touche, LLP conducted a financial audit of the Hawaii Public Employees Health Fund (Health Fund) for the fiscal year July 1, 1997 to June 30, 1998.

Because the Health Fund did not account for its financial activities in an enterprise fund as required by generally accepted accounting principles and because gain contingencies have been recorded in the financial statements, in the opinion of Deloitte & Touche LLP, based on their audit, the financial statements do not present fairly the financial position of the Health Fund at June 30, 1998, and the results of its operations for the year ended in conformity with generally accepted accounting principles. In addition, the Health Fund's management declined to provide us with a written representation letter required by generally accepted auditing standards. This raises serious questions about its responsibility for and accuracy of financial information provided about the Health Fund.

We found several deficiencies in the financial accounting and internal control practices of the Health Fund. One deficiency was serious enough that the auditors expressed an adverse opinion on the Health Fund's financial statements. An adverse opinion is the worst possible opinion issued by CPA firms.

The Health Fund's failure to follow proper accounting and financial reporting standards resulted in approximately $294 million of revenues and $203 million of expenses not recorded and reported by the fund. In addition, the Health Fund incorrectly recorded $17.4 million in underwriting gains, as well as $2.1 million of related interest income, as assets as of June 30, 1998.

We also found that a lack of clarity between the Health Fund and its insurance carriers as to the definition and measurement of rate stabilization reserves has resulted in substantial excess reserves. Total reserves held by insurance carriers amounted to approximately $86 million as of June 30, 1998.

We also found that interest income earned on the reserves held by the insurance carriers is not being monitored. With one exception, the Health Fund has no agreements with the insurance carriers that specify the interest rates to be used on the reserves held by the carriers or any reporting requirements. Interest income of only $2.5 million or about 2.9 percent was reported by the Health Fund as of June 30, 1998 on the over $86 million held by the carriers.

We also found that the majority of agreements with the insurance carriers to provide health care benefits in fiscal year 1998 were unsigned, thus placing the fund and the State at risk.

Finally, the Health Fund has been unable to implement a long-term care insurance benefit plan, nor has it been able to return excess premiums in the millions of dollars to employees as required by state law.

Recommendations and Response

We recommend that the Health Fund comply with state law and account for and report its financial activities as required by generally accepted accounting principles. We also recommend that management clarify the definition of a rate stabilization reserve, enforce the provisions of the contracts with the insurance carriers on the return of excess reserves to the State, and negotiate adequate interest rate earnings on reserves held by insurance carriers. In addition, management should negotiate the minimum interest rates to be earned by the carriers, and require the carriers to provide a quarterly report on the interest earned and reserve amounts held.

In addition, we recommend that the Health Fund ensure that contracts with insurance carriers are timely and properly executed. The Health Fund management should work more closely with the Legislature and the Departments of Budget and Finance and the Attorney General in resolving the issues relating to (a) the adoption of a long-term care insurance benefit plan and (b) the disposition of excess reserves created by employee contributions.

The Department of Budget and Finance responded by providing rationale for the delay in implementing a long-term care insurance benefit plan. In addition, it provided information on a current legislative request that proposes to implement this insurance benefit plan.

The Health Fund indicates that the board of trustees is unable to fully respond to all of the findings because of the short time frame but will continue to evaluate the findings and respond at some future public hearing.

The Health Fund believes that although the accounting standards "may be technically correct," its financial transactions present a better picture of its operations under the current fund reporting. We disagree, the current financial reporting of the Health Fund does not comply with the generally accepted accounting principles. The principles enable everyone to compare the performance of such entities as health funds and be able to rely on financial statements.

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