



Financial Statements and Report of Independent
Certified Public Accountants

**Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii**

June 30, 2008 and 2007

Submitted by
The Auditor
State of Hawaii

December 18_, 2008

Ms. Marion Higa
Office of the Auditor
State of Hawaii

Dear Ms. Higa:

This is our report on the financial audits of the Hawaii Employer-Union Health Benefits Trust Fund of the State of Hawaii (Trust Fund) for the years ended June 30, 2008 and 2007. Our audits were performed in accordance with the terms of our contract with the State of Hawaii.

OBJECTIVES OF THE AUDIT

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the Trust Fund's basic financial statements for the years ended June 30, 2008 and 2007. More specifically, the objectives of the audit were as follows:

1. To provide a basis for an opinion on the fairness of the presentation of the basic financial statements of the Trust Fund.
2. To determine whether expenditures and other disbursements have been made and all revenues and other receipts to which the Trust Fund is entitled have been collected and accounted for in accordance with the laws, rules and regulations, and policies and procedures of the State of Hawaii.
3. To determine whether the Trust Fund has complied with the laws and regulations that may have a material effect on the basic financial statements.

SCOPE OF THE AUDIT

Our audit was performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants and *Government Auditing Standards*, issued by the Comptroller General of the United States. The scope of our audit included an examination of the transactions and accounting records of the Trust Fund for the years ended June 30, 2008 and 2007.

Ms. Marion Higa
Office of the Auditor
State of Hawaii

December 18, 2008

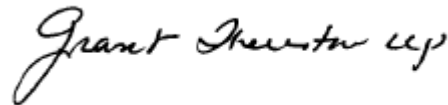
ORGANIZATION OF THE REPORT

This report is presented in two parts as follows:

- Part I – The financial statements and related notes of the Trust Fund for the year ended June 30, 2008 and 2007 including our opinion on the basic financial statements.
- Part II – Our report on internal control over financial reporting and on compliance and other matters.

We wish to express our sincere appreciation for the excellent cooperation and assistance extended by the officers and staff of the Trust Fund.

Very truly yours,



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PART I
FINANCIAL SECTION



Report of Independent Certified Public Accountants

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To the Auditor
State of Hawaii

We have audited the accompanying statements of net assets – enterprise fund of the Hawaii Employer-Union Health Benefits Trust Fund of the State of Hawaii (Trust Fund) and statements of plan net assets as of June 30, 2008 and 2007, and the related statements of revenues, expenses and changes in net assets – enterprise fund, cash flows – enterprise fund and statements of changes in plan net assets for the year then ended. These financial statements are the responsibility of the management of the Trust Fund. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Trust Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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.

As discussed in note A, the financial statements of the Trust Fund are intended to present the financial position, and the changes in financial position and cash flows, of only that portion of the business-type activities of the State of Hawaii that is attributable to the transactions of the Trust Fund. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2008 and 2007, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

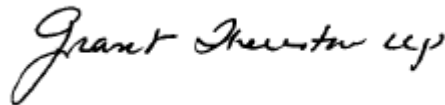
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Trust Fund as of June 30, 2008 and 2007, and the changes in its net assets and its cash flows where applicable, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

To the Auditor
State of Hawaii

In accordance with *Government Auditing Standards*, we have also issued a report dated December __, 2008 on our consideration of the Trust Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 8 through 12 and the schedules of funding progress and employer contributions on page 50 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

As discussed in note N, the accompanying financial statements as of and for the year ended June 30, 2007 has been restated.



Honolulu, Hawaii
December 18, 2008

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2008 and 2007

This section of the Hawaii Employer-Union Health Benefits Trust Fund of the State of Hawaii (Trust Fund) financial report presents the reader with an introduction and overview of the Trust Fund's financial performance for the years ended June 30, 2008 and 2007. This discussion has been prepared by management and should be read in connection with the financial statements and the notes thereto, which follow this section.

Chapter 87A of the Hawaii Revised Statutes (HRS) established the Trust Fund. The Trust Fund is the state agency that provides eligible State of Hawaii (State) and County (Honolulu, Hawaii, Maui and Kauai) employees and retirees and their eligible dependents with health and life insurance benefits at a cost affordable to both the public employers and participants beginning July 1, 2003. HRS Chapter 87 that established the Hawaii Public Employees Health Fund (Health Fund) was repealed and the net assets of the Health Fund were transferred to the Trust Fund.

During 2007, the Trust Fund adopted Governmental Accounting Standards Board Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other than Pensions* (GASB 43). GASB 43 establishes accounting and financial reporting standards for plans that provide other postemployment benefits (OPEB) other than pensions. GASB 43 requires a statement of plan net assets and a statement of changes in plan net assets for defined benefit OPEB plans that are administered as trusts or equivalent arrangements.

Further, the reporting of active employee and retiree (including their respective beneficiaries) healthcare benefits provided through the same plan should separate the two benefits for accounting purposes between active employee and retiree healthcare benefits. Accordingly, the Trust Fund reports the retiree healthcare benefits as OPEB in conformity with GASB 43 and the active employee healthcare benefits as risk financing in conformity with adopted Governmental Accounting Standards Board Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues* (GASB 10) as amended.

In August 2006, the Trust Fund issued a Request for Proposals seeking proposals to provide benefit plans effective July 1, 2007. The evaluation committee recommended and the Board of Trustees approved the award of contracts for twelve benefit plans for the period July 1, 2007 through June 30, 2009. New plans include a High Deductible Health Plan that gives employees the opportunity to participate in Health Savings Accounts, two additional Health Maintenance Organization (HMO) plans, and an additional PPO plan.

Beginning July 1, 2007 the Trust Fund began offering self-funded medical and prescription drug plans. Under self-funded arrangements, the Trust Fund contracts with plan administrators for provider networks, claims processing, cost containment and other services. Instead of premiums, the Trust Fund pays administrative fees to the contractor and reimburses the contractor only for claims paid. For most active employees the rate for self-funded medical and prescription drug plans are lower than their counterparts during the 2008 plan year. For active employee plans, Kaiser rates increased by an average of 6.6%, Hawaii Dental Service rates decreased by 6.0% and Vision Service Plan rates increased by 7.9%.

Additionally, the Trust Fund's Board of Trustees revised the current single and family rate structure to provide lower rates for employees who enroll only one dependent in the Trust Fund health benefit plans, who previously had been paying the same rates as employees with three or more family members. Implementation of the two-party rate meant a decrease of over 20% in Preferred Provider Organization (PPO) rates for employees in the two-party category. For single employees, PPO rates decreased by approximately 4-6%, while family rates increased by

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2008 and 2007

approximately 1-3% depending upon the plan selected. The two-party rate brought the Trust Fund in line with the approach taken by most private sector employers in the community.

The financial reports of the Trust Fund include the following statements:

Active Employee Healthcare Benefits

Statement of net assets - This statement summarizes the assets and liabilities and presents an overall picture of the financial position.

Statement of revenue, expenses and changes in net assets – This statement summarizes the financial results of the operations for the year.

Statement of cash flows – This statement identifies the sources and uses of cash.

Retiree Healthcare Benefits

Statement of plan net assets – This statement summarizes the OPEB plan assets, liabilities and net assets held in trust. Net assets held in trust represent the amount of total assets less total liabilities.

Statement of changes in plan net assets – This statement summarizes the contribution income, investment income, administrative fee income, and other income as well as benefit expenses and administrative expenses during the year.

FINANCIAL HIGHLIGHTS

In July 2005, the State Legislature enacted HB 1608 which authorized and set forth the requirements for the establishment of a Voluntary Employee Beneficiary Association (VEBA) trust by public employee organizations to provide health benefits for its members. HB1608 established a VEBA trust three-year pilot program to allow for the analysis of the costs and benefits of a VEBA trust against those of the Trust Fund. Effective March 1, 2006, the Hawaii State Teachers Association (HSTA) implemented the three-year pilot program. As a result, all active HSTA employees were enrolled in the VEBA trust and subsequently canceled from the Trust Fund's health benefits plans.

In addition, Chapter 87D of the Hawaii Revised Statutes which authorized the establishment of the VEBA, also included the option for HSTA retirees to make a one-time choice to either remain with the Trust Fund or transfer to the HSTA VEBA benefit plans. The option period was from October through November 2006. As a result, approximately 1,400 HSTA retirees transferred to the HSTA VEBA. HSTA employees that retired on or after March 1, 2006 are required to be enrolled with the HSTA VEBA and do not have the option to enroll with the Trust Fund.

The Trust Fund collected in the aggregate \$550,767,545 and \$40,605,906 in employer and employee contributions for the health benefit plans and Medicare reimbursements, respectively, and paid carriers in the aggregate

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2008 and 2007

\$226,817,573 and \$341,436,143 and retirees \$40,605,906 in premiums, self-insured claims and Medicare reimbursements, respectively, for the year ended June 30, 2008. The monthly premiums for the Trust Fund's benefit plans include administrative fees that are intended to cover the Trust Fund's administrative expenses. The aggregated administrative fees collected from the employers totaled approximately \$4,971,000 for the year ended June 30, 2008. The Trust Fund held \$2,706,555 in reserves for carrier retrospective premiums as of June 30, 2008.

The Trust Fund collected in the aggregate \$534,474,414 and \$38,060,523 in employer and employee contributions for the health benefit plans and Medicare reimbursements, respectively, and paid carriers in the aggregate \$462,775,359 and retirees \$38,060,523 in premiums and Medicare reimbursements, respectively, for the year ended June 30, 2007. The monthly premiums for the Trust Fund's benefit plans include administrative fees that are intended to cover the Trust Fund's administrative expenses. The aggregated administrative fees collected from employers totaled approximately \$3,600,000 for the year ended June 30, 2007. The Trust Fund held \$39,657,236 in reserves for carrier retrospective premiums as of June 30, 2007.

The administrative expenses budgeted for the Trust Fund totaled approximately \$11,681,399 for the year ended June 30, 2008. Actual administrative expenditures for the active employee healthcare benefits totaled \$2,169,714, excluding the loss from the payment methodology of approximately \$34,551 for the year ended June 30, 2008. The expenses included \$1,022,098 for personal services; \$347,827 for consultant services; \$48,090 for depreciation; \$208,696 for computer system maintenance fees; and \$543,003, for other expenses such as open enrollment, office supplies, telephone, travel, copier rental and equipment for the year ended June 30, 2008. Actual administrative expenditures for the retiree healthcare benefits totaled \$1,577,702 excluding the loss from the payment methodology of \$31,894 and the administrative fees charged to the employers of \$1,988,355.

The administrative expenses budgeted for the Trust Fund totaled approximately \$4,466,300 for the year ended June 30, 2007. Actual administrative expenditures for the active employee healthcare benefits totaled \$2,199,941, excluding the loss from the payment methodology of approximately \$634,190 for the year ended June 30, 2007. The expenses included \$758,915 for personal services; \$328,217 for consultant services; \$187,499 for depreciation; \$353,140 for computer system maintenance fees; and \$572,170 for other expenses such as open enrollment, office supplies, telephone, travel, copier rental and equipment for the year ended June 30, 2007. Actual administrative expenditures for the retiree healthcare benefits totaled \$1,798,792 excluding the loss from the payment methodology of \$540,235 and the administrative fees charged to the employers of \$1,619,808.

Since HRS Chapter 87A does not contain the same statutory requirements that were in Chapter 87 related to the refund of excess insurance reserves, the Trust Fund recognized the excess insurance reserves for the plan years ended June 30, 2008 and 2007 as revenues rather than premium reserves payable to employers and employees. As a result, the Trust Fund recognized in the aggregate \$61,437,077 and \$773,742 in premium gains from VSP vision plans, Royal State National dual-coverage plans, and other for active employee and retiree health benefit plans for the years ended June 30, 2008 and 2007, respectively.

The aggregated net asset value of capital assets was \$3,566,954 and \$279,852 at June 30, 2008 and 2007, respectively. The aggregated depreciation expense totaled \$80,150 and \$340,907 for the year ended June 30, 2008 and 2007. In August 2007, the Trust Fund issued a Request for Proposal seeking proposals to furnish a benefits administration system implementation and maintenance services. The evaluation committee recommended and the Board of Trustees approved the award of a contract to provide, implement and maintain a Benefits

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2008 and 2007

Administration System for the Trust Fund. The Trust Fund has incurred approximately \$3,300,000 in construction-in-progress related to this contract as of June 30, 2008.

The adoption of GASB 43 in 2007 resulted in separate reporting of the active employee and retiree healthcare benefits for financial statement purposes. As 2007 was the first year of such reporting, the summary financial results are presented as of and for the fiscal years ended June 3008 and 2007 only.

A summary of operations and changes in net assets for the years ended June 30, 2008 and 2007 for active employees follows:

	2008	2007
Operating revenues (administrative fees)	\$ 2,982,532	\$ 1,979,765
Non-operating revenues	26,675,551	2,434,652
Total revenues	29,658,083	4,414,417
Operating expenses and total expenses	2,204,265	2,834,131
Non-operating expenses	40,774,282	-
Total expenses	42,978,547	2,834,131
(Loss) income before transfers	(13,320,464)	1,580,286
Transfers	-	(1,745)
(DECREASE) INCREASE IN NET ASSETS	\$(13,320,464)	\$ 1,578,541

A summary of the Trust Fund's net assets for active employees is shown below as of June 30,:

	2008	2007
Current assets	\$58,070,029	\$70,894,793
Capital assets	2,126,180	153,919
Total assets	\$60,196,209	\$71,048,712
Current liabilities	\$47,628,954	\$45,185,571
Long-term liabilities	69,754	45,176
Total liabilities	47,698,708	45,230,747
Net assets		
Invested in capital assets	2,126,180	153,919
Unrestricted	10,371,321	25,664,046
Total net assets	12,497,501	25,817,965
Total liabilities and net assets	\$60,196,209	\$71,048,712

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2008 and 2007

A summary of operations and changes in plan net assets for the years ended June 30, 2008 and 2007 for retirees follows:

	2008	2007
Additions:		
Contributions, including administrative fees of \$1,988,355 and \$1,619,808 in 2008 and 2007, respectively	\$ 296,659,784	\$ 242,980,561
Interest	1,861,136	1,637,675
Increase in premium reserves	37,294,964	340,692
Total additions	335,815,884	244,958,928
Deductions:		
Benefits	(248,049,233)	(241,360,754)
Administrative expenses	(1,609,596)	(2,339,027)
Total deductions	(249,658,829)	(243,699,781)
Increase in plan net assets	\$ 86,157,055	\$ 1,259,147

A summary of the Trust Fund's plan net assets for retirees is shown below as of June 30,:

	2008	2007
Assets:		
Cash and cash equivalents	\$ 73,296,129	\$ 41,912,589
Receivables	43,172,568	5,833,853
Prepaid expenses	12,472	13,769
Deposits	10,092,000	10,092,000
Capital assets, net	1,440,774	125,933
Total assets	128,013,943	57,978,144
Liabilities:		
Premiums and other payables	15,657,808	31,779,064
Total liabilities	15,657,808	31,779,064
Net Assets held in Trust for Other Postemployment Benefits	\$112,356,135	\$ 26,199,080

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

STATEMENTS OF NET ASSETS - ENTERPRISE FUND

As of June 30,

ASSETS

	2008	2007 As restated (note N)
CURRENT ASSETS		
Cash and cash equivalents (note B3)	\$ 16,745,522	\$ 53,568,327
Premiums receivable from individuals, net of allowance \$244,621 and \$234,350 in 2008 and 2007, respectively	68,521	31,913
Premiums receivable from State of Hawaii and counties	7,676,639	7,366,122
Premiums reserves held by insurance companies (note D)	24,134,500	134,192
Accrued interest receivable	118,139	469,411
Prepaid expenses	18,708	16,828
Deposits (note L)	9,308,000	9,308,000
Total current assets	58,070,029	70,894,793
NONCURRENT ASSETS		
Capital assets, net of accumulated depreciation \$2,202,514 and \$2,154,424 in 2008 and 2007, respectively (notes B2 and C)	2,126,180	153,919
Total assets	\$ 60,196,209	\$ 71,048,712
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Vouchers and contracts payable	\$ 144,693	\$ 193,690
Accrued wages and employee benefits payable (note E)	167,118	55,981
Due to State of Hawaii	28,274	23,858
Retrospective premium payable (note D)	1,723,381	22,775,336
Premiums and benefit claims payable (notes B8 and L)	45,540,297	22,104,420
Compensated absences, current portion (note B4)	25,191	32,286
Total current liabilities	47,628,954	45,185,571
NONCURRENT LIABILITIES		
Compensated absences (note B4)	69,754	45,176
Total liabilities	47,698,708	45,230,747
NET ASSETS		
Invested in capital assets	2,126,180	153,919
Unrestricted	10,371,321	25,664,046
Total net assets	12,497,501	25,817,965
Total liabilities and net assets	\$ 60,196,209	\$ 71,048,712

The accompanying notes are an integral part of these statements.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS - ENTERPRISE FUND

Year ended June 30,

	2008	2007
Operating revenues		
Administrative fees (note H)	\$ 2,982,532	\$ 1,979,765
Total operating revenues	2,982,532	1,979,765
Operating expenses		
Personal services	1,022,098	758,915
Contracted services	347,827	328,217
Equipment	242,789	262,433
Repairs and maintenance	208,696	353,140
Occupancy (note J)	136,973	123,593
Depreciation	48,090	187,499
Insurance	44,415	54,416
Loss from payment methodology (note I)	34,551	634,190
Postage	31,985	24,763
Printing and binding	25,718	46,012
Transportation	19,557	11,871
Supplies	11,285	5,429
Rental of equipment	9,665	8,675
Telephone	8,208	6,499
Provision for bad debt	6,329	23,763
Training	4,923	3,290
Dues and subscriptions	1,149	823
Other	7	603
Total operating expenses	2,204,265	2,834,131
Operating income (loss)	778,267	(854,366)
Non-operating revenues and expenses		
Increase in premium reserves (note D)	24,142,113	433,050
Interest income and other	2,533,438	2,001,602
Excess benefit expense over contributions received of \$193,252,085 (note L)	(40,774,282)	-
Total non-operating revenues	(14,098,731)	2,434,652
Loss before transfers	(13,320,464)	1,580,286
Transfers		
Transfer to other government agencies	-	(1,745)
(DECREASE) INCREASE IN NET ASSETS	(13,320,464)	1,578,541
Net assets at beginning of the year	25,817,965	24,239,424
Net assets at end of year	\$ 12,497,501	\$ 25,817,965

The accompanying notes are an integral part of these statements.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

STATEMENTS OF CASH FLOWS - ENTERPRISE FUND

Year ended June 30,

	<u>2008</u>	<u>2007</u> As restated (note N)
Cash flows from operating activities:		
Cash paid to vendors	\$ (1,145,987)	\$ (1,074,030)
Cash paid to employees	(893,478)	(770,455)
Cash received from State of Hawaii, counties and individuals for premiums and administrative fees	289,018,735	290,082,007
Cash paid for premiums and benefit payments	(324,808,239)	(271,780,623)
Cash paid for premium deposit for self-funded plans	-	(9,308,000)
Reserves returned by insurance carriers	141,805	147,593
Transfer of vacation credits to other governmental agency	-	(1,745)
Net cash (used in) provided by operating activities	<u>(37,687,164)</u>	<u>7,294,747</u>
Cash flows from capital and related financing activities:		
Purchases of furniture, equipment, and software development	<u>(2,020,351)</u>	<u>(27,798)</u>
Net cash used in capital and related financing activities	<u>(2,020,351)</u>	<u>(27,798)</u>
Cash flows from investing activities:		
Interest received	<u>2,884,710</u>	<u>1,814,068</u>
Net cash provided by investing activities	<u>2,884,710</u>	<u>1,814,068</u>
NET (DECREASE) INCREASE IN CASH	(36,822,805)	9,081,017
Cash at the beginning of year	<u>53,568,327</u>	<u>44,487,310</u>
Cash at end of year	<u>\$ 16,745,522</u>	<u>\$ 53,568,327</u>

The accompanying notes are an integral part of these statements.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

STATEMENTS OF CASH FLOWS - ENTERPRISE FUND (continued)

Year ended June 30,

	2008	2007 As restated (note N)
Reconciliation of change in net assets to net cash provided by operating activities:		
Operating loss	\$ 778,267	\$ (854,366)
Adjustments to reconcile operating loss to net cash (used in) provided by operating activities:		
Depreciation	48,090	187,499
Reserves provided by operating activities	4,247,341	157,133
(Increase) decrease in premiums receivable from individuals	(36,608)	57,257
Increase in premiums receivable from State of Hawaii and counties	(310,517)	(131,223)
(Increase) decrease in premium reserves held by insurance companies	(24,000,308)	13,401
(Increase) decrease increase in prepaid expenses	(1,880)	15,711
Increase in deposits	-	(9,308,000)
(Decrease) increase in vouchers and contracts payable	(48,997)	118,382
Increase (decrease) in accrued wages and employee benefits payable	111,137	(10,494)
Increase in amounts due to State of Hawaii	4,416	15,892
(Decrease) increase in premiums payable to carriers	(18,495,588)	17,042,508
Increase (decrease) in compensated absences	17,483	(8,953)
	<u>\$ (37,687,164)</u>	<u>\$ 7,294,747</u>

The accompanying notes are an integral part of these statements.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

STATEMENTS OF PLAN NET ASSETS

As of June 30,

ASSETS	<u>2008</u>	<u>2007</u> As restated (note N)
ASSETS		
Cash (note B3)	\$ 73,296,129	\$ 41,912,589
Receivables		
Premiums receivable from individuals, net of allowance \$982 and \$705 in 2008 and 2007, respectively	260	96
Medicare reimbursements receivable from individuals, net of allowance of \$385,128 and \$253,792 in 2008 and 2007, respectively	16,484	29,238
Premiums receivable from State of Hawaii and counties	5,864,123	5,231,114
Premiums reserves held by insurance companies (note D)	37,212,941	189,342
Accrued interest receivable	78,760	384,063
Total receivables	<u>43,172,568</u>	<u>5,833,853</u>
Prepaid expenses	12,472	13,769
Deposits (note L)	10,092,000	10,092,000
Capital assets, net of accumulated depreciation of \$1,794,769 and \$1,762,709 in 2008 and 2007, respectively (notes B2 and C)	<u>1,440,774</u>	<u>125,933</u>
Total assets	128,013,943	57,978,144
LIABILITIES		
Vouchers and contracts payable (note E)	95,724	158,474
Due to State of Hawaii	60	67
Accrued wages and employee benefits payable	111,411	45,803
Retrospective premium payable (note D)	983,175	16,881,900
Premiums and benefit claims payable (notes B8 and L)	14,404,141	14,629,442
Compensated absences (note B4)	63,297	63,378
Total liabilities	<u>15,657,808</u>	<u>31,779,064</u>
NET ASSETS HELD IN TRUST FOR OTHER POSTEMPLOYMENT BENEFITS	<u>\$ 112,356,135</u>	<u>\$ 26,199,080</u>

The accompanying notes are an integral part of these statements.

Hawaii Employer - Union Health Benefits Trust Fund
State of Hawaii

STATEMENTS OF CHANGES IN PLAN NET ASSETS

Year ended June 30,

ADDITIONS	<u>2008</u>	<u>2007</u>
Contributions		
Employer, including administrative fees of \$1,988,355 and \$1,619,808 in 2008 and 2007, respectively (note M)	\$ 296,198,991	\$ 242,697,193
Plan member	460,793	283,368
Total contributions	<u>296,659,784</u>	<u>242,980,561</u>
Investment income		
Interest	1,861,136	1,637,675
Increase in premium reserves (note D)	<u>37,294,964</u>	<u>340,692</u>
Total additions	335,815,884	244,958,928
DEDUCTIONS		
Benefits	(248,049,233)	(241,360,754)
Administrative expenses (operating)	<u>(1,609,596)</u>	<u>(2,339,027)</u>
Total deductions	<u>(249,658,829)</u>	<u>(243,699,781)</u>
NET INCREASE	86,157,055	1,259,147
NET ASSETS HELD IN TRUST FOR OTHER POSTEMPLOYMENT BENEFITS		
Beginning of year	<u>26,199,080</u>	<u>24,939,933</u>
End of year	<u><u>\$ 112,356,135</u></u>	<u><u>\$ 26,199,080</u></u>

The accompanying notes are an integral part of these statements.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS

June 30, 2008 and 2007

NOTE A – FINANCIAL REPORTING ENTITY

Chapter 87A of the Hawaii Revised Statutes (HRS) established the Hawaii Employer-Union Health Benefits Trust Fund (Trust Fund). The Trust Fund was established to design, provide and administer health and other benefit plans for State of Hawaii and County (Honolulu, Hawaii, Maui and Kauai) employees, retirees and their dependents beginning July 1, 2003. HRS Chapter 87 that established the Hawaii Public Employees Health Fund (Health Fund) was repealed and the net assets of the Health Fund were transferred to the Trust Fund.

The Trust Fund is administratively attached to the Department of Budget and Finance in the executive branch of the State of Hawaii (“State”). The Trust Fund’s basic financial statements reflect only its portion of the fund type categories. The State Comptroller maintains the central accounts for all State funds and publishes annual financial statements for the State, which includes the Trust Fund’s financial activities.

The Trust Fund is administered by a Board of Trustees (the “Board”) composed of ten trustees appointed by the Governor of the State of Hawaii. The Board is responsible for determining the nature and scope of benefit plans offered by the Trust Fund, negotiating and entering into contracts with insurance carriers, establishing eligibility and management policies for the Trust Fund, and overseeing all Trust Fund activities. The Board relies on professional services provided by a salaried Administrator, the State Attorney General and a Benefit Plan Consultant.

The Trust Fund currently provides medical, prescription drug, dental, vision, chiropractic, dual-coverage medical and prescription and group life insurance benefits. The medical plans include a statewide service benefit plan and a federally-qualified HMO plan. Other benefit plans are offered on a statewide basis.

The employers’ share of benefit plan contributions for collectively bargained employees are negotiated by the State and Counties with the exclusive representative of each employee bargaining unit. Employer contributions for all other employees not covered by collective bargaining contracts and for retirees are prescribed by the HRS. Any remaining premium balance is paid by employees through payroll deductions or Premium Conversion Plan reductions.

State and county contributions also include the employees’ share made through payroll deductions, contributions for retired employees, and Medicare reimbursements made by the Trust Fund to eligible retired employees and their spouses for Medicare Part B insurance premiums withheld from their social security benefits.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE A – FINANCIAL REPORTING ENTITY (continued)

As of June 30, 2008, the Trust Fund provided insurance coverage to approximately the following individuals:

Active employees	55,100
Retirees	37,600
Spouses	36,600
Domestic partners	1,000
Dependents under the age of 19	29,500
Dependents between the ages of 19 – 23 who are full-time students	7,600
Disabled dependents	400
	<hr/>
Total	167,800

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Measurement Focus and Basis of Accounting

The accounting policies of the Trust Fund conform to accounting principles generally accepted in the United States of America as applicable to enterprise activities of governmental units as promulgated by the Governmental Accounting Standards Board (GASB). In accordance with GASB standards, the Trust Fund has elected not to apply the Financial Accounting Standards Board pronouncements on accounting and financial reporting that were issued after November 30, 1989.

Effective July 1, 2007, the State and, accordingly, the Trust Fund implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This statement establishes standards for the measurement, recognition, and display of other postemployment benefit expenses and related liabilities and note disclosures in the financial reports. The Statement was implemented prospectively. Comparability with reports issued in prior years is affected (note E).

Effective July 1, 2006, the Trust Fund adopted Governmental Accounting Standards Board Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other than Pensions* (GASB 43). GASB 43 establishes accounting and financial reporting standards for plans that provide other postemployment benefits (OPEB) other than pensions. GASB 43 requires a statement of plan net assets and a statement of changes in plan net assets for defined benefit OPEB plans that are administered as trusts or equivalent arrangements.

The reporting of active and retiree (including their respective beneficiaries) healthcare benefits provided through the same plan should separate the two benefits for accounting purposes between active and retiree healthcare benefits. Accordingly, the Trust Fund reports the retiree healthcare benefits as OPEB in conformity with GASB 43 and the active employee healthcare benefits as risk financing in conformity with adopted Governmental Accounting Standards Board Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues* (GASB 10) as amended.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

1. Measurement Focus and Basis of Accounting (continued)

The Trust Fund administers postemployment healthcare benefits under an agent multiple-employer defined benefit plan as defined by GASB 43.

In 2008 and 2007, the accounting for the active employee healthcare benefits are reported under the statement of net assets – enterprise fund, statement of revenue, expenses and changes in net assets – enterprise fund and statement of cash flows – enterprise fund. The accounting for the retiree healthcare benefits are reported in the statement of plan net assets and statement of changes in plan net assets. For financial reporting purposes, certain assets, liabilities, revenues and expenses have been allocated for the separate accounting of active and retiree healthcare benefits. In previous years, the retirees were included in the Trust Fund's basic financial statements which consisted of a statement of net assets – enterprise fund, statement of revenues, expenses, and changes in net assets – enterprise fund, and a statement of cash flows – enterprise fund.

Basis of accounting – active healthcare benefits. The accounting for the active employee healthcare benefits are reported as an enterprise fund. An enterprise fund is used to account for the acquisition, operation and maintenance of government facilities and services that are entirely or predominantly supported by user charges. The Trust Fund operations are accounted for on the flow of economic resources measurement focus and the accrual basis of accounting is utilized. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services or goods in connection with the proprietary fund's ongoing operations. Revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. The principal operating revenues of the Trust Fund are administrative fees. Interest income from investments and increase in premium reserves are reported as non-operating income.

Basis of accounting – retiree healthcare benefits. The financial statements for the retiree healthcare benefits are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contribution. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

2. Capital Assets

The Trust Fund's capital assets consist of furniture and equipment with estimated useful lives greater than one year and with an acquisition cost greater than \$5,000. Purchased capital assets are valued at cost. Donated capital assets are recorded at their fair value at the date of donation. Depreciation expense is determined using the straight-line method over the assets' useful life of 7 years.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3. Cash and Cash Equivalents

Cash represents amounts held in the State Treasury. The State Director of Finance is responsible for safekeeping of all monies paid into the State Treasury (cash pool). The Director of Finance may invest any monies of the State, which in the Director's judgment are in excess of the amounts necessary for meeting the immediate requirements of the State. Cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or participates in the State Treasury Investment Pool System. Cash accounts that participate in the investment pool accrue interest based on the weighted average cash balances of each account.

The State requires that the depository banks pledge, as collateral, government securities held in the name of the State for deposits not covered by federal deposit insurance.

Investments can be categorized to give an indication of the level of risk assumed by the Trust Fund. Category 1 includes investments that are insured or for repurchase agreements, collateralized by underlying securities that are so held. Category 2 includes uninsured and unregistered investments for which the securities are held by the broker-dealer in the Trust Fund's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker-dealer but not in the Trust Fund's name. Investments with an original maturity of 3 months or less are considered cash equivalents

Cash includes the following as of June 30,:

	<u>Active</u>	<u>Retiree</u>	<u>Total</u>
2008			
Category 1 investments	\$ 9,000,000	\$ 6,000,000	\$15,000,000
Cash	<u>7,745,522</u>	<u>67,296,129</u>	<u>75,041,651</u>
	<u>\$16,745,522</u>	<u>\$73,296,129</u>	<u>\$90,041,651</u>
2007			
Category 1 investments	\$30,250,000	\$24,750,000	\$55,000,000
Cash	<u>26,133,933</u>	<u>14,346,983</u>	<u>40,480,916</u>
	<u>\$56,383,933</u>	<u>\$39,096,983</u>	<u>\$95,480,916</u>

Since other cash is included in the State cash pool, the category of risk is not determinable at the Trust Fund's level.

4. Compensated Absences

All employees earn vacation at the rate of one and three-quarters working days for each month of service. Vacation days may be accumulated to a maximum of 90 days. Employees are entitled to receive cash

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4. Compensated Absences (continued)

payment for accumulated vacation upon termination. The accompanying financial statements present the cost of accumulated unpaid vacation as a liability. A reconciliation of changes in aggregate liabilities for accumulated vacation is as follows for the year ended June 30,:

	2008	2007
Balance at beginning of year	\$140,840	\$148,992
Additions	95,624	85,920
Reductions	(78,222)	(94,072)
Balance at end of year	158,242	140,840
Less current portion	41,985	58,701
	\$116,257	\$ 82,139

All employees earn sick leave credits at the rate of one and three-quarters working days for each month of service. Sick leave credits may be accumulated without limit. Sick leave can be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for unpaid sick leave credits is reported in the accompanying financial statements. However, a Trust Fund employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the Employees' Retirement System of the State of Hawaii. Accumulated sick leave as of June 30, 2008 and 2007 relating to the Trust Fund approximated \$502,000 and \$465,000, respectively.

5. Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

6. Receivables

Receivables consists primarily of amounts due from employers and employees for health benefits premium contributions, as well as amounts due from individuals for Medicare Part B reimbursements. The employee receivables are reported as net receivables and were based on management's estimate of amounts considered collectible. Management considered receivables outstanding for more than 60 days

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

6. Receivables (continued)

by employees who are no longer employed by State or Counties to be uncollectible. An allowance for employer receivables is not considered necessary based on past collection experience. The Medicare reimbursement receivables from individuals are reported as net receivables and were based on management's estimate of amounts considered collectible. Management considered receivables from individuals who are deceased and do not have a surviving spouse enrolled in Medicare Part B to be uncollectible.

7. Risk Management

The Trust Fund is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. A liability for a claim for a risk of loss is established if information indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss is reasonably estimable.

8. Benefits Claims Expense

The benefits claims expense for the self-funded medical and prescription drug plans which began on July 1, 2007 includes the ultimate net cost of all reported and unreported claims incurred through June 30, 2008 for active employee healthcare benefits. Unreported claims incurred are not recorded for the accounting of retiree healthcare benefits. Management has made certain assumptions based on currently available information and industry statistics in determining the benefits claim expense. Accordingly, the ultimate costs may vary significantly from the estimated amounts reported in the financial statements. Management believes that, given the inherent variability in benefits claim expense, such aggregate liabilities are within a reasonable range of adequacy. Such estimates are based on estimated claims cost reported prior to June 30, 2008 and estimates (based on actuarial projections of historical loss development) of claims cost incurred but not reported. Reserves are continually reviewed and adjusted as experience develops or new information becomes known; such adjustments are charged to net assets as incurred for active employees.

Management recorded its best estimate of approximately \$46,200,000 as of June 30, 2008 based on the Trust Fund's consulting actuary's estimate for the liability for unpaid claims. This amount includes administrative fees payable to the contracted plan administrator for services provided.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE C – CAPITAL ASSETS

The aggregated capital asset activity for the years ended June 30, 2008 and 2007 were as follows:

	Balance at July 1, 2007	Increases	Decreases	Balance at June 30, 2008
Capital assets being depreciated				
Office furniture and equipment	\$ 4,196,985	\$ 43,130	\$ –	\$ 4,240,115
Less accumulated depreciation	(3,917,133)	(80,150)	–	(3,997,283)
	279,852	(37,020)	–	242,832
Software development in progress	–	3,324,122	–	3,324,122
Capital assets, net	<u>\$ 279,852</u>	<u>\$3,287,102</u>	<u>\$ –</u>	<u>\$ 3,566,954</u>
	Balance at July 1, 2006	Increases	Decreases	Balance at June 30, 2007
Capital assets being depreciated				
Office furniture and equipment	\$ 4,146,444	\$ 50,541	\$ –	\$ 4,196,985
Less accumulated depreciation	(3,576,226)	(340,907)	–	(3,917,133)
Capital assets, net	<u>\$ 570,218</u>	<u>\$(290,366)</u>	<u>\$ –</u>	<u>\$ 279,852</u>

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS

The Trust Fund's primary purpose is to provide employee-beneficiaries, retiree-beneficiaries and dependent-beneficiaries with a health benefits plan and group life insurance. To effectuate that purpose, the Trust Fund requested proposals and awarded multi-year health and life insurance benefit contracts commencing July 1, 2003 and expiring through June 30, 2007. The Trust Fund entered into new contracts for health and life insurance benefit contracts commencing July 1, 2007 and expiring June 30, 2009.

For the years ended June 30, 2008 and 2007, all of the carriers use experience ratings in determining the premium rates except for Kaiser Foundation Health Plan and Mutual Benefits Association of Hawaii and for the medical and prescription drug plans which became self-funded beginning July 1, 2007. For self-funded plans the Trust Fund pays administrative fees to the contractor and reimburses the contractor only for claims paid instead of a premium to the carrier. The carriers that have experience rating contract perform a preliminary and final annual accounting for each plan year to determine the premium surplus or underwriting loss. If in a plan year the earned premium exceeds total charges (net incurred and paid claims plus retention and the incurred reserve), the premium surplus will be held in a rate stabilization reserve or, at the option of the Board, the entire difference will be refunded to the Trust Fund. If there is an underwriting loss in the first plan year, the loss will be offset against any premium surplus from the second plan year. If there is a premium surplus in the first plan year and an underwriting loss in the second plan year, the premium surplus will be

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS (continued)

offset against the underwriting loss, if the premium surplus was held in a rate stabilization reserve. Premium surpluses refunded to the Trust Fund are not available to offset underwriting losses in subsequent plan years. If the initial two- year term is extended, the current premium surplus held in a rate stabilization reserve or underwriting loss will roll forward and be used to offset future surpluses or losses.

In addition, the annual accounting for active employees and retirees will be maintained separately. As such, the premium surplus of one group cannot be used to offset the underwriting loss of another group. Upon expiration or termination of the contract, any premium surplus will be refunded to the Trust Fund and any underwriting losses will not be paid by the Trust Fund.

Health Maintenance Organization

The Trust Fund entered into a contract with Kaiser Foundation Health Plan, Inc. (Kaiser) to provide active employees and retirees with health maintenance organization (HMO) benefits for the period July 1, 2003 through June 30, 2005 and subsequently exercised its option to extend the contracts for an additional two years through June 30, 2007. The Trust Fund entered into a new contract with Kaiser for the period July 1, 2007 through June 30, 2009. The HMO does not use experience rating for setting the premium rates. Accordingly, there is no premium surplus or underwriting loss.

Medical and Prescription Drug Benefits

The Trust Fund entered into a contract with the Hawaii Medical Service Association (HMSA) to provide medical and prescription drug benefits for active employees and retirees for the period July 1, 2003 through June 30, 2005 and subsequently exercised its option to extend the contract for an additional two years through June 30, 2007. From July 1, 2003 through June 30, 2007, the gains and losses of the medical and prescription drug plans will be combined in order to determine whether there was a premium surplus or net loss for the active employees and retirees. Any net premium surplus will be refunded to the Trust Fund and any net loss will not be paid to HMSA at the end of the contract period.

All surpluses not refunded to the Trust Fund will be held by HMSA in a rate stabilization reserve to be used to offset any deficit from other plan years. Interest will be paid on these reserves beginning 120 days after the plan year and will be adjusted once a year at the time of the annual accounting.

Effective July 1, 2006, a ten percent (10%) retrospective premium agreement with HMSA for both active employees and retirees was executed. Under this agreement, the Trust Fund will pay HMSA ninety percent (90%) of the premiums due each month. At the end of the plan year, if claims and retention exceed ninety percent (90%) of the premiums due for the plan year, the Trust Fund will pay HMSA the amount of the excess up to the withheld ten percent (10%). Since HMSA is still allowed to receive the retrospective premium if they experience losses for the plan year based on the final accounting, a payable to HMSA was recorded.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS (continued)

Medical and Prescription Drug Benefits (continued)

The payable to HMSA for the plan year is as follows:

	Active employees	Retirees	Total
As of June 30, 2007			
Plan year ended June 30, 2007			
Medical contract	\$15,652,433	\$ 8,451,520	\$24,103,953
Prescription drug contract	3,804,868	6,513,321	10,318,189
	\$19,457,301	\$14,964,841	\$34,422,142

As of June 30, 2008 and 2007, the Trust Fund had the following financial experience related to the medical plans provided by HMSA:

	Active employees	Retirees	Total
Final underwriting gain for plan year ended June 30, 2004	\$ 7,052,188	\$ 4,233,158	\$ 11,285,346
Amounts refunded to the Trust Fund for plan year ended June 30, 2004	(7,052,188)	(4,233,158)	(11,285,346)
Final underwriting gain for plan year ended June 30, 2005	11,875,407	15,835,063	27,710,470
Interest	271,889	348,281	620,170
Estimated underwriting gain for plan year ended June 30, 2006, subject to final accounting	509,687	2,731,523	3,241,210
Amounts held by insurance carrier at June 30, 2006	12,656,983	18,914,867	31,571,850
Additional underwriting gain (loss) based on final accounting for plan year ended June 30, 2006	804,335	(942,970)	(138,635)
Interest	224,087	631,029	855,116
Estimated underwriting loss for plan year ended June 30, 2007, subject to final accounting	(3,229,764)	(3,836,954)	(7,066,718)
Amounts held by insurance carrier at June 30, 2007	10,455,641	14,765,972	25,221,613
Additional underwriting gain based on final accounting for plan year ended June 30, 2007	57,117	31,794	88,911
Interest	218,223	691,936	910,159
Amounts held by insurance carrier at June 30, 2008	\$10,730,981	\$15,489,702	\$ 26,220,683

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS (continued)

Medical and Prescription Drug Benefits (continued)

	Active employees	Retirees	Total
Final underwriting gain for plan year ended June 30, 2004	\$ 7,052,188	\$ 4,233,158	\$11,285,346
Final underwriting gain for plan year ended June 30, 2005	11,875,407	15,835,063	27,710,470
Final underwriting gain for plan year ended June 30, 2006	1,314,022	1,788,553	3,102,575
Final underwriting loss for plan year ended June 30, 2007	<u>(3,172,647)</u>	<u>(3,805,160)</u>	<u>(6,977,807)</u>
Cumulative underwriting gain at June 30, 2008	<u>\$17,068,970</u>	<u>\$18,051,614</u>	<u>\$35,120,584</u>

As of June 30, 2008 and 2007, the Trust Fund had the following financial experience related to the prescription drug plans provided by HMSA:

	Active employees	Retirees	Total
Final underwriting gain for plan year ended June 30, 2004	\$ 9,822,838	\$ 13,271,969	\$ 23,094,807
Amounts refunded to the Trust Fund for plan year ended June 30, 2004	(9,822,838)	(13,271,969)	(23,094,807)
Final underwriting gain for plan year ended June 30, 2005	10,334,757	13,103,593	23,438,350
Interest	206,115	290,462	496,577
Estimated underwriting gain for plan year ended June 30, 2006, subject to final accounting	<u>2,254,593</u>	<u>3,630,532</u>	<u>5,885,125</u>
Amounts held by carrier at June 30, 2006	12,795,465	17,024,587	29,820,052
Additional underwriting gain based on final accounting for plan year ended June 30, 2006	189,855	279,456	469,311
Interest	811,858	807,580	1,619,438
Estimated underwriting (loss) gain for plan year ended June 30, 2007, subject to final accounting	<u>(3,593,098)</u>	<u>1,990,458</u>	<u>(1,602,640)</u>
Amounts held by insurance carrier at June 30, 2007	10,204,080	20,102,081	30,306,161
Additional underwriting gain based on final accounting for plan year ended June 30, 2007	218,992	45,467	264,459
Interest	<u>852,176</u>	<u>980,771</u>	<u>1,832,947</u>
Amounts held by insurance carrier at June 30, 2008	<u>\$11,275,248</u>	<u>\$ 21,128,319</u>	<u>\$32,403,567</u>

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS (continued)

Medical and Prescription Drug Benefits (continued)

	Active employees	Retirees	Total
Final underwriting gain for plan year ended June 30, 2004	\$ 9,822,838	\$13,271,969	\$23,094,807
Final underwriting gain for plan year ended June 30, 2005	10,334,757	13,103,593	23,438,350
Final underwriting gain for plan year ended June 30, 2006	2,444,448	3,909,988	6,354,436
Final underwriting (loss) gain for plan year ended June 30, 2007	<u>(3,374,106)</u>	<u>2,035,925</u>	<u>(1,338,181)</u>
Cumulative estimated underwriting gain at June 30, 2008	<u>\$19,227,937</u>	<u>\$32,321,475</u>	<u>\$51,549,412</u>

As of June 30, 2008 and 2007, the Trust Fund had the following combined financial experience related to the medical and prescription drug plans provided by HMSA:

	Active employees	Retirees	Total
Final underwriting gain for plan year ended June 30, 2004	\$ 16,875,026	\$ 17,505,127	\$ 34,380,153
Amounts refunded to the Trust Fund for plan year ended June 30, 2004	(16,875,026)	(17,505,127)	(34,380,153)
Final underwriting gain for plan year ended June 30, 2005	22,210,164	28,938,656	51,148,820
Interest	478,004	638,743	1,116,747
Estimated underwriting gain for plan year ended June 30, 2006, subject to final accounting	<u>2,764,280</u>	<u>6,362,055</u>	<u>9,126,335</u>
Amounts held by insurance carrier at June 30, 2006	25,452,448	35,939,454	61,391,902
Additional underwriting gain (loss) based on final accounting for plan year ended June 30, 2006	994,190	(663,514)	330,676
Interest	1,035,945	1,438,609	2,474,554
Estimated underwriting loss for plan year ended June 30, 2007, subject to final accounting	<u>(6,822,862)</u>	<u>(1,846,496)</u>	<u>(8,669,358)</u>
Amounts held by insurance carrier at June 30, 2007	20,659,721	34,868,053	55,527,774
Additional underwriting gain based on final accounting for plan year ended June 30, 2007	276,109	77,261	353,370
Interest	<u>1,070,399</u>	<u>1,672,707</u>	<u>2,743,106</u>
Amounts held by insurance carrier at June 30, 2008	<u>\$22,006,229</u>	<u>\$ 36,618,021</u>	<u>\$58,624,250</u>

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS (continued)

Medical and Prescription Drug Benefits (continued)

	<u>Active employees</u>	<u>Retirees</u>	<u>Total</u>
Final underwriting gain for plan year ended June 30, 2004	\$16,875,026	\$17,505,127	\$34,380,153
Final underwriting gain for plan year ended June 30, 2005	22,210,164	28,938,656	51,148,820
Final underwriting gain for plan year ended June 30, 2006	3,758,470	5,698,541	9,457,011
Final underwriting loss for plan year ended June 30, 2007	<u>(6,546,753)</u>	<u>(1,769,235)</u>	<u>(8,315,988)</u>
Cumulative estimated underwriting gain at June 30, 2008	<u>\$36,296,907</u>	<u>\$50,373,089</u>	<u>\$86,669,996</u>

Vision Care Benefits

The Trust Fund entered into a contract with Vision Service Plan (VSP) to provide vision care benefits for active employees and retirees for the period July 1, 2003 through June 30, 2005 and subsequently exercised its option to extend the contract for an additional two years through June 30, 2007. The Trust Fund entered into a contract for the period July 1, 2007 through June 30, 2009. The contracts include a five percent (5%) retrospective premium agreement for both active employees and retirees. Under these agreements, the Trust Fund will pay VSP ninety-five percent (95%) of the premiums due each month.

At the end of the plan year, if claims and retention exceed 95% of the premiums due for the plan year, the Trust Fund will pay VSP the amount of the excess up to the withheld 5%. Since VSP is still allowed to receive the retrospective premium if they experience losses for the plan year based on the final accounting, a payable to VSP was recorded. The payable to VSP for the plan year is as follows:

	<u>Active employees</u>	<u>Retirees</u>	<u>Total</u>
<u>As of June 30, 2008</u>			
Plan year ended June 30, 2008	\$253,341	\$137,237	\$390,578
<u>As of June 30, 2007</u>			
Plan year ended June 30, 2007	\$229,788	\$149,421	\$379,209

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS (continued)

Vision Care Benefits (continued)

As of June 30, 2008 and 2007, the Trust Fund had the following financial experience related to the vision care plans provided by VSP:

	<u>Active employees</u>	<u>Retirees</u>	<u>Total</u>
<u>Plan year ended June 30, 2004</u>			
Final underwriting gain (loss)	\$ 545,197	\$ (43,778)	\$ 501,419
<u>Plan year ended June 30, 2005</u>			
Final underwriting gain	\$ 632,130	\$ 7,049	\$ 639,179
<u>Plan year ended June 30, 2006</u>			
Estimated underwriting gain, prior to retrospective premiums	\$ 45,776	\$ 194,428	\$ 240,204
Additional underwriting loss based on final accounting	<u>(14,836)</u>	<u>(5,086)</u>	<u>(19,922)</u>
Final underwriting gain, prior to retrospective premiums	30,940	189,342	220,282
2006 retrospective premiums	<u>264,098</u>	<u>151,048</u>	<u>415,146</u>
Final underwriting gain	<u>\$ 295,038</u>	<u>\$ 340,390</u>	<u>\$ 635,428</u>
<u>Plan year ended June 30, 2007</u>			
Estimated underwriting gain, prior to retrospective premiums	\$ 39,646	\$ (4,446)	\$ 35,200
Additional underwriting gain based on final accounting	<u>4,378</u>	<u>2,356</u>	<u>6,734</u>
Final underwriting gain, prior to retrospective premium	44,024	(2,090)	41,934
2007 retrospective premiums	<u>229,788</u>	<u>149,421</u>	<u>379,209</u>
Final underwriting gain	<u>\$ 273,812</u>	<u>\$ 147,331</u>	<u>\$ 421,143</u>
Cumulative estimated underwriting gain, including retrospective premiums is as follows:			
As of June 30, 2008	\$ 1,746,177	\$ 450,992	\$ 2,197,169
As of June 30, 2007	\$ 1,741,799	\$ 448,636	\$ 2,190,435

Hawaii Employer-Union Health Benefits Trust Fund
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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS (continued)

Vision Care Benefits (continued)

	Active employees	Retirees	Total
<u>Plan year ended June 30, 2008</u>			
Estimated underwriting gain (loss), prior to retrospective premiums	\$ 88,318	\$(186,250)	\$ (97,932)
2008 retrospective premiums held by the Trust Fund at June 30, 2008 due to the insurance carrier, subject to final accounting	253,341	137,237	390,578
Estimated underwriting gain (loss), subject to final accounting	\$ 341,659	\$ (49,013)	\$ 292,646

For plan years with an underwriting gain based on the final accounting, the withheld (5%) retrospective premiums are not available to offset underwriting losses. Therefore, these retrospective premiums were recognized as an increase in premium reserves in the year the final accounting was completed as follows:

	Active employees	Retirees	Total
<u>As of June 30, 2008</u>			
Plan year ended June 30, 2007	\$229,788	\$149,421	\$379,209
<u>As of June 30, 2007</u>			
Plan year ended June 30, 2006	\$264,098	\$151,048	\$415,146

Life Insurance Benefits

The Trust Fund entered into a contract with Aetna Life Insurance Company (Aetna) to provide term life insurance benefits to all eligible active employees and retirees for the period July 1, 2003 through June 30, 2007.

Hawaii Employer-Union Health Benefits Trust Fund
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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS (continued)

Life Insurance Benefits (continued)

As of June 30, 2008, the Trust Fund had the following financial experience related to the group life insurance contract with Aetna:

	Active employees	Retirees	Total
Final underwriting gain for plan year ended June 30, 2004	\$ 760,037	\$ 92,741	\$ 852,778
Amounts refunded to the Trust Fund for plan year ended June 30, 2004	(760,037)	(92,741)	(852,778)
Final underwriting gain for plan year ended June 30, 2005	989,272	181,354	1,170,626
Amounts refunded to the Trust Fund for plan year ended June 30, 2005	(147,593)	(76,033)	(223,626)
Final underwriting gain for plan year ended June 30, 2006	817,581	236,971	1,054,552
Interest	87,102	49,883	136,985
Estimated underwriting gain (loss) for plan year ended June 30, 2007	447,873	(83,887)	363,986
Amounts held by insurance carrier at June 30, 2007	2,194,235	308,288	2,502,523
Interest	46,174	6,296	52,470
Amounts held by insurance carrier at June 30, 2008	<u>\$2,240,409</u>	<u>\$ 314,584</u>	<u>\$2,554,993</u>
Fund underwriting gain for plan year ended June 30, 2004	\$ 760,037	\$ 92,741	\$ 852,778
Final underwriting gain for plan year ended June 30, 2005	989,272	181,354	1,170,626
Final underwriting gain for plan year ended June 30, 2006	817,581	236,971	1,054,552
Estimated underwriting gain (loss) at June 30, 2007 for plan year ended June 30, 2007, subject to final accounting	447,873	(83,887)	363,986
Cumulative estimated underwriting gain at June 30, 2008	<u>\$3,014,763</u>	<u>\$ 427,179</u>	<u>\$3,441,942</u>

Hawaii Employer-Union Health Benefits Trust Fund
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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS (continued)

Life Insurance Benefits (continued)

The Trust Fund entered into a contract with Standard Insurance Company (Standard) to provide term life insurance benefits to all eligible active employees and retirees for the period July 1, 2007 through June 30, 2009. As of June 30, 2008, the Trust Fund had the following financial experience related to the group life insurance contract with Standard:

	Active employees	Retirees	Total
Estimated underwriting gain (loss) at June 30, 2008 for plan year ended June 30, 2008, subject to final accounting	\$ 175,852	\$ (44,730)	\$ 131,122
Amounts held by insurance carrier at June 30, 2008	\$ 175,852	\$ (44,730)	\$ 131,122

Dental Benefits

The Trust Fund entered into a contract with Hawaii Dental Service (HDS) to provide dental benefits for active employees and retirees for the period July 1, 2003 through June 30, 2005 and subsequently exercised its option to extend the contract for an additional two years through June 30, 2007. The Trust Fund entered into a contract with HDS for the period July 1, 2007 through June 30, 2009. The contracts include a ten percent (10%) retrospective premium agreement for both active employees and retirees. Under these agreements, the Trust Fund will pay HDS ninety percent (90%) of the premiums due each month. At the end of the plan year, if claims and retention exceed 90% of the premiums due for the plan year, the Trust Fund will pay HDS the amount of the excess up to the withheld ten percent (10%). Since HDS is still allowed to receive the retrospective premium if they experience losses for the plan year based on the final accounting, a payable to HDS was recorded. The payable to HDS for the plan year is as follows:

	Active employees	Retirees	Total
<u>As of June 30, 2008</u>			
Plan year ended June 30, 2008	\$1,470,040	\$ 845,938	\$2,315,978
<u>As of June 30, 2007</u>			
Plan year ended June 30, 2007	\$3,088,247	\$1,767,638	\$4,855,885

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS (continued)

Dental Benefits (continued)

As of June 30, 2008 and 2007, the Trust Fund had the following financial experience related to the dental care plans provided by HDS:

	Active employees	Retirees	Total
<u>Plan year ended June 30, 2004</u>			
Final underwriting loss	<u>\$(2,069,104)</u>	<u>\$(1,141,373)</u>	<u>\$(3,210,477)</u>
<u>Plan year ended June 30, 2005</u>			
Final underwriting loss	<u>\$(1,179,107)</u>	<u>\$ (674,674)</u>	<u>\$(1,853,781)</u>
<u>Plan year ended June 30, 2006</u>			
Estimated underwriting loss, prior to retrospective premiums	\$(3,979,287)	\$(1,873,453)	\$(5,852,740)
Additional underwriting gain based on final accounting	204,776	29,290	234,066
2006 retrospective premiums paid in 2007	<u>3,359,097</u>	<u>1,659,312</u>	<u>5,018,409</u>
Final underwriting loss	<u>\$ (415,414)</u>	<u>\$ (184,851)</u>	<u>\$ (600,265)</u>
<u>Plan year ended June 30, 2007</u>			
Estimated underwriting (loss) gain, prior to retrospective premiums	\$(1,596,605)	\$ 406,453	\$(1,190,152)
Additional underwriting gain based on final accounting	143,651	32,554	176,205
2007 retrospective premiums paid in 2008	<u>3,088,247</u>	<u>1,767,638</u>	<u>4,855,885</u>
Final underwriting gain	<u>\$ 1,635,293</u>	<u>\$ 2,206,645</u>	<u>\$ 3,841,938</u>
Cumulative underwriting (loss) gain for the 4 year contract ended June 30, 2007			
As of June 30, 2008	\$(2,028,332)	\$ 205,747	\$(1,822,585)
As of June 30, 2007	\$(2,171,983)	\$ 173,193	\$(1,998,790)
<u>Plan year ended June 30, 2008</u>			
Estimated underwriting loss, prior to retrospective premiums	\$(2,436,457)	\$(1,045,828)	\$(3,482,285)
2008 retrospective premiums held by the Trust Fund at June 30, 2008	<u>1,470,040</u>	<u>845,938</u>	<u>2,315,978</u>
Estimated underwriting loss, subject to final accounting	<u>\$ (966,417)</u>	<u>\$ (199,890)</u>	<u>\$(1,166,307)</u>

Hawaii Employer-Union Health Benefits Trust Fund
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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS (continued)

Chiropractic Benefits

The Trust Fund entered into a contract with Mutual Benefit Association of Hawaii (MBAH) to provide active employees with chiropractic benefits for the period July 1, 2003 through June 30, 2005 and subsequently exercised its option to extend the contracts for an additional two years through June 30, 2007. The contract for the additional term was changed from an experience rated contract to a non-experience rated contract. As experience rating is not used for setting the premium rates, accordingly, there will be no premium surplus or underwriting loss for the period July 1, 2005 through June 30, 2007.

Dual-Coverage Medical and Prescription Drug Benefits

The Trust Fund entered into a contract with Royal State National Insurance Company, Ltd. (RSN) to provide active employees with dual-coverage medical and prescription drug benefits for the period February 1, 2004 through June 30, 2005 and subsequently exercised its option to extend the contract for an additional two years through June 30, 2007. The Trust Fund entered into a new contract with Royal for the period July 1, 2007 through June 30, 2009. As of June 30, 2008 and 2007, the Trust Fund had the following financial experience related to the dual-coverage medical and prescription drug plans provided by RSN:

Final underwriting gain at June 30, 2006	\$ 99,631
Interest	<u>3,621</u>
Amounts held by insurance carrier at June 30, 2007	<u>\$103,252</u>
Final underwriting gain at June 30, 2007	\$ 85,488
Interest	<u>1,937</u>
Amounts held by insurance carrier at June 30, 2008	<u>\$ 87,425</u>
Final underwriting gain at June 30, 2004	\$ 45,862
Final underwriting gain at June 30, 2005	166,202
Final underwriting gain at June 30, 2006	103,252
Estimated underwriting loss at June 30, 2007 for plan year ended June 30, 2007, subject to final accounting	<u>(824)</u>
Cumulative estimated underwriting gain as of June 30, 2007	314,492
Additional underwriting gain for plan year ended June 30, 2007	<u>88,249</u>
Cumulative estimated underwriting gain as of June 30, 2008	<u>\$402,741</u>
Estimated underwriting gain at June 30, 2008 for plan year ended June 30, 2008, subject to final accounting	<u>\$352</u>

Hawaii Employer-Union Health Benefits Trust Fund
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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS (continued)

All Contracts

Following is a summary of the premium reserves and interest available to offset underwriting losses for the plan years July 1, 2003 through June 30, 2008 held by insurance carriers as of June 30, 2008 and 2007:

	Active employees	Retirees	Total
<u>As of June 30, 2008</u>			
<u>For plan year ended June 30, 2008:</u>			
VSP – Vision contract	\$ 88,318	\$ –	\$ 88,318
Standard – Life insurance contract	175,852	–	175,852
RSN – Dual coverage contract	341,952	–	341,952
	\$ 606,122	\$ –	\$ 606,122
 <u>As of June 30, 2007</u>			
<u>For plan year ended June 30, 2007:</u>			
VSP – Vision contract	\$ 269,434	\$ 144,975	\$ 414,409
Aetna – Life insurance contract	496,085	–	496,085
HDS – Dental contract	–	173,193	173,193
 <u>For plan year ended June 30, 2006:</u>			
HMSA – Medical contract	1,460,339	2,269,328	3,729,667
HMSA – Prescription drug contract	3,091,679	4,548,998	7,640,677
Aetna – Life insurance contract	856,471	257,305	1,113,776
 <u>For plan year ended June 30, 2005:</u>			
HMSA – Medical contract	12,147,296	16,183,344	28,330,640
HMSA – Prescription drug contract	10,540,872	13,394,055	23,934,927
Aetna – Life insurance contract	841,679	105,321	947,000
	\$29,703,855	\$37,076,519	\$66,780,374

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS (continued)

All Contracts (continued)

Following is a summary of the premium reserves not available to offset underwriting losses in subsequent years held by insurance companies reflected as premium reserves held by insurance companies as of June 30, 2008 and 2007:

	<u>Active employees</u>	<u>Retirees</u>	<u>Total</u>
<u>As of June 30, 2008</u>			
<u>For plan years ended June 30, 2004 – 2007:</u>			
HMSA – Medical contract	\$10,730,981	\$15,489,702	\$26,220,683
HMSA – Prescription drug contract	11,275,248	21,128,319	32,403,567
VSP – Vision contract	273,812	147,331	421,143
Aetna – Life insurance contract	1,767,034	240,959	2,007,993
HDS – Dental contract	–	206,630	206,630
RSN – Dual coverage contract	87,425	–	87,425
	<u>\$24,134,500</u>	<u>\$37,212,941</u>	<u>\$347,441</u>
<u>As of June 30, 2007</u>			
<u>For plan year ended June 30, 2006:</u>			
VSP – Vision contract	\$ 30,940	\$ 189,342	\$ 220,282
RSN – Dual coverage contract	103,252	–	103,252
	<u>\$ 134,192</u>	<u>\$ 189,342</u>	<u>\$ 323,534</u>

Hawaii Employer-Union Health Benefits Trust Fund
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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS (continued)

All Contracts (continued)

Following is a summary of retrospective premium payable as of June 30, 2008 and 2007:

	<u>Active employees</u>	<u>Retirees</u>	<u>Total</u>
<u>As of June 30, 2008</u>			
<u>Plan year ended June 30, 2008:</u>			
VSP – Vision contract	\$ 253,341	\$ 137,237	\$ 390,578
HDS – Dental contract	1,470,040	845,938	2,315,978
	<u>\$ 1,723,381</u>	<u>\$ 983,175</u>	<u>\$ 2,706,556</u>
<u>As of June 30, 2007</u>			
<u>Plan year ended June 30, 2007:</u>			
VSP – Vision contract	\$ 229,788	\$ 149,421	\$ 379,209
HDS – Dental contract	3,088,247	1,767,638	4,855,885
HMSA – Medical and prescription drug contract	19,457,301	14,964,841	34,422,142
	<u>\$22,775,336</u>	<u>\$16,881,900</u>	<u>\$39,657,236</u>

Following is a summary of the increase in premium reserves for the year ended June 30, 2008 and 2007:

	<u>Active employees</u>	<u>Retirees</u>	<u>Total</u>
<u>Plan years ended June 30, 2004 – 2007:</u>			
HMSA – medical and prescription drug contract	\$22,006,229	\$36,618,021	\$58,624,250
VSP – Vision contract	273,812	147,331	421,143
Aetna – Life insurance contract	1,767,034	240,959	2,007,993
HDS – Dental contract	–	206,630	206,630
RSN – Dual coverage contract	87,425	–	87,425
Other	7,613	82,023	89,636
	<u>\$24,142,113</u>	<u>\$37,294,964</u>	<u>\$61,437,077</u>
<u>Increase in premium reserves as of June 30, 2008</u>			
	<u>\$24,142,113</u>	<u>\$37,294,964</u>	<u>\$61,437,077</u>
<u>For plan year ended June 30, 2006:</u>			
VSP – Vision contract	\$ 295,038	\$ 340,390	\$ 635,428
RSN – Dual coverage contract	103,252	–	103,252
Other	34,760	302	35,062
	<u>\$ 433,050</u>	<u>\$ 340,692</u>	<u>\$ 773,742</u>
<u>Increase in premium reserves as of June 30, 2007</u>			
	<u>\$ 433,050</u>	<u>\$ 340,692</u>	<u>\$ 773,742</u>

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS (continued)

All Contracts (continued)

HRS Section 87A does not require the Trust Fund to return insurance carrier refunds, rate credits, interest income and other earnings in excess of funds used to stabilize health benefits plan or long-term care benefits plan costs to the State General Fund and the respective counties. In addition, HRS Section 87A does not require the Trust Fund to return insurance carrier refunds, rate credits and other earnings, as authorized by the Board, to identifiable employees who participated in ascertainable years that created the refund or credit. Accordingly, the Trust Fund recognizes the gains as increases in reserves and related receivable as premium reserves held by insurance companies.

NOTE E – RETIREMENT BENEFITS

1. Employees' Retirement System

Plan Description

All eligible employees of the State are required by Chapter 88 of the Hawaii Revised Statutes to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. The ERS issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information for ERS. That report may be obtained by writing to the ERS at 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

The ERS consists of a contributory plan and a noncontributory plan. Employees covered by Social Security on June 30, 1984 were given the option of joining the noncontributory plan or remaining in the contributory plan. All new employees hired after June 30, 1984, who are covered by Social Security, are generally required to join the noncontributory plan. Both plans provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the payment of salary in lieu of vacation, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after this date is based on the three highest paid years of service excluding the payment of salary in lieu of vacation. Vesting requirements for the contributory and noncontributory plans are five years and ten years, respectively. All contributions, benefits and eligibility requirements are governed by Chapter 88.

On July 1, 2006, a new hybrid contributory plan became effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan are eligible for retirement at age 62 with 5 years of credited service or age 55 and 30 years of credited service. Members will receive a benefit multiplier of 2% for each year of credited service in the hybrid plan. The benefit options are similar to the current contributory plan. Approximately 58,000 current members, all members of the noncontributory plan and certain members of the contributory plan, are eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006 are required to join the hybrid plan.

Hawaii Employer-Union Health Benefits Trust Fund
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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE E – RETIREMENT BENEFITS (continued)

1. Employees' Retirement System (continued)

Funding Policy

Most covered employees of the contributory plan are required to contribute 7.8% of their salary. Police officers, firefighters, investigators of the department of the prosecuting attorney and the attorney general, narcotics enforcement investigators, and public safety investigators are required to contribute 12.2% in 2007 of their salary. The actuarial cost or funding method used to calculate the total employer contribution required is the entry age normal actuarial cost method. Under this method, the total employer contributions to the ERS is comprised of normal cost plus level annual payments required to amortize the unfunded actuarial accrued liability over the closed period ending June 30, 2029.

The employer contribution rate for June 30, 2008 and 2007 was 13.75%.

The Trust Fund's share of the aggregated pension expense was approximately \$151,000 and \$136,000 for the years ended June 30, 2008 and 2007, respectively and are included in the its financial statements.

2. Post-Retirement Health Care and Life Insurance Benefits

Plan Description

In addition to providing pension benefits, the State, pursuant to HRS Chapter 87A, provides certain health care and life insurance benefits to all qualified employees under a multiple employer defined benefit post employment program.

For employees hired before July 1, 1996, the State pays the entire monthly health care premium for employees retiring with ten or more years of credited service, and 50% of the monthly premium for employees retiring with fewer than ten years of credited service.

For employees hired after June 30, 1996, and who retire with fewer than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the retired employees' monthly Medicare or non-Medicare premium. For employees hired after June 30, 1996, and who retire with at least 15 years but fewer than 25 years of service, the State pays 75% of the retired employees' monthly Medicare or non-Medicare premium; for those retiring with over 25 years of service, the State pays the entire health care premium.

For employees hired after June 30, 2001, and who retire with fewer than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the retired employees' monthly Medicare or non-Medicare premium based on the self plan. For employees hired after June 30, 2001, and who retire with at least 15 years but fewer than 25 years of service, the State pays 75% of the retired employees' monthly Medicare or non-Medicare

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE E – RETIREMENT BENEFITS (continued)

2. Post-Retirement Health Care and Life Insurance Benefits (continued)

Plan Description

premium based on the self plan; for those retiring with over 25 years of service, the State pays the entire health care premium based on the self plan.

Funding Policy

For active employees, the employer's contributions are based upon negotiated collective bargaining agreements.

Annual OPEB Cost and Net OPEB Obligation

The Trust Fund's annual other postemployment (OPEB) cost (expense) is allocated by the State based on the Trust Fund's proportionate share of contributions for retiree health benefits and was calculated at .05% of the State's annual required contribution (ARC) for the year ended June 30, 2008. The ARC is an amount actuarially determined in accordance with GASB Statement 45 which was implemented effective July 1, 2007. The following table shows the components of the annual OPEB cost for the year, the amount contributed to the plan, and changes in the Trust Fund's net OPEB obligation.

	2008
Annual required contribution	\$260,951
Interest on net OPEB obligation	–
Adjustment to annual required contribution	–
Annual OPEB cost	260,951
Contributions made	(93,803)
Increase in net OPEB obligation	167,148
Net OPEB obligation at beginning of year	–
Net OPEB obligation at end of year	\$167,148

The percentage of annual OPEB cost contributed was 35.9%.

The Trust Fund's share of the aggregate post retirement benefits expense was approximately \$72,000 for the year ended June 30, 2007 and is included in its financial statements.

Hawaii Employer-Union Health Benefits Trust Fund
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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE E – RETIREMENT BENEFITS (continued)

2. Post-Retirement Health Care and Life Insurance Benefits (continued)

Funded Status, Funding Progress, Actuarial Methods and Assumptions

As of July 1, 2007, the most recent actuarial valuation date, the plan was 0% funded. The funded status, funding progress, actuarial methods and assumptions of the multiple employer plan is disclosed at footnote K. The methods and assumptions used by the State are the same as disclosed in footnote K. The investment rate of return for the State was 5%.

NOTE F – COMMITMENTS AND CONTINGENCIES

1. Deferred Compensation

The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all State employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but does have the duty of due care that would be required of an ordinary prudent investor. Accordingly, the assets and liabilities of the State's deferred compensation plan are not reported in the State's or Trust Fund's financial statements.

2. Litigation

On December 18, 2003, a lawsuit was brought in the First Circuit Court, State of Hawaii, by certain public employees against certain trustees of the Trust Fund and the State (collectively, "State defendants"). The plaintiffs contended that the Trust Fund's trustees breached their fiduciary duties by adopting two-tier rate structures for the Trust Fund's health plans. The plaintiffs claimed that health plans with three or four-tier rate structures were fairer and more equitable to public employees who have a single dependent. In addition to seeking declaratory and injunctive relief, the plaintiffs sought to recover damages based on the difference between what they had been paying under the Trust Fund's two-tier rate structure and what they would have paid under a three or four-tier rate structure. The State defendants were granted summary judgment in this action in an order filed on February 15, 2005. A "Final Judgment in Favor of Defendants and Against Plaintiffs on All Claims" was entered in this action on February 24, 2005. The plaintiffs filed an appeal on March 17, 2005. The appeal was heard by the Hawaii Supreme Court on July 11, 2007. On August 24, 2007, the Hawaii Supreme Court issued an opinion affirming the summary judgment in favor of the State defendants. A Judgment on Appeal was entered on September 21, 2007. The Judgment on Appeal ends this lawsuit.

Hawaii Employer-Union Health Benefits Trust Fund
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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE F – COMMITMENTS AND CONTINGENCIES

2. Litigation (continued)

On June 30, 2006, a class action lawsuit was brought in the First Circuit Court, State of Hawaii, by certain State and county retirees against the Trust Fund, the Trust Fund's board of trustees, and the State ("collectively "State defendants"), as well as various county governments that participate in the Trust Fund's health benefit plans. The plaintiffs' amended complaint alleges various claims based on an argument that the Trust Fund is constitutionally, statutorily, and contractually required to provide health benefit plans that provide retirees and their dependents with benefits that are substantially equal to those provided to active employees and their dependents. In addition, the plaintiffs claim that the Trust Fund's failure to provide substantially equal health benefit plans to retirees and their dependents was negligent. The plaintiffs seek declaratory and injunctive relief, damages, and attorneys' fees and costs. The damages sought appear to be amounts that the plaintiffs (and their class) have paid for health benefits which they would not have paid had their plans been equivalent to the Trust Fund's active employee plans. The defendants filed motions to dismiss the plaintiffs' complaint. The judge decided that the Trust Fund had primary jurisdiction over issues involved in the plaintiffs' claims and stayed this action pending referral of those issues to the Trust Fund. In May and June 2007, the plaintiffs filed a petition with the Trust Fund's board of trustees seeking a declaratory ruling. The Trust Fund's board of trustees held a hearing on the plaintiffs' petition under the Trust Fund rules and Chapter 91 of the Hawaii Revised Statutes ("HRS"). After the hearing, the Trust Fund's board of trustees issued Findings of Fact, Conclusions of Law, and Order. The plaintiffs filed an appeal for judicial review of the Findings of Fact, Conclusions of Law, and Order under HRS §91-14. Plaintiffs appealed the Trust Fund's rulings to the First Circuit Court, State of Hawaii. After briefing and oral argument, the First Circuit Court overturned the EUTF Board's rulings. The State and the EUTF Board have appealed the decision in September 2008 and briefing of the appeal will begin after the record on appeal is transmitted to Hawaii's appellate court. The State defendants intend to vigorously defend this action.

3. Reserve for Encumbrances

The aggregated reserve for outstanding encumbrances as of June 30, 2008 and 2007 amounted to approximately \$8,310,000 and \$319,000, respectively.

NOTE G – RISK MANAGEMENT

The Trust Fund is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; and workers' compensation. The State generally retains the first \$250,000 per occurrence of property losses and the first \$3 million with respect to general liability claims. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is \$25 million (\$10 for earthquake, named hurricane, and flood) and the annual aggregate for general liability losses per occurrence is \$7 million. The State also has an insurance policy to cover medical malpractice risk in the amount of \$30 million per occurrence with no annual aggregate limit.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE G – RISK MANAGEMENT (continued)

The State is generally self-insured for workers' compensation and automobile claims. The State's estimated reserve for losses and loss adjustment costs includes the accumulation of estimates for losses and claims reported prior to fiscal year end, estimates (based on projections of historical developments) of claims incurred but not reported, and estimates of costs for investigating and adjusting all incurred and unadjusted claims. Amounts reported are subject to the impact of future changes in economic and social conditions. The State believes that, given the inherent variability in any such estimates, the reserves are within a reasonable and acceptable range of adequacy. Reserves are continually monitored and reviewed, and as settlements are made and reserves adjusted, the differences are reported in current operations. A liability for a claim is established if information indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss is reasonably estimable.

In accordance with HRS 87A-25, the Trust Fund obtained additional fiduciary liability insurance with an annual aggregate for losses of \$10 million and a fidelity bond to cover employee dishonesty with an annual aggregate for losses of \$1 million. In addition, the Trust Fund also obtained a public officials and employment practices insurance policy to cover any wrongful acts or employment practices violation in which the Trust Fund retains the first \$25,000 per occurrence and the annual aggregate for losses is \$3 million.

NOTE H – ADMINISTRATIVE FEES

The activities of the Trust Fund were principally supported through administrative fees for services. The administrative fees are assessed each pay period and vary depending upon the type of bargaining agreements. For the years ended June 30, 2008 and 2007, the aggregated administrative fees amounted to approximately \$4,970,000 and \$3,600,000, respectively.

NOTE I – CARRIER PAYMENT METHODOLOGY

Premiums paid to the carriers are calculated on a monthly basis by multiplying the total number of active employees and retirees enrolled in the various plans on the last day of the month by the premium rates set forth in the contract agreements, whereas employer and employee billings are calculated on a semi-monthly basis. As a result, the Trust Fund recognizes a gain or loss between the total premiums actually collected from the employers and employees and the total premiums actually paid to the carriers. For the year ended June 30, 2008 and 2007, the Trust Fund recognized aggregated losses of approximately \$66,000 and \$1,174,000, respectively.

NOTE J – LEASE COMMITMENT

The Trust Fund's office is located in the City Financial Tower. The office space was previously being leased and paid for by the State Department of Accounting and General Services for the use of the State Department of Budget and Finance. In December 2004, the State Department of Accounting and General Services (Lessee) entered into a new lease agreement with the Employees' Retirement System of the State of Hawaii (Lessor) for the same office space for the use of the Trust Fund. The lease is being paid for by the Trust Fund.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE J – LEASE COMMITMENT (continued)

The lease commenced on January 1, 2005 and expires on November 30, 2009. The lease includes a renewal and escalation clause. In addition to minimum rent, the lease provides for the payment of common area maintenance charges.

At June 30, 2008, the aggregated minimum rental commitment under the noncancelable operating lease is as follows:

Year ending June 30,	<u>Amount</u>
2009	\$217,000
2010	<u>90,000</u>
	<u><u>\$307,000</u></u>

The aggregated rent expense for the year ended June 30, 2008 and 2007 was \$228,289 and \$224,715, respectively.

NOTE K – FUNDED STATUS AND FUNDING PROGRESS – OPEB PLAN

The funded status of the plan as of the most recent actuarial valuation date is as follows:

Actuarial valuation date	Actuarial value of assets (a)	Actuarial accrued liability (AAL) (b)	Unfunded AAL (UAAL) (b) – (a)	Funded ratio (a) / (b)	Covered payroll (c)	UAAL as of percentage of covered payroll (b) – (a) / (c)
7/1/2007	\$0	\$9,194,300,000	\$9,194,300,000	0%	\$2,789,000,000	330%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

The accompanying schedule of employer contributions present information about the amounts contributed to the plan by employers in comparison to the ARC, an amount that is actuarially determined in accordance with the parameters of GASB Statement 43. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE K – FUNDED STATUS AND FUNDING PROGRESS – OPEB PLAN (continued)

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. Additional information as of the latest actuarial valuation follows:

Valuation date	7/1/07
Actuarial cost method	Entry age normal
Amortization method	Level percentage of pay, open
Amortization period	30 years
Actuarial assumptions:	
Investment rate of return (2)	5% – 8%
Healthcare cost trend rate (1):	
Medical and prescription drug	9.5% initial; 5% ultimate
Dental	7% initial; 4% ultimate
Vision	5% initial; 3% ultimate
Medicare Part B	3.1% initial; 5% ultimate
Projected salary increases	3.5%

(1) Includes an inflation assumption of 3%.

(2) Percentage varies by employer based on anticipated pre-funding.

Membership of the plan consisted of the following at July 1, 2007, the date of the latest actuarial valuation:

Retirees and beneficiaries receiving benefits	36,967
Terminated plan members entitled to but not yet receiving benefits	3,055
Active plan members	<u>51,886</u>
Total	<u><u>91,908</u></u>
Number of participating employers	8

NOTE L – BENEFIT CLAIMS EXPENSE

Beginning July 1, 2007, the Trust Fund offered self-funded medical and prescription drug plans, administered by Hawaii Medical Service Association (HMSA), Health Management Associates (HMA), and National Medical Health Card Systems (NMHCS) under contracts for the period July 1, 2007 through June 30, 2009. Under the self-funded arrangements, the contract administrators provide the Trust Fund provider networks, claims processing, cost containment and other services. Instead of premiums, the Trust Fund pays administrative fees to the contractor for the services rendered and reimburses the contractor for claims paid.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE L – BENEFIT CLAIMS EXPENSE (continued)

Activity in the liability for unpaid benefit claims expense related to the self-funded medical and prescription drug plans for the year ended June 30, 2008 is as follows:

	Active employees	Retirees	Total
Balance at beginning of year	\$ –	\$ –	\$ –
Claims incurred related to current year	222,333,349	141,275,040	363,608,389
Contractor processing administrative fees related to current year	11,693,018	12,301,757	23,994,775
	<u>234,026,367</u>	<u>153,576,797</u>	<u>387,603,164</u>
Paid related to current year	<u>(197,074,575)</u>	<u>(144,361,568)</u>	<u>(341,436,143)</u>
Balance at end of year	<u>\$ 36,951,792</u>	<u>\$ 9,215,229</u>	<u>\$ 46,167,021</u>

The Trust Fund incurred benefit claims expense in excess of contributions for the year ended June 30, 2008. Premium reserve funds were utilized to cover this excess cost. For active employee healthcare benefits, the excess cost of \$40,774,282 is reported as a non-operating expense on the statement of revenues, expenses and changes in net assets – enterprise fund.

According to the terms of contracts with HMSA and NMHCS, the Trust Fund was initially required to make a deposit to cover estimated claims costs for the self-funded medical and prescription drug plans. The deposits held by the carriers for the self-funded medical and prescription drug plans as of June 30, 2008 and 2007 are as follows:

	Active employees	Retirees	Total
HMSA – Medical and drug contract	\$6,300,000	\$ 3,700,000	\$10,000,000
NHMCS – Drug contract	<u>3,008,000</u>	<u>6,392,000</u>	<u>9,400,000</u>
	<u>\$9,308,000</u>	<u>\$10,092,000</u>	<u>\$19,400,000</u>

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE M– CONTRIBUTIONS

The aggregate employer and employee contributions were as follows for the years ended June 30, 2008 and 2007:

	2008	2007
Required contributions		
Employer		
State of Hawaii	\$307,468,074	\$297,608,410
City & County of Honolulu	78,566,154	75,154,478
County of Hawaii	18,094,948	16,941,945
County of Maui	16,152,590	15,272,034
County of Kauai, including Department of Water	8,776,495	8,415,468
Board of Water Supply – Honolulu	5,911,034	5,625,770
Hawaii Department of Water Supply	1,135,213	1,044,391
	436,104,508	420,062,496
Employee	115,650,073	112,905,795
	551,754,581	532,968,291
Pre-funding contributions		
Employer		
Board of Water Supply – Honolulu	2,000,000	–
County of Hawaii	13,613,063	–
County of Maui	12,208,000	–
County of Kauai	6,450,000	–
	34,271,063	–
	\$586,025,644	\$532,968,291

NOTE N – PRIOR-PERIOD ADJUSTMENT

The Statement of Net Assets – Enterprise Fund and Statement of Plan Net Assets have been restated to reflect the correction of the Cash and cash equivalents and Premiums receivable from State of Hawaii and counties amounts. As a result of the restatement, Cash and cash equivalents and the Premiums receivable from State of Hawaii and counties in the Statement of Net Assets – Enterprise Fund decreased and increased by \$2,815,606, respectively. Cash and cash equivalents and the Premiums receivable in the Statement of Plan Net Assets increased and decreased by \$2,815,606, respectively. The restatement has no effect on the changes in net assets – Enterprise Fund or the changes in plan net assets on any of the years presented. Therefore, the

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2008 and 2007

NOTE N – PRIOR-PERIOD ADJUSTMENT (continued)

Statements of Revenues, Expenses and Changes in Net Assets – Enterprise Fund and Statements of Changes in Plan Net Assets have not been restated. The effects of the restatement were as follows:

	2007	
	As previously reported	As restated
Statement of Net Assets – Enterprise Fund		
Cash and cash equivalents	\$56,383,933	\$53,568,327
Premiums receivable from State of Hawaii and counties	4,550,516	7,366,122
Statement of Plan Net Assets		
Cash and cash equivalents	39,096,983	41,912,589
Premiums receivable from State of Hawaii and counties	8,046,720	5,231,114

Hawaii Employer-Union Health Benefit Trust Fund
State of Hawaii

REQUIRED SUPPLEMENTARY INFORMATION
(unaudited)

June 30, 2008

Schedule of Funding Progress

Actuarial valuation Date	Actuarial value of assets (a)	Actuarial accrued liability (AAL) (b)	Unfunded AAL (UAAL) (b) - (a)	Funded ratio (a) / (b)	Covered payroll (c)	UAAL as of percentage of covered payroll (b) - (a) / (c)
7/1/2006	\$0	\$6,269,500,000	\$6,269,500,000	0%	\$2,695,000,000	233%
7/1/2007	\$0	\$9,194,300,000	\$9,194,300,000	0%	\$2,789,000,000	330%

Schedule of Employer Contributions

Year ended June 30,	Annual required contribution	Percentage contribution
2007	\$514,000,000	47%
2008	\$683,500,000	42%

PART II

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS



Report on Internal Control Over Financial Reporting and on Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

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To the Auditor
State of Hawaii

We have audited the financial statements of the Hawaii Employer-Union Health Benefits Trust Fund of the State of Hawaii (Trust Fund), as of and for the year ended June 30, 2008, and have issued our report thereon dated December 18, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Trust Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Trust Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Trust Fund's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency described in the accompanying schedule of findings and responses to be a significant deficiency in internal control over financial reporting.

To the Auditor
State of Hawaii

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be presented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

Compliance and Other Matters

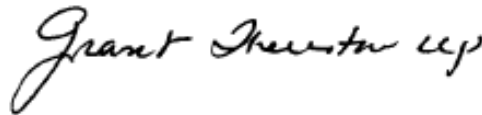
As part of obtaining reasonable assurance about whether the Trust Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D of the Hawaii Revised Statutes) and procurement rules, directives and circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audits, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to the Board of Trustees and management of the Trust Fund in a separate letter dated December 18, 2008.

The Trust Fund's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the Trust Fund's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the State of Hawaii, Board of Trustees and the management of the Trust Fund and is not intended to be and should not be used by anyone other than these specified parties.

Honolulu, Hawaii
December 18, 2008



State of Hawaii
Hawaii Employer-Union Health Benefits Trust Fund

SCHEDULE OF FINDINGS AND RESPONSES

June 30, 2008

Prior-Period Adjustment

Criteria: As a result of audit procedures performed, we brought to management’s attention an adjustment to correct the prior year financial statements regarding cash and cash equivalents and premiums receivable from State of Hawaii and counties.

Condition: While the overall cash and cash equivalents and premiums receivable from State of Hawaii and counties were correct, the balances reported on the separate financial statements for the active and retiree healthcare benefits were inaccurate. As a result, the financial statements for the year ended June 30, 2007 were restated. Cash and cash equivalents and the Premiums receivable from State of Hawaii and counties in the Statement of Net Assets – Enterprise Fund decreased and increased by \$2,815,606, respectively. Cash and cash equivalents and the Premiums receivable in the Statement of Plan Net Assets increased and decreased by \$2,815,606, respectively.

Context: The restated balances at June 30, 2007 were as follows:

Statement of Net Assets – Enterprise Fund	
Cash and cash equivalents	\$53,568,327
Premiums receivable from State of Hawaii and counties	7,366,122
 Statement of Plan Net Assets	
Cash and cash equivalents	41,912,589
Premiums receivable from State of Hawaii and counties	5,231,114

Cause: The finding described above was primarily due to error/oversight.

Effect: The balances were either understated or overstated on the separate financial statements for the active and retiree healthcare benefits at June 30, 2007 by \$2,815,606.

Recommendation: We recommend that management ensure that all transactions in the Trust Funds’s financial statements are properly reported in accordance with generally accepted accounting standards in the United States of America.

View of the responsible official and planned correction actions: Refer to the Response of Affected Agency.

LINDA LINGLE
GOVERNOR



STATE OF HAWAII
HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND

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ADMINISTRATOR
JAMES WILLIAMS

December 18, 2008

Grant Thornton LLP
1132 Bishop Street, Suite 100
Honolulu, Hawaii 96813-2830

Dear Grant Thornton:

Thank you for the opportunity to respond to the audit report of the Hawaii Employer-Union Health Benefits Trust Fund (EUTF) for the fiscal year ended June 30, 2008. The audit report indicated that the EUTF had a deficiency in internal control over financial reporting that is considered to be a significant deficiency. The condition stated in the report was that overall cash and cash equivalents and premiums receivable from State of Hawaii and counties were correct, while the balances reported on the separate financial statements for the active and retiree healthcare benefits were inaccurate. Therefore, financial statements for year ended June 30, 2007 were restated.

For the year ended June 30, 2007, the EUTF reported the retiree healthcare benefits as Other Post Employment Benefits in conformity with Governmental Accounting Standards Board Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other than Pensions* and the active employee healthcare benefits as risk financing in conformity with adopted GASB No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues* as amended. This was the first year that EUTF implemented separate statements.

The EUTF recognizes the issues raised concerning the balances reported and does concur with the restated financial statements for year ended June 30, 2007, however, EUTF does not concur that this is a "significant" deficiency as overall cash and cash equivalents and premiums receivable from State of Hawaii and counties were correct.

The EUTF will improve and strengthen its procedures and controls over the following process:

- Financial Statements for actives and retirees will be reviewed and verified separately.
- Adjusting journal entries that EUTF has prepared will be compared and reconciled on a detailed basis to adjusting journal entries that Grant Thornton proposes and sends to EUTF. Discrepancies will be monitored and documented.

Thank you again for the opportunity to review and respond to the audit report.

Sincerely,~

A handwritten signature in cursive script, appearing to read "Jim Williams".
Jim Williams
Administrator



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