HAWAII EMPLOYER-UNION
HEALTH BENEFITS TRUST FUND
STATE OF HAWAII

Annual Financial Report

June 30, 2011 and 2010

MGO Certified Public Accountants.

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To the Board of Directors of
the Hawaii Employer-Union Health Benefits Trust Fund
of the State of Hawaii and
Ms. Marion Higa, State Auditor
State of Hawaii, Office of the Auditor
Honolulu, HI

Independent Auditor's Report

We have audited the accompanying statements of net assets (deficit) for the enterprise fund and fiduciary assets and liabilities for the agency fund of the Hawaii Employee-Union Health Benefits Trust Fund of the State of Hawaii (Trust Fund) as of June 30, 2011 and 2010, and the related statements of revenues, expenses and changes in net deficit, and cash flows for the enterprise fund for the years then ended. These financial statements are the responsibility of the Trust Fund's management. Our responsibility is to express opinions 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 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 the 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 opinions.

As discussed in Note 1, 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 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, 2011 and 2010, 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 respective financial position of the enterprise fund and agency fund of the Trust Fund as of June 30, 2011 and 2010, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 8 2012, on our consideration of the Trust Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters for the year ended June 30, 2011. 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 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the Four-Year Loss Development Information identified in the accompanying table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information, because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Trust Fund's basic financial statements as a whole. The Schedule of Administrative Operating Expenses – Enterprise Fund and the Schedule of Changes in Fiduciary Assets and Liabilities (Schedules) listed as supplementary information in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The supplementary information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements. These Schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

Macias Gini & O'Connell LLP

Newport Beach, California
February 8, 2012

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, 2011 and 2010. 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. However, if an OPEB plan is not administered as a trust or equivalent arrangement it is required to be reported as an agency fund.

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.

Beginning July 1, 2007 the Trust Fund began offering self-funded medical and prescription drug plans in addition to the fully insured HMO plan. 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.

The Board of Trustees approved exercising its option to extend the contract for two years (July 1, 2009 through June 30, 2011) for Hawaii Dental Service, Hawaii Medical Service Association, Health Management Associates, Kaiser Foundation Health Plan, Inc., Royal State National Insurance Company, Vision Service Plan and for two one year extensions (July 1, 2009, through June 30, 2010, and July 1, 2010, through June 30, 2011) for informedRx and Standard Life Insurance.

Effective February 1, 2010, the Trust Fund Board of Trustees approved a new 80/20 PPO plan administered by Hawaii Medical Service Association (HMSA). The 90/10 PPO plan was administered by Health Management Associates (HMA).

Act 245, Session Laws of Hawaii (SLH) 2005 (partially codified as HRS Chapter 87D), temporarily authorized employee organizations to establish voluntary employees beneficiary association (VEBA) trusts to provide health benefits to state and county employees in their bargaining units outside of the Trust Fund. It established a 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 cancelled from the Trust Fund's health benefit plans. Act 245's sunset dates were amended three times: July 1, 2009, July 1, 2010 and December 31, 2010.

In addition, Chapter 87D of the Hawaii Revised Statues, 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 were required to be enrolled with the HSTA VEBA.

As a result of Act 245 sun setting on December 31, 2010, effective January 1, 2011, approximately, 12,500 HSTA VEBA active employees and 2,500 retirees were transferred to the Trust Fund. In December 2010, Judge Sakamoto (Kona, et al v Abercrombie, Civil No. 10-1-1966-09 KKS) ruled that HSTA VEBA members (actives and retirees) were entitled to the same standard of coverage in benefits when they were transitioned to the Trust Fund on January 1, 2011. The enrollment of HSTA VEBA members into these new Trust Fund-created health and other benefit plans was done solely to comply with Judge Sakamoto's ruling and does not create any constitutional or contractual right to the benefits by these plans. The State does not agree with Judge Sakamoto's ruling. If Judge Sakamoto's ruling is overturned, stayed, or modified, the Trust Fund reserves the right to move HSTA VEBA members into regular Trust Fund plans. See further discussion in Note 9 to the financial statements.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

Enterprise Fund - Active Employee Healthcare Benefits

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

Statement of revenue, expenses and changes in net deficit – 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.

Agency Fund - *Retiree Healthcare Benefits*

Statement of fiduciary assets and liabilities - This statement summarizes the financial position of the OPEB plan assets and liabilities reported as an agency fund.

FINANCIAL HIGHLIGHTS

For the year ended June 30, 2011, the Trust Fund collected in the aggregate $592,493,336 and $165,914,796 in employer and employee contributions for the health benefit plans and Medicare Part B premium reimbursements, respectively, and paid carriers in the aggregate $184,408,814 and $442,031,638 and retirees $47,217,116 in premiums, self-insured claims and Medicare Part B premium reimbursements, respectively, for the year ended June 30, 2011. 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 $5,431,271 for the year ended June 30, 2011. The Trust Fund reported $4,187,438 for carrier retrospective premiums payable as of June 30, 2011.

For the year ended June 30, 2010, the Trust Fund collected in the aggregate $513,232,601 and $160,081,601 in employer and employee contributions for the health benefit plans and Medicare reimbursements, respectively, and paid carriers in the aggregate $157,684,549 and $433,599,594 and retirees $44,830,546 in premiums, self-insured claims and Medicare reimbursements, respectively, for the year ended June 30, 2010. 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 $5,117,032 for the year ended June 30, 2010. The Trust Fund reported $1,268,524 for carrier retrospective premiums payable as of June 30, 2010.

The administrative expenses budgeted for the Trust Fund totaled approximately $4,908,426 for the year ended June 30, 2011. Actual administrative operating expenses for the enterprise fund totaled $4,627,726 for the year ended June 30, 2011. The expenses included $2,034,019 for personnel services; $1,958,482 for consultant services; $37,344 for equipment; $306,199 for lease rent; and $291,682 for other expenses such as open enrollment, office supplies, telephone, travel, repairs and maintenance, copier rental and postage for the year ended June 30, 2011.

The administrative expenses budgeted for the Trust Fund totaled approximately $5,212,288 for the year ended June 30, 2010. Actual administrative operating expenses for the enterprise fund totaled $4,334,911 for the year ended June 30, 2010. The expenses included $1,668,784 for personnel services; $1,787,862 for consultant services; $179,828 for equipment; $314,994 for lease rent; and $383,443 for other expenses such as open enrollment, office supplies, telephone, travel, repairs and maintenance, copier rental and postage for the year ended June 30, 2010.

For the year ended June 30, 2010, the presentation of the operations of the self-insured plans for active employees reported in the enterprise fund was changed to show the aggregate amount of premium revenues recognized as operating revenues and related benefit claims expense incurred as operating expenses. This change was a result of the financial reporting criteria of GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues* (GASB 10), where the risk of loss for these self-insured plans transfers from the employers to the Trust Fund, thus the activity should be reported in aggregate in the statement of revenues, expenses and changes in net deficit. The 2009 amounts in the Financial Analysis section below have been restated to reflect this change in order to be comparable to the 2010 amounts.

FINANCIAL ANALYSIS

Enterprise Fund

A summary of the Trust Fund's net assets (deficit) for active employees is shown below as of June 30, 2011 and 2010:

	2011	2010	Change	% Change
Assets				
Current assets	$ 54,294,191	$ 36,830,892	$ 17,463,299	47.4%
Capital assets	7,217,258	8,658,429	(1,441,171)	-16.6%
Total assets	61,511,449	45,489,321	16,022,128	35.2%
Liabilities				
Current liabilities	62,685,806	49,734,089	12,951,717	26.0%
Long-term liabilities	901,744	680,580	221,164	32.5%
Total liabilities	63,587,550	50,414,669	13,172,881	26.1%
Net assets (deficit)				
Invested in capital assets	7,217,258	8,658,429	(1,441,171)	-16.6%
Unrestricted	(9,293,359)	(13,583,777)	4,290,418	31.6%
Total net deficit	$ (2,076,101)	$ (4,925,348)	$ 2,849,247	57.8%

The enterprise fund's total assets increased by approximately $16.0 million or 35.2% during the fiscal year ended June 30, 2011. The increase is primarily attributable to the following: 1) an increase of approximately $8 million to the premiums receivable from State of Hawaii and Counties due to an increase to active employee rates effective March 1, 2011, and effective January 1, 2011, the enrollment of approximately 12,500 HSTA VEBA actives and 2,500 HSTA VEBA retirees into the trust fund; and 2) an increase in cash and cash equivalents of approximately $10.2 million due lower than projected claim benefit payments in the self-funded accounts.

The enterprise fund's total liabilities increased by approximately $13.2 million or 26.1% during the fiscal year ended June 30, 2011. The increase was attributable to the following: 1) an increase to the retrospective premium payable of approximately $2 million, which represents 5% of premiums held back by the Trust Fund as an estimated contingency in the event the Trust Fund incurs expenses greater than premiums paid., 2) an increase to the premiums payable account in the amount of approximately $7.2 million due to the HSTA VEBA members enrollment into the Trust Fund, 3) an increase in the benefit claims payable in the amount of approximately $3.1 million

There was approximately $2.8 million or 57.8% reduction of the Total Net Deficit for the year ended June 30, 2011. This is primarily attributable to a $3.9 million net decrease in self-insured claims expense and change in incurred but not reported claims expense, off-set by a decrease in self-insured premium revenues of $10.0 million.

A summary of the Trust Fund's net assets (deficit) for active employees is shown below as of June 30, 2010 and 2009:

	2010	2009*	Change	% Change
Assets				
Current assets	$ 36,830,892	$ 32,496,347	$ 4,334,545	13.3%
Capital assets	8,658,429	6,554,713	2,103,716	32.1%
Total assets	45,489,321	39,051,060	6,438,261	16.5%
Liabilities				
Current liabilities	49,734,089	56,296,172	(6,562,083)	-11.7%
Long-term liabilities	680,580	424,620	255,960	60.3%
Total liabilities	50,414,669	56,720,792	(6,306,123)	-11.1%
Net assets (deficit)				
Invested in capital assets	8,658,429	6,554,713	2,103,716	32.1%
Unrestricted	(13,583,777)	(24,224,445)	10,640,668	43.9%
Total net deficit	$ (4,925,348)	$ (17,669,732)	$ 12,744,384	72.1%

* 2009 balances were restated to reflect amounts reclassified from the agency fund to the enterprise fund to better account for and report administrative costs to administer the Trust Fund. Balances affected include capital assets, current assets and current liabilities.

The enterprise fund's total assets increased by approximately $6.4 million or 16.5% during the fiscal year ended June 30, 2010. The increase is primarily attributable to the following: 1) an increase to active employee rates effective July 1, 2009, caused an increase of approximately $4.2 million to the premiums receivable from State of Hawaii and Counties, 2) an increase of approximately $2.3 million in deposits to HMA due to the increase in enrollment count for the 90/10 PPO plan effective February 1, 2010, 3) an increase of approximately $3.0 million in the capital assets due to the implementation of the new Benefits Administration System effective September 2009.

The enterprise fund's total liabilities decreased by approximately $6.3 million or 11.1% during the fiscal year ended June 30, 2010. The decrease is primarily attributable to the decrease of approximately $7.7 million in benefit claims liability payable to the self-funded carriers. There was also an increase in Trust Fund's OPEB liability.

There was approximately $12.7 million or 72.1% reduction of the Total Net Deficit for the year ended June 30, 2010. This is primarily attributable to the $14.6 million decrease in claims expense which caused a net gain in the self-funded plans.

A summary of changes in net deficit for the years ended June 30, 2011 and 2010, for active employees follows:

	2011	2010*	Change	% Change
Revenues				
Operating revenues	$ 248,953,635	$ 258,717,861	$ (9,764,226)	-3.8%
Nonoperating revenues	1,147,445	4,348,544	(3,201,099)	-73.6%
Total revenues	250,101,080	263,066,405	(12,965,325)	-4.9%
Expenses				
Operating expenses	247,251,833	250,322,021	(3,070,188)	-1.2%
Total expenses	247,251,833	250,322,021	(3,070,188)	-1.2%
Increase (decrease) in net assets	2,849,247	12,744,384	(9,895,137)	77.6%
Net deficit at beginning of year, as restated	(4,925,348)	(17,669,732)	12,744,384	-72.1%
Total net deficit at end of year	$ (2,076,101)	$ (4,925,348)	$ 2,849,247	57.8%

The enterprise fund's total revenues decreased by approximately $13.0 million or 4.9% for fiscal year ended June 30, 2011. The enterprise fund's operating revenues decreased due to the decrease in premium revenue for self insurance plans. In February 2010, the Trust Fund offered a new HMSA 80/20 PPO plan. This plan had lower premiums than the 90/10 PPO plan and was the prevalent plan. The nonoperating revenues decreased due to $3.2 million decrease of subsidy from the agency fund and interest income.

The enterprise fund's operating expenses decreased by approximately $3.1 million or 1.2% for fiscal year ended June 30, 2011. There was approximately $7.9 million decrease in claims expenses and $4.0 million increase in incurred but not reported claims.

The enterprise fund's total net deficit changed by approximately $2.8 million or 57.8% for fiscal year ended June 30, 2011. This is primarily attributable to a $3.9 million net decrease in self-insured claims expense and change in incurred but not reported claims expense due to the addition of the HMSA 80/20 PPO plan effective February 1, 2010, off-set by a decrease in self-insured premium revenues of $10.0 million.

A summary of changes in net deficit for the years ended June 30, 2010 and 2009, for active employees follows:

	2010	2009*	Change	% Change
Revenues				
Operating revenues	$ 258,717,861	$ 225,420,482	$ 33,297,379	14.8%
Nonoperating revenues	4,348,544	15,063,335	(10,714,791)	-71.1%
Total revenues	263,066,405	240,483,817	22,582,588	9.4%
Expenses				
Operating expenses	250,322,021	272,534,878	(22,212,857)	-8.2%
Total expenses	250,322,021	272,534,878	(22,212,857)	-8.2%
Increase (decrease) in net assets	12,744,384	(32,051,061)	44,795,445	139.8%
Net deficit at beginning of year, as restated	(17,669,732)	14,381,329	(32,051,061)	-222.9%
Total net deficit at end of year	$ (4,925,348)	$ (17,669,732)	$ 12,744,384	72.1%

* 2009 balances were restated to reclassify revenues related to self-insured plans as operating revenues and related claims expense as operating expenses. In addition, amounts previously reported as transfers are now classified as nonoperating revenues. Furthermore, amounts were reclassified from the agency fund to the enterprise fund to better account for and report administrative costs to administer the Trust Fund. Balances affected by the reclassification of agency fund activity include operating revenues and operating expenses.

The enterprise fund's total revenues increased by approximately $22.6 million or 9.4% for fiscal year ended June 30, 2011. The enterprise fund's operating revenues increased due to the increase in active employee rates effective July 1, 2009. The nonoperating revenues decreased due to $12.6 million decrease of subsidy from the agency fund.

The enterprise fund's operating expenses decreased by approximately $22.2 million or 8.2% for fiscal year ended June 30, 2011. There was approximately $900,000 increase in informedRx prescription drug rebate, $14.6 million decrease in claims expenses and $3.3 million decrease in incurred but not reported claims.

The enterprise fund's total net deficit changed by approximately $12.7 million or 72.1% for fiscal year ended June 30, 2011. This increase is attributable to the increase of active employee rates effective July 1, 2009, and the addition of the 80/20 PPO plan effective February 1, 2010.

Agency Fund

A summary of the Trust Fund's plan assets and liabilities for retirees is shown below as of June 30, 2011 and 2010:

	2011	2010	Change	% Change
Assets:				
Cash and cash equivalents	$ 90,800,499	$ 49,889,100	$ 40,911,399	82.0%
Cash and cash equivalents - pre-funding deposits	-	135,182,090	(135,182,090)	-100.0%
Cash and investments held by fiscal agent	169,272,987	-	169,272,987	n/a
Receivables	37,806,413	31,098,553	6,707,860	21.6%
Deposits	10,248,076	10,248,076	-	0.0%
Total assets	$ 308,127,975	$ 226,417,819	$ 81,710,156	36.1%
Liabilities:				
Premiums payables	$ 7,921,812	$ 5,716,500	$ 2,205,312	38.6%
Benefit claims payable	15,275,791	12,867,761	2,408,030	18.7%
Amounts held on behalf of employers for benefits	282,990,527	206,816,699	76,173,828	36.8%
Other	1,939,845	1,016,859	922,986	90.8%
Total liabilities	$ 308,127,975	$ 226,417,819	$ 81,710,156	36.1%

The agency fund's cash and cash equivalents increase of approximately $40.9 million was mainly attributable to the net experience gain of self-funded plans for retirees. The net gain increase was approximately $29.0 million. There also was a $0.58 million write-up of investments held in the State investment pool. At the end of fiscal year ended June 30, 2011, the OPEB pre-funding deposits by various employers were being held by a fiscal agent. The $34.1 million, net of the agency fund's cash and cash equivalents – pre funding deposits decrease of approximately $135.2 million, offset with the agency fund's cash and investment held by fiscal agent increase of approximately $169.3 million was attributable to the collection of pre-funding deposits for OPEB by various employers. The agency fund's receivables account increase of $6.7 million was attributable to the increase in retiree rates effective January 1, 2011.

The agency fund's premiums payable increase of approximately $2.2 million was due to the increase in retiree rates. The agency fund's benefit claims payable increase of approximately $2.4 million was attributable to an increase in premiums and the addition of the participants in the HSTA VEBA Trust for fiscal year ended June 30, 2011. The amounts held on behalf of employees for benefits increase of approximately $76.9 million was attributable to the following: 1) an increase in OPEB pre-funding deposits by various employers, 2) write-up of investments held in State investment pool, 3) increase in net gain from the self-funded plans due to the increase in premium revenue being more than the increase in benefit claims expenses.

A summary of the Trust Fund's plan assets and liabilities for retirees is shown below as of June 30, 2010 and 2009:

	2010	2009*	Change	% Change
Assets:				
Cash and cash equivalents	$ 49,889,100	$ 32,159,322	$ 17,729,778	55.1%
Cash and cash equivalents - pre-funding deposits	135,182,090	93,707,587	41,474,503	44.3%
Receivables	31,098,553	27,041,670	4,056,883	15.0%
Deposits	10,248,076	10,092,000	156,076	1.5%
Total assets	$ 226,417,819	$ 163,000,579	$ 63,417,240	38.9%
Liabilities:				
Premiums payables	$ 5,716,500	$ 4,688,210	$ 1,028,290	21.9%
Benefit claims payable	12,867,761	14,318,267	(1,450,506)	-10.1%
Amounts held on behalf of employers for benefits	206,816,699	142,948,269	63,868,430	44.7%
Other	1,016,859	1,045,833	(28,974)	-2.8%
Total liabilities	$ 226,417,819	$ 163,000,579	$ 63,417,240	38.9%

* 2009 balances were restated to reflect amounts reclassified from the agency fund to the enterprise fund to better account for and report administrative costs to administer the Trust Fund. The agency fund no longer reports prepaid expenses, capital assets, vouchers and contracts payable, accrued wages and employee benefits, and compensated absences.

The agency fund's cash and cash equivalents increase of approximately $17.7 million was mainly attributable to the decrease of approximately $11.4 million in claims expenses during the year and a $1.2 million write-up of investments held in the State investment pool. The agency fund's cash and cash equivalents – pre funding deposits increase of approximately $41.5 million was attributable to the collection of pre-funding deposits for OPEB by various employers. The agency fund's receivables account increase of $4.1 million was attributable to the increase in retiree rates effective July 1, 2009 and January 1, 2010.

The agency fund's premiums payable increase of approximately $1.0 million was due to the increase in retiree rates. The agency fund's benefit claims payable decrease of approximately $1.4 million was attributable to lower claims expenses for fiscal year ended June 30, 2010. The amounts held on behalf of employees for benefits increase of approximately $63.9 million was attributable to the following: 1) an increase in OPEB pre-funding deposits by various employers, 2) write-up of investments held in State investment pool, 3) increase in net gain from the self-funded plans due to a decrease in benefit claims expenses and increase in premium revenue.

CAPITAL ASSETS

The aggregated net asset value of capital assets was $7,217,258 at June 30, 2011. The aggregated depreciation expense totaled $1,547,140 for the year ended June 30, 2011. The Trust Fund acquired $106,000 in computer hardware/equipment related to its disaster recovery contingency plan. There were no disposals of capital assets during fiscal year 2011.

The aggregated net asset value of capital assets was $8,658,429 at June 30, 2010. The aggregated depreciation expense totaled $914,118 for the year ended June 30, 2010. 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 Administration System for the Trust Fund. The new Benefits Administration System was implemented in September 2009.

ECONOMIC FACTORS AFFECTING NEXT YEAR

Factors Affecting 2012

The carrier contracts for the active employees and retiree plans for the Trust Fund, including contracts for HSTA participants were extended from July 1, 2011, through December 27, 2011, and again from December 28, 2011, through December 31, 2011. Approvals were received from the State Procurement Office to extend these contracts. In addition contracts for prescription drug plans were extended for six months from January 1, 2012. In April 2011, the Trust Fund issued Request for Proposals seeking proposals to provide medical, prescription drug, dental, vision and life benefit plans effective January 1, 2012. The evaluation committee made recommendations in June 2011 and July 2011, to the Board of Trustees, which approved awards of contracts for all plans. A procurement protest was filed by the Trust Fund's current carrier challenging the awards for the prescription drug plans. In December 2011, the State's hearings officer rendered a decision and affirmed the award of the contract to the carrier selected by the Board of Trustees for the active employees and non-Medicare retirees. The Trust Fund will implement effective May 1, 2012. The contract award for Medicare eligible retirees was vacated and sent back to the evaluation committee. In January 2012, the evaluation committee made a recommendation to the Board of Trustees which approved the award of the contract for prescription drug plan for Medicare eligible retirees.

The current self-funded arrangement with the medical plans (HMSA) will change to participating fully insured plans effective January 1, 2012. The dental and vision plans were changed from retrospective premium plans to participating fully insured plans. The Prescription drug plan will be the only plan with a self-funded arrangement effective January 1, 2012.

The Federal Affordable Care Act became effective July 1, 2011 for the Trust Fund's active employee plan. The plan lost its grandfather status due to the increase in the employees' share of premiums effective the same day. The definition of dependent child was expanded to age 26 and requirements that the child be unmarried and a full time student were dropped. Additional dependents were enrolled as a result.

Under GASB 43, the Trust Fund does not meet the criteria of a trust fund, therefore, deposits made by employers to the Trust Fund do not meet the criteria of contributions to other postemployment benefits (OPEB) that may be considered an asset to offset the liability. The Trust Fund submitted legislation to the 2012 Legislature (HB2491 and SB2753) to administer a separate trust fund for the purpose of receiving employer contributions that will prefund OPEB costs for retirees and their beneficiaries.

Factors Affecting 2011

Effective January 1, 2011, the Hawaii State Teacher's Association (HSTA) voluntary employees beneficiary association (VEBA) health benefit plan was terminated and all employees will receive benefits through the Trust Fund. Approximately, 12,500 HSTA VEBA active employees and 2,500 retirees were transferred to the Trust Fund. In December 2010, Judge Sakamoto ruled that HSTA VEBA members (actives and retirees) were entitled to the same standard of coverage in benefits when they were transitioned to the Trust Fund on January 1, 2011.

REQUEST FOR INFORMATION

This financial report is designed to provide the Board of Trustees, State Auditor, and our membership, with a general overview of the Trust Fund's finances and to account for the money it receives. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to:

Hawaii Employer-Union Health Benefits Trust Fund
P.O. Box 2121
Honolulu Hawaii 96805-2121

Respectfully Submitted,

Barbara Coriell
Administrator

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HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
STATE OF HAWAII

ENTERPRISE FUND
Statements of Net Assets (Deficit)
June 30, 2011 and 2010

	2011	2010
Assets		
Current assets		
Cash and cash equivalents (Note 3)	$ 10,205,190	$ -
Receivables		
Premiums receivable from State of Hawaii and counties	31,071,398	23,024,861
Other receivables held by insurance companies (Note 5)	260,576	31,696
Rebates receivable (Note 5)	908,865	1,755,967
Accrued interest receivable	96,552	328,172
Prepaid expenses	242,930	181,516
Deposits (Note 6)	11,508,680	11,508,680
Total current assets	54,294,191	36,830,892
Capital assets, net of accumulated depreciation of $6,527,399 in 2011 and $4,980,259 in 2010 (Note 4)	7,217,258	8,658,429
Total assets	61,511,449	45,489,321
Liabilities		
Current Liabilities		
Vouchers and contracts payable	320,041	108,345
Accrued wages and employee benefits payable	181,006	109,786
Due to State of Hawaii	21,360	196,075
Due to employees	1,219,222	669,224
Retrospective premiums payable (Note 5)	2,254,527	254,142
Premiums payable (Note 5)	17,228,808	10,026,690
Benefit claims payable (Note 6)	41,392,678	38,334,060
Compensated absences, current portion	68,164	35,767
Total current liabilities	62,685,806	49,734,089
Noncurrent Liabilities		
Compensated absences (Note 2)	166,546	136,890
Other post-employment benefits (Note 8B)	735,198	543,690
Total liabilities	63,587,550	50,414,669
Net Assets (Deficit)		
Net assets		
Invested in capital assets	7,217,258	8,658,429
Unrestricted	(9,293,359)	(13,583,777)
Total net deficit	$ (2,076,101)	$ (4,925,348)

See accompanying notes to financial statements.

HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
STATE OF HAWAII

ENTERPRISE FUND
Statements of Revenues, Expenses, and Changes in Net Assets (Deficit)
Years ended June 30, 2011 and 2010

	2011	2010
Operating revenue		
Premium revenue-self insurance	$ 243,323,819	$ 253,295,079
Administrative fee (Note 2)	3,217,590	3,019,049
Administrative fee-Agency Fund (Note 2)	2,213,681	2,097,983
Increase in premium reserves - fully insured risk sharing plans	198,545	305,750
Total operating revenues	248,953,635	258,717,861
Operating expense		
Claims expense-self insurance (Note 6)	240,391,553	248,281,987
Change in incurred but not reported (IBNR) claims	657,100	(3,310,000)
Gain/loss on carrier payment methodology (Note 2)	28,314	101,005
Depreciation (Note 4)	1,547,140	914,118
Administrative operating expenses	4,627,726	4,334,911
Total operating expenses	247,251,833	250,322,021
Operating income	1,701,802	8,395,840
Nonoperating revenue (expense)		
Interest income and other, net of write up of investments held in State pool of $743,937 in 2011 and $1,806,133 in 2010. (Note 3)	1,147,445	2,150,063
Subsidy from Agency Fund (Note 7)	-	2,198,481
Total nonoperating revenues and expenses	1,147,445	4,348,544
INCREASE IN NET ASSETS	2,849,247	12,744,384
Total net deficit at beginning of year	(4,925,348)	(17,669,732)
Total net deficit at end of year	$ (2,076,101)	$ (4,925,348)

See accompanying notes to financial statements.

HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
STATE OF HAWAII

ENTERPRISE FUND
Statements of Cash Flows
Years ended June 30, 2011 and 2010

	2011	2010
Cash flows from operating activities:		
Cash paid to vendors	$ (2,443,425)	$ (3,043,867)
Cash paid to employees	(1,709,238)	(1,510,134)
Cash received from State of Hawaii, counties and individuals for premiums and benefit payments	241,282,381	253,145,274
Cash paid for premiums and benefit payments	(230,702,479)	(256,010,350)
Rebates received related to prescription drug plan	2,733,735	5,087,297
Reserves returned by insurance carriers	(228,880)	854,021
Net cash provided by (used in) operating activities	8,932,094	(1,477,759)
Cash flows from capital and related financing activities:		
Purchases of furniture, equipment and software development	(105,969)	(3,017,834)
Net cash used in capital and related financing activities	(105,969)	(3,017,834)
Cash flows from non-capital and related financing activities:		
Subsidy from Agency Fund	-	2,198,481
Net cash provided by non-capital and related financing activities	-	2,198,481
Cash flows from investing activities:		
Interest received	1,379,065	2,297,112
Net cash provided by investing activities	1,379,065	2,297,112
Net change in cash and cash equivalents	10,205,190	-
Cash and cash equivalents at beginning of year	-	-
Cash and cash equivalents at end of year	$ 10,205,190	$ -
Reconciliation of operating income to net cash provided by (used in) operating activities:		
Operating income	$ 1,701,802	$ 8,395,840
Adjustments to reconcile operating income to net cash (used) by operating activities:		
Depreciation	1,547,140	914,118
Increase in premiums receivable from State of Hawaii and counties	(8,046,537)	(4,221,661)
(Increase) decrease in other receivables held by insurance companies	(228,880)	854,021
Decrease in rebates receivable	847,102	1,234,302
Increase in prepaid expenses	(61,414)	(147,576)
Increase in deposits	-	(2,200,680)
Increase (decrease) in vouchers and contracts payable	211,696	(230,164)
Increase (decrease) in accrued wages and employee benefits payable	71,220	(25,663)
Increase (decrease) in amounts due to State of Hawaii	(174,715)	187,896
Increase in amounts due to employees	549,998	661,858
Increase (decrease) in retrospective premiums payable to carriers	2,000,385	(1,589,172)
Increase in premiums payable to carriers	7,202,118	2,164,162
Increase (decrease) in benefits claims payable	3,058,618	(7,659,353)
Increase in compensated absences	62,053	-
Increase in other postemployment benefits	191,508	184,313
Total adjustments	7,230,292	(9,873,599)
Net cash provided by (used in) operating activities	$ 8,932,094	$ (1,477,759)

See accompanying notes to financial statements.

HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
STATE OF HAWAII

AGENCY FUND
Statements of Fiduciary Assets and Liabilities
June 30, 2011 and 2010

	2011	2010
Assets		
Cash and cash equivalents (Note 3)	$ 90,800,499	$ 49,889,100
Cash received for pre-funding deposits (Note 3)	-	135,182,090
Cash and investments held by fiscal agent (Note 3)	169,272,987	-
Receivables		
Medicare reimbursements from individuals, net of allowance of $491,146 in 2011 and $403,332 in 2010	389,207	173,878
Premium receivable from State of Hawaii and counties	32,274,892	27,283,772
Other receivables held by insurance companies (Note 5)	42,721	24,584
Rebates receivable (Note 5)	5,063,909	3,385,529
Accrued interest receivable	35,684	230,790
Total receivables	37,806,413	31,098,553
Deposits (Note 6)	10,248,076	10,248,076
Total assets	$ 308,127,975	$ 226,417,819
Liabilities		
Due to State of Hawaii	$ 62	$ 62
Due to retirees	6,872	2,415
Retrospective premium payable (Note 5)	1,932,911	1,014,382
Premiums payable (Note 5)	7,921,812	5,716,500
Benefit claims payable (Note 6)	15,275,791	12,867,761
Amounts held on behalf of employers for benefits	282,990,527	206,816,699
Total liabilities	$ 308,127,975	$ 226,417,819

See accompanying notes to financial statements.

(1) 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.

Act 245, Session Laws of Hawaii 2005, established a voluntary employees' beneficiary association (VEBA) trust pilot program for the administration of the healthcare benefits for active employees and retirees, which the Hawaii State Teachers Association (HSTA) implemented in March 2006. The program sunset date was December 31, 2010, and the VEBA trust was terminated. Effective January 1, 2011, all HSTA employees and retirees receiving benefits under the VEBA trust were enrolled in the benefit programs administered through the Trust Fund. Approximately, 12,500 HSTA active employees and 2,500 retirees 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 (Board) composed of ten trustees appointed by the Governor of the State. 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 preferred provider organization 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.

The Trust Fund provided insurance coverage to approximately the following individuals as of June 30, 2011 and 2010:

	2011	2010
Active employees	66,350	53,900
Retirees	41,704	39,285
Dependents	77,384	77,840
Total	185,438	171,025

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Proprietary Fund (Enterprise Fund) **-** The accounting for the active employee healthcare benefits is 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 enterprise fund operations are reported using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the timing of cash flows.

The enterprise fund statements apply all effective pronouncements of the Governmental Accounting Standards Board (GASB). In addition, these statements apply all Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedures, Accounting Principles Board Opinions (APBO) and Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989, except those that conflict with GASB pronouncements. The Trust Fund has elected not to apply the FASB pronouncements on accounting and financial reporting that were issued after November 30, 1989.

The enterprise fund distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services or goods in connection with the enterprise fund's ongoing operations. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. The principal operating revenues of the Trust Fund are premium contributions and administrative fees. Interest income from investments is reported as nonoperating income.

Fiduciary Fund (Agency Fund) **-** The Trust Fund reports assets and liabilities in an agency fund resulting from the collection of contributions from employers and retirees and payments of postemployment health benefits for retirees and their beneficiaries.

The Trust Fund follows GASB 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 organizations to report a statement of fiduciary assets and liabilities – agency fund for multiple-employer OPEB plans that are not administered as trusts or equivalent arrangements. For fiscal years 2011 and 2010, the Trust Fund does not meet the criteria of a trust or equivalent arrangement for the purposed of GASB 43, thus assets and liabilities for the postemployment health benefits are reported as an agency fund.

The agency fund is reported using the same basis of accounting as the enterprise fund. The agency fund is reported using the accrual basis of accounting. The agency fund reports no plan net assets and the assets accumulated in excess of liabilities are reported as a liability for amounts held on behalf of employers for postemployment health benefits.

Financial Statement Presentation **-** The reporting of active and postemployment (including their respective beneficiaries) healthcare benefits provided through the same plan should separate the two benefits for accounting purposes between active and postemployment healthcare benefits. Accordingly, the Trust Fund reports the postemployment healthcare benefits in conformity with GASB 43 and the active employee healthcare benefits as risk financing in conformity with GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues* (GASB 10), as amended. The Trust Fund administers postemployment healthcare benefits under an agent multiple-employer defined benefit plan as defined by GASB 43.

In fiscal years 2011 and 2010, the accounting for the active employee healthcare benefits are reported under the statements of net assets (deficit) – enterprise fund, statements of revenue, expenses and changes in net deficit – enterprise fund and statements of cash flows – enterprise fund. The accounting for the postemployment healthcare benefits are reported in the statements of fiduciary assets and liabilities – agency fund. For financial reporting purposes, certain assets, liabilities, revenues and inflows and expenses and outflows have been allocated for the separate accounting of active employees and postemployment healthcare benefits.

Capital Assets

The Trust Fund's capital assets consist of furniture, equipment and software 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 seven years.

Cash and Cash Equivalents

Cash and cash equivalents represent amounts held in and by the State Treasury. The Trust Fund invests funds in the State Treasury cash and investment pool (State Pool) as well as directs the State Treasurer to invest in specific investments outside of the State Pool. Investments are reported in the accompanying statement of net assets (deficit) and statement of fiduciary assets and liabilities at fair value. Changes in fair value that occur during a fiscal year are recognized as interest income in the statement of revenues, expenses and changes in net deficit and as a change in amounts held on behalf of employers for benefits in the statement of fiduciary assets and liabilities reported for that fiscal year.

For the purposes of the accompanying statement of cash flows, the enterprise fund considers all highly liquid investments with maturities of three months or less when purchased, and their equity in the State Pool to be cash equivalents.

<u>Compensated Absences</u>

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 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 compensated absence liabilities for accumulated vacation is as follows for the years ended June 30, 2011 and 2010:

	2011	2010
Balance at beginning of year	$ 172,657	$ 186,110
Additions	107,390	88,627
Reductions	(45,337)	(102,080)
Balance at end of year	234,710	172,657
Less current portion	(68,164)	(35,767)
	$ 166,546	$ 136,890

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, 2011 and 2010, relating to the Trust Fund approximated $528,447 and $384,855.

<u>Receivables</u>

Receivables consist 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 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.

<u>Risk Management</u>

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 as of the date of the financial statements and the amount of the loss is reasonably estimable.

<u>Benefits Claims Expense and Cost</u>

The benefits claims expense reported in the enterprise fund relates to the self-funded medical and prescription drug plans and includes the ultimate net cost of all reported claims incurred through the end of the fiscal year, for active employee healthcare benefits. The benefits claims expense also includes an additional estimate for unreported claims that have been incurred as of fiscal year-end. The cost of benefits claims for retirees, which also include provisions for unreported claims, are reported as a component of benefit claims payable in the agency fund.

Management has made certain assumptions based on currently available information and industry statistics in determining the benefits claims 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 claims expense, such aggregate liabilities are within a reasonable range of adequacy. Such estimates are based on estimated claims cost reported prior to fiscal year-end, 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. Rebates receivable are recorded in the period that the claim is paid and is netted against the cost of the claim.

Management recorded its best estimate for the obligation of unpaid claims of $41,392,678 and $38,334,060 for active employees and $ 15,275,791 and $12,867,761 for retirees as of June 30, 2011 and 2010, respectively, based on the Trust Fund's consulting actuary's estimate for the liability for unpaid claims. These amounts include administrative fees payable to the contracted plan administrator for services provided and benefit claims incurred as of June 30, 2011 and 2010.

<u>Carrier Payment Methodology</u>

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 years ended June 30, 2011 and 2010, respectively, the Trust Fund recognized losses of approximately $28,314 and $101,005 and $25,110 and $89,570, related to active employees and retirees, respectively.

HRS Section 87A states that the Trust Fund employer contributions are irrevocable. 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 gain/loss on carrier payment methodology and related receivable as other receivables held by insurance companies.

Administrative Fees

The Trust Fund assesses and collects administrative fees from employers to support the activities of the Trust Fund. The administrative fees are assessed each pay period and vary depending upon the type of bargaining agreements. For the years ended June 30, 2011 and 2010, respectively, the administrative fees charged to participating agencies to administer the plans was $3,217,590 and $3,019,049 and $2,213,681 and $2,097,983 for active employees and retirees, respectively. These amounts are recognized as revenues in the enterprise fund, as all administrative expenses are recognized in the enterprise fund.

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 and 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.

Reclassifications

Certain reclassifications have been made to the 2010 financial statement in order to conform to the current year presentation.

(3) CASH AND INVESTMENTS

As of June 30, 2011 and 2010, the Trust Fund's cash and investments were distributed and reported in the financial statements as follows:

	2011		
	Enterprise Fund	Agency Fund	Total
Cash and cash equivalents:			
Cash	$ -	$ 18,636,214	$ 18,636,214
Equity in the State Pool	10,205,190	90,800,499	101,005,689
Mutual funds	-	150,636,773	150,636,773
Total	$ 10,205,190	$ 260,073,486	$ 270,278,676

	2010		
	Enterprise Fund	Agency Fund	Total
Cash and cash equivalents:			
Certificates of deposit	$ -	$ 55,552,264	$ 55,552,264
Equity in the State Pool	-	51,889,100	51,889,100
Repurchase agreements	-	77,629,826	77,629,826
Total	$ -	$ 185,071,190	$ 185,071,190

Trust Fund Investment Pool

The Trust Fund invests funds received from employers to fund future OPEB benefits as they become due. The Board is responsible for safekeeping these monies and has appointed an Investment Committee responsible for investing Trust Fund assets in compliance with applicable HRS and with the foremost intention of providing sufficient investment appreciation to meet the current and future OPEB benefit payments. Cash is pooled with funds from employers and is invested in accordance with the Trust Fund's Statement of Investment Policy and Guidelines (Investment Policy).

Investments Authorized - Section 87A-24(2) of the HRS empowers the Board to invest monies "in the same manner specified in section 88-119(1)(A), (1)(B), (1)(C), (2), (3), (4), (5), (6), and (7)." Permissible investments under section 88-119 "Investments" are as follows:

(1) Real estate loans and mortgages. Obligations (as defined in section 431:6-101) of any of the following classes:
- (a) Obligations secured by mortgages of nonprofit corporations desiring to build multi-rental units (ten units or more) subject to control of the government for occupancy by families displaced as a result of government action;
- (b) Obligations secured by mortgages insured by the Federal Housing Administration;
- (c) Obligations for the repayment of home loans made under the Servicemen's Readjustment Act of 1944 or under Title II of the National Housing Act;

(2) Government obligations, etc. Obligations of any of the following classes:
- (a) Obligations issued or guaranteed as to principal and interest by the United States or by any state thereof or by any municipal or political subdivision or school district of any of the foregoing; provided that principal of and interest on the obligations are payable in currency of the United States; or sovereign debt instruments issued by agencies of, or guaranteed by foreign governments;
- (b) Revenue bonds, whether or not permitted by any other provision hereof, of the State or any municipal or political subdivision thereof, including the board of water supply of the city and county of Honolulu, and street or improvement district bonds of any district or project in the State; and
- (c) Obligations issued or guaranteed by any Federal Home Loan Bank, including consolidated Federal Home Loan bank obligations, the Home Owner's Loan Corporation, the Federal National Mortgage Association, or the Small Business Administration;

(3) Corporate obligations. Below investment grade or nonrated debt instruments, foreign or domestic, in accordance with investment guidelines adopted by the board;

(4) Preferred and common stocks. Shares of preferred or common stock of any corporation created or existing under the laws of the United States or of any state or district thereof or of any country;

(5) Obligations eligible by law for purchase in the open market by federal reserve banks;

(6) Obligations issued or guaranteed by the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, or the African Development Bank;

(7) Obligations secured by collateral consisting of any of the securities or stock listed above and worth at the time the investment is made at least fifteen per cent more than the amount of the respective obligations;

Asset Allocation - Asset allocation refers to the strategic deployment of assets among the major classes of investments permitted under the HRS. It is the primary determinant of success in meeting long-term investment objectives. The Trust Fund's asset allocation is established by the Board with input from the Investment Committee and the Investment Consultant and is a function of the Board's expectations of current and future liquidity and income needs, eligible investments types under the HRS, expectations of asset class investment performance likely to be achieved over the long-term, and the Board's tolerance for investment risk. The selected asset allocation for the Trust Fund's two asset pools is as follows:

Asset Classification	Target	Minimum	Maximum
Short-term Liquidity/Operating Asset Pool			
Cash and equivalents and short-duration fixed income	100%	0%	100%
Long-term Investment Portfolio			
Cash and cash equivalents	0%	0%	100%
U.S. Fixed Income	35%	30%	40%
Inflation Linked Securities	15%	10%	20%
U.S. Real Estate Securities	10%	5%	15%
U.S. Equities	25%	20%	30%
International Equities	15%	10%	20%

Rebalancing - The Board has a policy of rebalancing the Portfolio when actual asset allocations fall outside of the desired ranges. In order to minimize transaction costs and operational risks, Trust Fund cash flows, such as contributions received or benefits paid, will be used to achieve rebalancing objectives. Moreover, the Investment Consultant will provide in its quarterly report the percentages that each asset class constitutes of total assets. If the percentage falls outside of the allowable target asset allocation ranges in the quarterly measurement, the Board or Investment Committee generally will provide direction to rebalance the Portfolio to target allocation. These customary rebalancing procedures notwithstanding, during periods of extreme market conditions, illiquid markets, or other extenuating circumstances in which rebalancing may be difficult or costly, the Board/Investment Committee may, at its discretion, elect to suspend rebalancing until a time it believes is prudent.

Interest Rate Risk – Interest rate risk is the risk that changes in the market rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. The Trust Fund does not have a policy to manage interest rate risk. As of June 30, 2011 and 2010, the Trust Fund had monies invested short-term in the State Pool, mutual funds, negotiable certificates of deposit and repurchase agreements all with original maturities of less than three months.

Credit Risk – Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. As a means to manage credit risk, the Trust Fund's policy requires individual securities to be rated investment-grade (Baaa3/BBB- or higher) by at least two of the three rating agencies (Moody's, S&P and/or Fitch) and for mutual funds to have an average rating above investment grade. As of June 30, 2011 the Trust Fund was invested in two fixed-income oriented mutual funds, the Vanguard Total Bond Market Index Fund, which only invests in investment grade securities, and the BlackRock Inflation Protection Fund. Mutual Funds are note rated by nationally recognized statistical rating organizations. However, based on each fund's underlying holdings, at June 30, 2011, the Vanguard Total Bond Market Index Fund and the BlackRock Inflation Protection Fund had average credit quality ratings of AAA/AA and AAA, respectively. At June 30, 2010, the repurchase agreements were not rated by a nationally recognized statistical rating organization.

Custodial Credit Risk – For an investment, custodial credit is the risk that, in the event of the failure of the counterparty, the Trust Fund will not be able to recover the value of its investments residing at its custodian bank or collateral securities that are lent by the custodian bank to outside party(ies). The Trust Fund's investments are held at custodian banks of pooled funds, or at the Trust Fund's own custodian bank. The Trust Fund's custodian is Bank of Hawaii (BOH) and investments are held with BOH's sub-custodian Bank of New York Mellon (BNY Mellon). BOH and BNY Mellon are "Qualified Custodians" as defined within Rule 206(4)-2 of the Investment Advisers Act of 1940 for which funds or securities are held separate from bank assets. The Trust Fund did not have custodial credit risk related to its mutual funds.

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Trust Fund will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The Trust Fund's Investment Policy or the HRS' do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits. At June 30, 2011, the Trust Fund had cash deposits of $18,386,214 that are in excess of the Federal Deposit Insurance Corporation limits. However, deposits are held short-term (less than one month) until monies can be invested with the fiscal agent.

Concentration of Credit Risk – The Trust Fund provides guidelines regarding portfolio diversification by placing limits on the amount the Trust Fund may invest in any one issuer, types of investment instruments, and position limits per issue of an investment instrument. At June 30, 2011 and 2010, the Trust Fund's investment concentration was as follows:

Investment Type/Issuer	Investment Type - Percentage of Portfolio	One Issuer of Investment Instrument - Percentage of Portfolio
2011:		
Mutual Funds	56%	
Vanguard		48%
BlackRock		8%
2010:		
Repurchase agreements	60%	
Bank of Hawaii		47%
First Hawaiian Bank		13%

State Treasury Cash and Investment Pool

The State Director of Finance is responsible for the 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 is invested in accordance with the State Investment Policy. Cash accounts that participate in the State Pool accrue interest based on the weighted average cash balances of each account. The weighted average maturity of the cash pool at June 30, 2011 and 2010, respectively, was 201 and 154 days.

Investments Authorized by the State's Investment Policy – Legally authorized investments include obligations of or guaranteed by the U.S. government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit, student loan resource securities (including auction rate securities, asset backed securities, program revenue notes and bonds, securities issued pursuant to Rule 144A of the Securities Act of 1933), money market funds, repurchase agreements with federally-insured financial institutions, commercial paper and banker's acceptances.

Credit Risk – Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The State's Investment Policy limits investments in state and U.S. Treasury securities, time certificates of deposit, U.S. government or agency obligations, repurchase agreements, commercial paper, bankers' acceptance, and money market funds and student loan resources securities maintaining a rating of AAA. As of June 30, 2011 and 2010, the State Pool has not been rated by a nationally recognized statistical rating organization.

The State Pool as of June 30, 2011 and 2010, included auction rate securities collateralized by student loans. During 2008, a number of these auctions failed and companies without the ability to hold such securities until maturity have taken significant losses. During the years ended June 30, 2011 and 2010, the State experienced a favorable change in the fair value of its investments in the auction rate securities due to improved market conditions, and recorded an increase in fair value. The Trust Fund's allocated share of the increase was $1,260,910 and $3,010,221 for the years ended June 30, 2011 and 2010, respectively, of which $743,937 and $1,806,133 and $516,973 and $1,204,088 was allocated to the enterprise fund and agency fund, respectively, resulting in a total cumulative decrease of $230,845 and $1,491,756 as of June 30, 2011 and 2010, respectively. These adjustments were recorded as an increase of cash and cash equivalents and interest income and other in the enterprise fund and cash and cash equivalents and amounts held on behalf of employers for benefits in the agency fund.

Additional information on the investment risks (interest rate risk, custodial credit risk, and concentration of credit risk) related to the State Pool are included in the State Comprehensive Annual Financial Report, which can be obtained from the State's Department of Accounting and General Services.

(4) CAPITAL ASSETS

The enterprise fund capital asset activity for the years ended June 30, 2011 and 2010, was as follows:

	Balance at July 1, 2010	Increases	Decreases	Balances at June 30, 2011
Capital assets being depreciated				
Office furniture and equipment	$ 4,268,938	$ -	$ -	$ 4,268,938
Computer equipment and software	9,369,750	105,969	-	9,475,719
Less accumulated depreciation	(4,980,259)	(1,547,140)	-	(6,527,399)
Capital assets, net	$ 8,658,429	$ (1,441,171)	$ -	$ 7,217,258

	Balance at July 1, 2009	Increases	Decreases	Balances at June 30, 2010
Capital assets, not being depreciated				
Software development in progress	$ 6,366,074	$ 1,578,309	$ (7,944,383)	$ -
Capital assets being depreciated				
Office furniture and equipment	4,254,783	14,155	-	4,268,938
Computer equipment and software	-	9,369,750	-	9,369,750
Less accumulated depreciation	(4,066,141)	(914,118)	-	(4,980,259)
Total capital assets, being depreciated net	188,642	8,469,787	-	8,658,429
Capital assets, net	$ 6,554,716	$ 10,048,096	$ (7,944,383)	$ 8,658,429

As of June 30, 2010, capital asset balances previously recorded in the agency fund were reclassified to the enterprise fund. The Trust Fund has developed an expense allocation to recover a portion of depreciation expense from the agency fund for use of the capital assets in administering the agency fund. Approximately 41% of the depreciation expense for fiscal years 2011 and 2010, was recovered from the agency fund as part of the administrative fee charged to the agency fund.

(5) 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 in August 2006 and awarded multi-year health and life insurance benefit contracts commencing July 1, 2007 and continuing through June 30, 2009 and subsequently exercised its option to extend contracts for an additional two year period through June 30, 2011.

Individual carriers / administrators are addressed below. The plans were offered with 3 different financial arrangements:

- Self funding: The medical PPOs with Health Management Associates (HMA) and Hawaii Medical Service Association (HMSA) acting as third party administrators (TPA), medical health maintenance organization (HMO), high deductible health plan (HDHP) and supplemental with HMSA, and the prescription drug coverage with NMHC (now informedRx) as administrator are all self funded plans. Rates are experience rated and are set by the Trust Fund Board acting on the advice of the consultant/actuary. Due to the size of the pool there is no stop loss insurance associated with these plans. The Trust Fund pays administrative fees to the TPAs and pays actual claim costs as claims are paid.

If claims are less than the amount projected and included in the premium collection from employers and employee-beneficiaries, surplus funds remain in the Trust Fund. In addition, prescription drug rebates are received from informedRx 6 to 9 months after they are realized.

- Fully insured: The Kaiser Basic and Comprehensive HMO plans and the Royal State Chiropractic Plan are all fully insured. Premiums are received from employers and paid to the carriers. There is no additional risk to the Trust Fund or funds to be paid to the Trust Fund. Rates are set by Kaiser and Royal State. Effective January 1, 2011, the Trust Fund created new plans for the HSTA VEBA active employees and retirees. HMSA medical and prescription drug, Kaiser Comprehensive HMO, Royal State Chiropractic Plan, HDS Dental, VSP vision, and Standard Life Insurance are all fully insured.

- Fully insured with Retrospective Risk Sharing and Risk Sharing: The Hawaii Dental Service (HDS) and Vision Services Plan (VSP) plans are funded through a fully insured retrospective risk sharing arrangement. Rates are set by HDS and VSP using the plans' experience. Full premium is collected from employers and 95% (HDS & VSP) is paid to the carriers. At the end of the year, if claims and retention exceed the reduced premium paid, the Trust Fund will pay the carriers the amount of the excess up to the withheld five percent (5%). The annual accounting for active employees and retirees is 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. The Royal State Dual Coverage Supplemental Plan is funded through a fully insured risk sharing arrangement and is similar to the HDS and VSP plans except there are no retrospective premiums.

Health Maintenance Organization – Closed Panel HMO

The Trust Fund entered into a contract with Kaiser Foundation Health Plan, Inc. (Kaiser) to provide active employees and retirees with HMO benefits for the period July 1, 2007 through June 30, 2009 and subsequently exercised its option to extend the contracts for an additional two years through June 30, 2011. The HMO is not a participating contract. Accordingly, there is no premium surplus or underwriting loss.

The Trust Fund entered into a contract with Kaiser to provide HSTA VEBA active employees and retirees with HMO benefits for the period January 1, 2011 through June 30, 2011. The HMO is under the same financial arrangement. Accordingly, there is no premium surplus or underwriting loss.

Medical and Prescription Drug Benefits

The Trust Fund entered into a contract with the HMSA and HMA to provide claims administration services for active employees and retirees for medical plans for the period July 1, 2007 through June 30, 2009, and subsequently exercised its option to extend the contract for an additional two years through June 30, 2011. The plans include a 90/10 PPO with HMA and a 90/10 PPO (July 1, 2009 through January 31, 2010), 80/20 PPO (effective February 1, 2010), HMO, HDHP and Supplemental Plan with HMSA. The amounts paid for claims and administrative services to HMSA and HMA are reconciled with the payments made by HMSA and HMA and any remaining surplus or deficit will be remitted to or owed by the Trust Fund. As of June 30, 2011 and 2010, respectively, amounts held by HMSA were $260,576 and $28,859 for active employees and $42,721 and $24,584 for retirees.

The Trust Fund entered into a contract with HMSA to provide HSTA VEBA active employees and retirees with medical and prescription drug benefits for the period January 1, 2011 through June 30, 2011. The plans included a 90/10 and 80/20 PPO and Supplemental for actives and a 90/10 PPO for retirees. The plans are fully insured and therefore, there is no premium surplus or underwriting loss.

The Trust Fund entered into a contract with informedRx for the period July 1, 2007, through June 30, 2009, and subsequently exercised its option to extend the contract for an additional year through June 30, 2010. The contract was extended again for an additional year through June 30, 2011. The Trust Fund's contract with informedRx entitles the Trust Fund to rebates from pharmaceutical manufacturers related to claims paid by the Trust Fund and processed by informedRx. As of June 30, 2011 and 2010, respectively, rebates receivable from informedRx were $884,153 and $1,658,814 for active employees and $5,063,909 and $3,385,529 for retirees.

Vision Care Benefits

The Trust Fund entered into a contract with VSP for the period July 1, 2007 through June 30, 2009 and subsequently exercised its option to extend the contract for an additional two years through June 30, 2011. 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.

The Trust Fund entered into a contract with VSP to provide HSTA VEBA active employees and retirees with vision benefits for the period January 1, 2011 through June 30, 2011. The contract included a five percent (5%) retrospective premium agreement for both active employees and retirees.

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. At June 30, 2011 and 2010, respectively, the Trust Fund's retrospective premium payable was $529,225 and $254,142 and $313,479 and $148,338 for active employees and retirees, respectively.

Dental Benefits

The Trust Fund entered into a contract with HDS for the period July 1, 2007, through June 30, 2009, and subsequently exercised its option to extend the contract for an additional two years through June 30, 2011. The contracts include a five percent (5%) retrospective premium agreement for both active employees and retirees. Under these agreements, the Trust Fund will pay HDS ninety-five percent (95%) of the premiums due each month.

The Trust Fund entered into a contract with HDS to provide HSTA VEBA active employees and retirees primary dental benefits and for active employees' supplemental dental benefits for the period January 1, 2011 through June 30, 2011. There was no retrospective premium agreement for the HSTA VEBA contract.

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 HDS the amount of the excess up to the withheld five percent (5%). 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. At June 30, 2011 and 2010, respectively, the Trust Fund's retrospective premium payable was $1,725,411 and $0 and $1,619,432 and $866,044 for active employees and retirees, respectively.

Life Insurance Benefits

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 and subsequently exercised its option to extend the contract for an additional year through June 30, 2010. The contract was extended again for an additional year through June 30, 2011. The amounts paid for claims and administrative services are reconciled with the payments made to Standard and any remaining surplus will be refunded to the Trust Fund and any underwriting losses will not be paid by the Trust Fund.

The Trust Fund entered into a contract with Standard to provide HSTA VEBA active employees' and retirees' life insurance benefits for the period January 1, 2011 through June 30, 2011.

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 July 1, 2007 through June 30, 2009 and subsequently exercised its option to extend the contract for an additional two years through June 30, 2011. The amounts paid for claims and administrative services are reconciled with the payments made to RSN and any remaining surplus will be refunded to the Trust Fund and any underwriting losses will not be paid by the Trust Fund. As of June 30, 2011 and 2010, respectively, amounts held by RSN were $0 and $2,837 for active employees and $0 for retirees.

Chiropractic Plan

The Trust Fund entered into a contract with RSN to provide active employees with chiropractic benefits for the period July 1, 2007 through June 30, 2009 and subsequently exercised its option to extend the contract for an additional two years through June 30, 2011. The Chiropractic plan is not a participating contract. Accordingly, there is no premium surplus or underwriting loss.

The Trust Fund entered into a contract with RSN to provide HSTA VEBA active employees with chiropractic benefits for the period January 1, 2011 through June 30, 2011.

<u>All Contracts</u>

The following is a summary of the of premium reserves held by insurance companies, rebates receivable, retrospective premiums payable, and premiums payable balances by insurance company at June 30, 2011 and 2010:

	2011	
	Active Employees	Retirees
Other receivables held by insurance companies		
HMSA	$ 260,576	$ 42,721
Rebates receivable		
Receivable from informedRx	$ 884,153	$ 5,063,909
Receivable from HMSA	24,712	-
	$ 908,865	$ 5,063,909
Retrospective premiums payable		
HDS - dental contract	1,725,411	1,619,432
VSP - vision contract	529,115	313,479
	$ 2,254,526	$ 1,932,911
Premiums payable		
HDS	$ 2,568,385	$ 1,790,048
HDS - HSTA	672,049	117,576
Kaiser Hawaii	6,274,043	3,681,120
Kaiser Hawaii - HSTA	1,324,511	169,425
RSN Dual/Chiro	123,375	-
RSN Chiro - HSTA	27,450	-
VSP	573,629	356,170
VSP - HSTA	91,875	18,176
Standard	220,176	141,523
Standard - HSTA	50,149	10,535
COBRA payable · HDS	376	-
COBRA payable · Royal	707	-
COBRA payable · Kaiser	2,780	-
COBRA payable · VSP	2,021	-
HMSA - HSTA	5,297,282	1,637,239
	$ 17,228,808	$ 7,921,812

HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
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Notes to Financial Statements
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	2010	
	Active Employees	**Retirees**
Other receivables held by insurance companies		
RSN	$ 2,837	$ -
HMSA	28,859	24,584
	$ 31,696	$ 24,584
Rebates receivable		
Receivable from informedRx	$ 1,658,814	$ 3,385,529
Receivable from HMSA	97,153	-
	$ 1,755,967	$ 3,385,529
Retrospective premiums payable		
HDS - dental contract	$ -	$ 866,044
VSP - vision contract	254,142	148,338
	$ 254,142	$ 1,014,382
Premiums payable		
HDS	$ 4,198,739	$ 1,959,347
Kaiser Hawaii	5,077,699	3,091,172
ROYAL DUAL	137,737	-
VSP	398,082	529,930
Standard	221,977	136,051
COBRA payable · HDS	9,783	-
COBRA payable · Royal	37	-
COBRA payable · Kaiser	2,431	-
COBRA payable · HMA	(19,795)	-
	$ 10,026,690	$ 5,716,500

(6) 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) (now informedRx) under contracts for the period July 1, 2007 through June 30, 2009, which were subsequently extended through June 30, 2011. 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. Activity in the liability for unpaid benefit claims expense related to the self-funded medical and prescription drug plans is as follows for the years ended June 30, 2011, 2010 and 2009:

	Active employees	Retirees	Total
Balance at July 1, 2008	$ 36,951,791	$ 9,215,230	$ 46,167,021
Current year claims and changes in estimates	258,521,518	173,267,524	431,789,042
Contractor processing administrative fees related to current year	13,427,564	14,004,110	27,431,674
Paid during current year	(262,907,460)	(182,168,597)	(445,076,057)
Balance at June 30, 2009	$ 45,993,413	$ 14,318,267	$ 60,311,680
Balance at July 1, 2009	$ 45,993,413	$ 14,318,267	$ 60,311,680
Current year claims and changes in estimates	236,864,948	161,907,925	398,772,873
Contractor processing administrative fees related to current year	11,960,034	13,756,828	25,716,862
Paid during current year	(256,484,335)	(177,115,259)	(433,599,594)
Balance at June 30, 2010	$ 38,334,060	$ 12,867,761	$ 51,201,821
Balance at July 1, 2010	$ 38,334,060	$ 12,867,761	$ 51,201,821
Current year claims and changes in estimates	231,188,748	189,723,257	420,912,005
Contractor processing administrative fees related to current year	11,746,538	14,839,743	26,586,281
Paid during current year	(239,876,668)	(202,154,970)	(442,031,638)
Balance at June 30, 2011	$ 41,392,678	$ 15,275,791	$ 56,668,469

Below is a summary of benefit claims payable by carrier at June 30, 2011 and 2010:

	2011	
	Active Employees	Retirees
Benefit claims payable:		
Benefit claims - HMA	$ 759,546	$ 6,773
Benefit claims - HMSA	15,983,113	9,480,775
Benefit claims - InformedRx	1,714,449	4,656,617
IBNR for Self Funded Plans	21,958,100	-
Admin Fee - HMA	92,573	3,785
Admin Fee - HMSA	884,232	902,938
Admin Fee - informedRx	665	224,903
	$ 41,392,678	$ 15,275,791

	2010	
	Active Employees	**Retirees**
Benefit claims payable:		
Benefit claims - HMA	$ 603,211	$ 3,152
Benefit claims - HMSA	13,515,719	7,342,185
Benefit claims - InformedRx	1,969,864	4,536,114
IBNR for Self Funded Plans	21,301,000	-
Admin Fee - HMA	94,529	1,719
Admin Fee - HMSA	849,062	822,051
Admin Fee - informedRx	675	162,540
	$ 38,334,060	$ 12,867,761

According to the terms of contracts with HMSA and informedRx, the Trust Fund was 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, 2011 and 2010, are as follows:

	Active Employees	**Retirees**	**Total**
HMSA – Medical and drug contract	$ 6,300,000	$ 3,700,000	$ 10,000,000
informedRx (formerly NHMCS) - Drug contract	3,008,000	6,392,000	9,400,000
HMA - Medical contract	2,200,680	156,076	2,356,756
	$ 11,508,680	$ 10,248,076	$ 21,756,756

(7) SUMMARY OF CONTRIBUTIONS AND PRE-FUNDED DEPOSITS

The employer and employee contributions recognized and deposits received for the years ended June 30, 2011 and 2010, were as follows:

	2011		
Required contributions	**Active Employees**	**Retirees**	**Total**
Employer			
State of Hawaii	$ 134,260,561	$ 246,355,234	$ 380,615,795
State of Hawaii - HSTA	27,246,171	12,083,955	39,330,126
City & County of Honolulu	40,285,371	62,811,760	103,097,131
County of Hawaii	11,402,215	13,795,387	25,197,602
County of Maui	11,989,191	10,868,475	22,857,666
County of Kauai, including Department of Water	5,521,342	6,814,806	12,336,148
Board of Water Supply – Honolulu	2,424,859	5,091,074	7,515,933
County of Hawaii - Department of Water	785,257	757,678	1,542,935
	233,914,967	358,578,369	592,493,336
Employee	164,654,202	1,260,594	165,914,796
	398,569,169	359,838,963	758,408,132
Pre-funded deposits			
Employer			
County of Hawaii	-	17,307,000	17,307,000
County of Kauai, including Department of Water	-	6,182,000	6,182,000
Board of Water Supply – Honolulu	-	7,300,000	7,300,000
County of Hawaii - Department of Water	-	1,310,000	1,310,000
	-	32,099,000	32,099,000
Subtotal – required and pre-funding deposits	398,569,169	391,937,963	790,507,132
Less: amounts received for administrative fees	(3,217,590)	(2,213,681)	(5,431,271)
Total contributions and deposits received for benefit payments	$ 395,351,579	$ 389,724,282	$ 785,075,861

	2010		
Required contributions	**Active employees**	**Retirees**	**Total**
Employer			
State of Hawaii	$ 127,245,376	$ 224,625,023	$ 351,870,399
City & County of Honolulu	39,531,299	57,160,226	96,691,525
County of Hawaii	11,078,480	12,483,917	23,562,397
County of Maui	11,446,612	9,682,157	21,128,769
County of Kauai, including Department of Water	5,298,434	6,005,463	11,303,897
Board of Water Supply – Honolulu	2,431,661	4,773,029	7,204,690
County of Hawaii - Department of Water	807,205	663,719	1,470,924
	197,839,067	315,393,534	513,232,601
Employee	158,967,090	1,114,511	160,081,601
	356,806,157	316,508,045	673,314,202
Pre-funded deposits			
Employer			
County of Hawaii	-	15,700,000	15,700,000
County of Maui	-	12,676,000	12,676,000
County of Kauai, including Department of Water	-	7,661,750	7,661,750
Board of Water Supply – Honolulu	-	4,000,000	4,000,000
County of Hawaii - Department of Water	-	1,300,000	1,300,000
	-	41,337,750	41,337,750
Subtotal – required and pre-funding deposits	356,806,157	357,845,795	714,651,952
Less: amounts received for administrative fees	(3,019,049)	(2,097,983)	(5,117,032)
Total contributions and deposits received for benefit payments	$ 353,787,108	$ 355,747,812	$ 709,534,920

The required contributions include both contributions for self-insured and fully-insured plans. The self-insured contributions are reported as operating revenues in the statement of revenues, expenses and changes in net deficit for the enterprise fund. The contributions related to the fully-insured plans are included as a component of the premium payable on the statements of net assets for the enterprise fund and the statements of fiduciary assets and liabilities for the agency fund. Contributions related to the fully-insured plans for the year ended June 30, 2011 for the enterprise fund and agency fund, respectively were $152,027,760 and $79,319,379 and for the year ended June 30, 2010 for the enterprise fund and agency fund, respectively were $103,511,078 and $62,115,956.

As a result of plan operations in the current year, the Trust Fund utilized previously built-up reserves to cover the cost of healthcare benefits resulting in a transfer from the agency fund to the enterprise fund of $2,198,481 for the year ended June 30, 2010. A similar transfer was not necessary for 2011.

(8) RETIREMENT BENEFITS

A. 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.

Funding Policy

The contribution rate for State employees administering the Trust Fund is approximately 6.05% of pay for 2011 and 2010. 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 employer contribution rates are a fixed percentage of compensation, including normal cost plus amounts required to pay for the unfunded actuarial accrued liability.

The employer contribution rate for June 30, 2011 and 2010, was 15%.

The Trust Fund's share of the aggregated pension expense was approximately $197,900, $169,800, and $186,000 for the years ended June 30, 2011, 2010 and 2009, respectively, and the annual expense is included in the financial statements.

Refer to the State's basic financial statements for information regarding required supplementary information regarding the funding progress and plan information for State Employees.

B. Postemployment 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 retirees under an agent multiple-employer defined benefit plan. The plan's participating employers include the State and Counties of Honolulu, Hawaii, Maui and Kauai (Counties).

For employees hired before July 1, 1996, and who retire with ten or more years of credited service, the State and the Counties pay 100% of the base monthly contribution set forth under HRS Section 87A- 33(b) for retirees enrolled in Medicare or non-Medicare health benefit plans. For retirees with fewer than ten years of credited service, the State and Counties pay 50% of the base monthly contribution set forth under HRS Section 87A-33(b).

For employees hired after June 30, 1996 but before July 1, 2001, and who retire with fewer than 10 years of service, the State and Counties make no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State and Counties pay a monthly contribution equal to 50% of the base monthly contribution set forth under HRS Section 87A-33(b). For employees retiring with at least 15 years but fewer than 25 years of service, the State and Counties pay a monthly contribution equal to 75% of the base monthly contribution set forth under HRS Section 87A-33(b). For employees retiring with at least 25 years of service, the State and Counties pay a monthly contribution equal to 100% of the base monthly contribution set forth under HRS Section 87A-33(b).

The contribution rates for employees hired after June 30, 2001, are consistent with the contribution rates for those hired after June 30, 1996, but only self plan base monthly contribution rates are applied. Those retirees may elect to enroll additional dependents, but they must pay the additional cost.

As of July 1, 2009, the date of the most recent actuarial valuation the plan membership was as follows:

	Retirees (including Surviving Spouse) Receiving Benefits	Deferred Vested Members not yet Receiving Benefits	Active Employees	Total
Employer:				
State of Hawaii	28,449	3,407	38,534	70,390
State of Hawaii - HSTA	2,015	1,003	13,195	16,213
City & County of Honolulu	6,286	637	8,751	15,674
County of Hawaii	1,290	127	2,327	3,744
County of Maui	1,051	166	2,390	3,607
County of Kauai, including Department of Water	633	85	1,076	1,794
Board of Water Supply – Honolulu	564	43	549	1,156
County of Hawaii - Department of Water Supply	78	-	181	259
	40,366	5,468	67,003	112,837

Funding Policy

Contributions to the plan are made by both the participating employers and employees. Contribution amounts are established by statute and are currently based on the pay-as-you-go amounts billed by the Trust Fund to the employers; however, employers may elect to make additional deposits based on their respective actuarial valuations. The retirees are responsible to pay the difference if the base contribution is less than the cost of the monthly premium. The current contributions are not sufficient to provide adequate assets to pay benefits when due in accordance with the requirements of GASB 43.

The participants required contribution to the Trust Fund is based on the pay-as-you-go basis and the actuarial determined annual required contribution (ARC) amount for the years ended June 30, 2011 and 2010, based on the July 2009, actuarial valuations, were as follows:

	2011		
	Required Contribution for June 30, 2011 (pay-as-you-go basis) [1]	ARC for June 30, 2011 [1]	ARC as a Percentage (%) of Covered Payroll [2]
Employer:			
State of Hawaii	$ 246,355,234	$ 842,260,000	46.1%
State of Hawaii - HSTA	12,083,955	211,862,000	30.8%
City & County of Honolulu	62,811,760	150,711,000	27.8%
County of Hawaii	13,795,387	34,969,000	27.5%
County of Maui	10,868,475	31,766,000	22.9%
County of Kauai, including Department of Water	6,814,806	16,483,000	23.8%
Board of Water Supply – Honolulu	5,091,074	10,387,000	25.6%
County of Hawaii - Department of Water Supply	757,678	2,319,000	24.6%
	$ 358,578,369	$ 1,300,757,000	

[1] Required contributions for the State of Hawaii – HSTA represent requirements for the six month period of January 1, 2011 through June 30, 2011. Effective January 1, 2011, benefits for the HSTA participants were administered by the Trust Fund. The ARC for State of Hawaii – HSTA represents the ARC for the full fiscal year ended June 30, 2011.

[2] Percentages are an estimate based information included in the actuarial valuation dated July 1, 2009. Actual amounts for fiscal year 2011 were not available.

	2010		
	Required Contribution for June 30, 2010 (pay-as-you-go basis)	ARC for June 30, 2010	ARC as a Percentage (%) of Covered Payroll
Employer:			
State of Hawaii	$ 224,625,023	$ 806,981,000	41.9%
City & County of Honolulu	57,160,226	113,135,000	20.3%
County of Hawaii	12,483,917	25,046,000	18.8%
County of Maui	9,682,157	21,800,000	16.1%
County of Kauai, including Department of Water	6,005,463	11,926,000	18.1%
Board of Water Supply – Honolulu	4,773,029	7,837,000	23.7%
County of Hawaii - Department of Water Supply	663,719	1,607,000	17.0%
	$ 315,393,534	$ 988,332,000	

Beginning in fiscal year 2008, the Trust Fund receives and holds deposits from participating employers to pre-fund retiree benefits on behalf of the employees in a separate account in the agency fund and allocates any interest earned related to those the pre-funding deposits based on accumulated amounts to date. These deposits do not meet the criteria of a contribution to the other postemployment benefits plan as the plan does not meet the criteria of a trust fund under GASB 43. The cumulative deposits and interest held by the Trust Fund in the agency fund for pre-funding are as follows for the years ended June 30, 2011 and 2010:

	2011	**2010**
Board of Water Supply – Honolulu	$ 14,555,346	$ 7,249,412
County of Hawaii	61,901,669	44,560,764
County of Maui	25,135,264	25,116,132
County of Kauai, including Department of Water	21,144,981	14,947,572
Hawaii County Department of Water Supply	4,478,575	3,166,173
City & County of Honolulu	40,172,152	40,142,037
	$ 167,387,987	$ 135,182,090

Each participating employer is required to disclose additional information with regard to funding policy, the employers' annual OPEB cost and contributions made, the funded status and funding progress of the employer's individual plan, and actuarial methods and assumptions used.

Annual OPEB Cost and Net OPEB Obligation Related to the Trust Fund

The employees that administer the Trust Fund are employees of the State. 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 postemployment health benefits and was calculated at 0.0393% and 0.0393% of the State's annual required contribution (ARC) for the years ended June 30, 2011 and 2010, respectively. The ARC is an amount actuarially determined in accordance with GASB 45, which was implemented effective July 1, 2007.

The following table shows the components of the annual OPEB cost, the amount contributed to the plan, and changes in the Trust Fund's net OPEB obligation for the years ended June 30, 2011 and 2010.

	2011	2010
Annual required contribution	$ 272,357	$ 272,953
Interest on net OPEB obligation	16,901	8,920
Adjustment to annual required contribution	(15,365)	(8,116)
Annual OPEB cost	273,893	273,757
Contributions made	(82,385)	(75,991)
Increase in net OPEB obligation	191,508	197,766
Net OPEB obligation at beginning of year	543,690	345,924
Net OPEB obligation at end of year	$ 735,198	$ 543,690

The percentage of annual OPEB cost contributed was 30.1%, 27.8% and 36.1% for the years ended June 30, 2011, 2010 and 2009, respectively.

Actuarial Methods and Assumptions Used in the State's Actuarial Valuation

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 for the latest actuarial valuation follows:

Valuation date	7/1/2009
Actuarial cost method	Entry age normal
Amortization method	Level percentage of payroll, open
Amortization period	30 years
Actuarial assumptions:	
Investment rate of return	4%
Healthcare cost trend rate (1):	
Medical and prescription drug, pre 65	10.5% initial; 5% ultimate
Medical and prescription drug, post 65	10.25% initial, 5% ultimate
Dental	6% initial; 4% ultimate
Vision	4% initial; 3% ultimate
Medicare Part B	14.6% initial; 5% ultimate
Projected salary increases	3.5%

(1) Includes an inflation assumption of 3%.

Refer to the State's basic financial statements for information regarding required supplementary information regarding the funding progress and plan information for State Employees.

(9) COMMITMENTS AND CONTINGENCIES

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.

Litigation

Dannenberg. et al. v. State of Hawai'i, Civil No. 06-1-1141 PWB
(formerly known as Everson, et al. v. State of Hawai'i, et al.)

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 regarding certain issues raised by their lawsuit. The Trust Fund's board of trustees held a hearing on the plaintiffs' petition under the Trust Fund rules and Chapter 91 of the 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 Trust Fund's Board's rulings. The State and the Trust Fund's Board appealed the First Circuit Court's decision. On March 26, 2010, the Hawaii Supreme Court affirmed in part and reversed in part the First Circuit Court's decision. The Hawaii Supreme Court held that the First Circuit Court: (1) did not err in concluding that a retired state and county government employee's health benefits are protected by Article XVI, Section 2 of the Hawaii Constitution as "accrued benefits," and (2) erred by concluding that HRS Chapter 87A requires that postemployment health benefits reasonably approximate those of active workers. On March 2, 2011, Judge Patrick Border of the First Circuit Court, State of Hawaii, heard and granted Plaintiffs' motion for class action certification. The class certified was all individuals who began working for the Territory of Hawaii, State of Hawaii, or any political subdivision thereof, prior to July 1, 2003, and who qualify as a retired employee-beneficiary and/or whose dependent qualifies as a dependent-beneficiary as those terms are defined in sections 87A-1 and 87A-21 of the Hawaii Revised Statutes.

The parties are currently engaged in discovery. No trial date has yet been set. State Defendants intend to continue to vigorously defend against Plaintiffs' claims in this lawsuit. The outcome of this lawsuit cannot be determined and no amount has been recorded in the financial statements as of or for the year ended June 30, 2011.

Kono, et al. v. Abercrombie, Civil No. 10-1-1966-09 KKS

On September 14, 2010, the Hawaii State Teachers Association Voluntary Employees Beneficiary Association Trust (VEBA Trust) and two participants in the VEBA Trust health plans filed a Complaint against the State of Hawaii (State) alleging: (1) The State diminished and impaired accrued health benefits of the active and retired teachers participating in the VEBA Trust health plans in violation of Article XVI, Section 2 of the Hawaii Constitution, by enacting Act 106, Session Laws of Hawaii 2010 (Act 106) and transferring the VEBA members to the Trust Fund and/or reassigning the administration of the VEBA Trust health benefits plans from the VEBA Trust to the Trust Fund; and (2) the State had taken $3.96 million in surplus funds from the VEBA Trust and this similarly diminished or impaired the VEBA members' accrued health benefits in violation of Article XVI, Section 2. Plaintiffs also alleged breach of contract by the State, and that the taking of the $3.96 million constituted unjust enrichment.

On October 12, 2010, the State filed a motion for judgment on the pleadings and to dismiss the Complaint in its entirety. On November 4, 2010, Plaintiffs filed a motion for preliminary injunction to maintain the status quo and prevent the transfer of the VEBA members to the Trust Fund.

Both the State's motion and Plaintiffs' motion were heard by the Honorable Karl K. Sakamoto, First Circuit Court, on December 7, 2010. While denying both motions, Judge Sakamoto held that the VEBA members did not have an accrued benefit in staying in the VEBA Trust health plans and that the transfer of VEBA members back to the Trust Fund health plans under Act 106 did not violate Article XVI, Section 2. The court further held that pursuant to Article XVI, Section 2, the VEBA members had an accrued benefit in the standard of coverage that they enjoyed in the VEBA Trust health plans and were entitled to maintain the same standard of coverage when they were transferred back to the Trust Fund. Regarding the $3.96 million, Judge Sakamoto found that to the extent that the surplus funds were part of the accrued benefits of the VEBA members who paid into the surplus, "the appropriate remedy is to allow the taking of the VEBA Trust surplus but that such amounts to be set aside to help ensure that the VEBA members can maintain their standard of accrued benefits."

On March 15, 2011, pursuant to his oral ruling, Judge Sakamoto issued an order denying the State's motion for judgment on the pleadings, an order denying Plaintiffs' motion for preliminary injunction, and a final judgment. The State timely filed an appeal of the two orders and the final judgment. Recently, the Hawaii Intermediate Court of Appeals dismissed the appeal because the form of Judge Sakamoto's final judgment did not comply with applicable requirements.

On October 6, 2011, the First Circuit Court entered an Amended Final Judgment Partly in Favor of Plaintiffs and Partly in Favor of the State. The Amended Final Judgment provides: (a) Act 106 does not violate Article XVI, Section 2; (b) the transfer of VEBA members to the Trust Fund health plans pursuant to Act 106 does not violate Article XVI, Section 2 nor does it breach any contract between VEBA members and the State; (c) former VEBA members who transfer to the Trust Fund pursuant to Act 106 are entitled to maintain the same standard of coverage benefits in their Trust Fund health benefits plans; and (d) to the extent that the surplus funds that the VEBA Trust returned to the State were part of accrued benefits of the VEBA members who paid into the surplus, such funds shall be used by the State to ensure that VEBA members can maintain their standard of coverage benefits.

On October 14, 2011, the State filed a Notice of Appeal of the Amended Final Judgment; on November 8, 2011, Plaintiffs filed a cross-appeal. This case is currently pending before the Hawaii Intermediate Court of Appeals. The State intends to vigorously defend its arguments on appeal. The outcome of this lawsuit cannot be determined and no amount has been recorded in the financial statements as of or for the year ended June 30, 2011.

(10) 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. In accordance with HRS 87A-25, the Trust Fund has obtained 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.

The Trust Fund is covered under the State's self-insurance program for workers' compensation. During fiscal years 2011 and 2010, the Trust Fund paid $11,076 and $16,771, respectively, in workers' compensation premiums to the State's General Fund.

There have been no significant reductions in insurance coverage and the amount of settlements has not exceeded insurance coverage for each of the past three fiscal years.

(11) LEASE COMMITMENT

The Trust Fund's office is located in the City Financial Tower. The State Department of Accounting and General Services (Lessee) leases the Trust Fund's office from the Employees' Retirement System of the State of Hawaii (Lessor). The lease is being paid for by the Trust Fund.

The lease commenced on January 1, 2005 and expired on November 30, 2009. In December 2009, the lease was amended with an expiration date of October 31, 2014. In January 2011, the lease was amended to surrender and acquire office space. The total rentable space was reduced from 10,324 square feet to 9,555 square feet. In addition to minimum rent, the lease provides for the payment of common area maintenance charges. At June 30, 2011, the aggregated minimum rental commitment under the noncancelable operating lease is as follows:

Year ending June 30,	
2012	306,000
2013	310,000
2014	310,000
2015	104,000
	$ 1,030,000

The rent expense for the year ended June 30, 2011 and 2010, was $306,199 and $314,994, respectively.

(12) SUBSEQUENT EVENTS

Carrier Contracts

The carrier contracts for the active employees and retiree plans for the Trust Fund, including contracts for HSTA participants were extended from July 1, 2011, through December 27, 2011, and again from December 28, 2011, through December 31, 2011. Approvals were received from the State Procurement Office to extend these contracts. In addition contracts for prescription drug plans were extended for six months from January 1, 2012.

Required Supplementary Information
Four-Year Loss Development Information
June 30, 2011 and 2010

SELF-INSURED HEALTHCARE PLANS

The Trust Fund began providing and administering fully-insured health and other benefit plans beginning July 1, 2003. The Trust Fund also began providing self-insured plans effective July 1, 2007. Therefore, the loss development tables on the following page show data for four successive policy years starting from the fiscal year ended June 30, 2008, for active employee and retiree self-insured plans.

The tables on the following page illustrates how the Trust Fund's earned revenue (net of reinsurance) and investment income compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by the Trust Fund related to the self-insured activities as of the end of each of the past four years. The rows of the table are defined as follows:

(1) This line shows the total of each fiscal year's gross earned contribution revenue and investment revenue, contribution revenue ceded to reinsurers, and net earned contribution revenue and reported investment revenue.

(2) This line shows each fiscal year's other operating costs of the Trust Fund including overhead and claims expense not allocable to individual claims.

(3) This line shows the Trust Fund's gross incurred claims and allocated claim adjustment expenses, claims assumed by reinsurers, and net incurred claims and allocated adjustment expenses (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (called policy year).

(4) This section of four rows shows the cumulative net amounts paid as of the end of successive years for each policy year.

(5) This line shows the latest re-estimated amount of claims assumed by reinsurers as of the end of the current year for each policy year.

(6) This section of four rows shows how each policy year's net incurred claims increased or decreased as of the end of successive years. (This annual re-estimation results from new information received on known claims, reevaluation of existing information on known claims, and emergence of new claims not previously known.)

(7) This line compares the latest re-estimated net incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of net claims cost is greater or less than originally thought.

As data for individual policy years mature, the correlation between original estimates and re-estimated amounts commonly is used to evaluate the accuracy of net incurred claims currently recognized in less mature policy years. The columns of the tables show data for successive policy years.

HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
STATE OF HAWAII
Required Supplementary Information
Four-Year Loss Development Information
June 30, 2011

Self-Insured Active Employee Healthcare Benefit Plans

	2008	2009	2010	2011
1. Required contribution and investment revenue:				
Earned	$ 195,936,354	$ 221,762,304	$ 256,755,699	$ 246,004,463
Ceded	-	-	-	-
Net earned	$ 195,936,354	$ 221,762,304	$ 256,755,699	$ 246,004,463
2. Unallocated expenses	$ 2,382,253	$ 2,324,705	$ 3,464,359	$ 3,828,417
3. Estimated claims and expenses, end of policy year:				
Incurred	$ 233,857,827	$ 267,973,485	$ 244,971,987	$ 241,048,648
Ceded	-	-	-	-
Net incurred	$ 233,857,827	$ 267,973,485	$ 244,971,987	$ 241,048,648
4. Net paid (cumulative) as of:				
End of policy year	$ 196,730,425	$ 262,097,745	$ 251,299,883	$ 237,215,369
One year later	231,169,876	283,354,922	239,959,499	
Two years later	231,157,984	283,378,367		
Three years later	231,157,984			
5. Reestimated ceded claims and expenses	$ -	$ -	$ -	$ -
6. Reestimated net incurred claims and expenses:				
End of policy year	$ 233,857,827	$ 267,973,485	$ 244,971,987	$ 241,048,648
One year later	231,169,876	283,354,922	239,959,499	
Two years later	231,157,984	283,378,367		
Three years later	231,157,984			
7. Increase (decrease) in estimated net incurred claims and expenses from end of policy year	$ (2,699,843)	$ 15,404,882	$ (5,012,488)	$ -

Self-Insured Other Postemployment Health Benefit Plans

	2008	2009	2010	2011
1. Required contribution and investment revenue:				
Earned	$ 16,722,162	$ 166,760,728	$ 211,253,620	$ 235,439,876
Ceded	-	-	-	-
Net earned	$ 16,722,162	$ 166,760,728	$ 211,253,620	$ 235,439,876
2. Unallocated expenses	$ -	$ -	$ -	$ -
3. Estimated claims and expenses, end of policy year:				
Incurred	$ 167,508,722	$ 183,539,058	$ 169,514,348	$ 199,476,186
Ceded	-	-	-	-
Net incurred	$ 167,508,722	$ 183,539,058	$ 169,514,348	$ 199,476,186
4. Net paid (cumulative) as of:				
End of policy year	$ 143,959,614	$ 181,276,558	$ 168,365,724	$ 197,019,136
One year later	164,519,936	188,620,467	169,424,601	
Two years later	164,731,483	188,597,900		
Three years later	164,731,483			
5. Reestimated ceded claims and expenses	$ -	$ -	$ -	$ -
6. Reestimated net incurred claims and expenses:				
End of policy year	$ 167,508,722	$ 183,539,058	$ 169,514,348	$ 199,476,186
One year later	164,519,936	188,620,467	169,424,601	
Two years later	164,731,483	188,597,900		
Three years later	164,731,483			
7. Increase (decrease) in estimated net incurred claims and expenses from end of policy year	$ (2,777,239)	$ 5,058,842	$ (89,747)	$ -

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HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
STATE OF HAWAII

ENTERPRISE FUND

Schedule of Administrative Operating Expenses

Years ended June 30, 2011 and 2010

	2011	2010
Operating expense:		
Personnel services	$ 2,034,019	$ 1,668,784
Contracted services	1,958,482	1,787,862
Equipment	37,344	179,828
Occupancy	306,199	314,994
Printing and binding	22,987	75,278
Insurance	80,679	85,767
Repairs and maintenance	23,813	31,511
Postage	57,105	104,350
Telephone	42,115	24,858
Transportation	14,012	12,511
Rental of equipment	21,727	22,643
Supplies	17,013	21,340
Training	11,270	110
Other	961	5,075
Total administrative expenses	$ 4,627,726	$ 4,334,911

HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
STATE OF HAWAII

AGENCY FUND
Schedule of Changes in Fiduciary Assets and Liabilities
Year ended June 30, 2011

		July 1, 2010
Assets		
Cash and cash equivalents	$	49,889,100
Cash received for pre-funding deposits		135,182,090
Cash and investments held by fiscal agent		-
Receivables		
Medicare reimbursements from individuals, net of allowance of $491,146 in 2011 and $403,332 in 2010		173,878
Premium receivable from State of Hawaii and counties		27,283,772
Other receivables held by insurance companies		24,584
Rebates receivable		3,385,529
Accrued interest receivable		230,790
Total receivables		31,098,553
Deposits		10,248,076
Total assets	$	226,417,819
Liabilities		
Due to State of Hawaii	$	62
Due to retirees		2,415
Retrospective premium payable		1,014,382
Premiums payable		5,716,500
Benefit claims payable		12,867,761
Amounts held on behalf of employers for benefits		206,816,699
Total liabilities	$	226,417,819

Additions	Deductions	June 30, 2011
$ 507,798,100	$ (466,886,701)	$ 90,800,499
13,588,649	(148,770,739)	-
169,272,987	-	169,272,987
47,038,400	(46,823,071)	389,207
360,950,329	(355,959,209)	32,274,892
42,721	(24,584)	42,721
8,400,267	(6,721,887)	5,063,909
190,661	(385,767)	35,684
416,622,378	(409,914,518)	37,806,413
-	-	10,248,076
$ 1,107,282,114	$ (1,025,571,958)	$ 308,127,975
$ -	$ -	$ 62
22,738	(18,281)	6,872
1,913,299	(994,770)	1,932,911
132,739,821	(130,534,509)	7,921,812
230,661,497	(228,253,467)	15,275,791
283,022,894	(206,849,066)	282,990,527
$ 648,360,249	$ (566,650,093)	$ 308,127,975

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To the Board of Directors of
the Hawaii Employer-Union Health Benefits Trust Fund
of the State of Hawaii and
Ms. Marion Higa, State Auditor
State of Hawaii, Office of the Auditor
Honolulu, HI

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

We have audited the financial statements of Hawaii Employee-Union Health Benefits Trust Fund of the State of Hawaii (Trust Fund), as of and for the year ended June 30, 2011, and have issued our report thereon dated February 8, 2012. 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

Management of the Trust Fund is responsible for establishing and maintaining effective 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 opinions 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.

A *deficiency in internal control* 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 and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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, contracts, and grant agreements, 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 audit, 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 management of the Trust Fund in a separate letter dated February 8, 2012.

The Trust Fund's responses to the findings identified in our audit are 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 Board of Trustees, Hawaii State Auditor, Trust Fund management and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Macias Gini & O'Connell LLP

Newport Beach, California
February 8, 2012

2010-01 Financial Reporting For Self-Insurance Activity

Criteria

Governmental Accounting Standards Board (GASB) Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues,* as amended (GASB 10), establishes accounting and financial reporting standards for risk financing and insurance-related activities of state and local governmental entities, including public entity risk pools.

Condition

During our audit, we evaluated the Trust Fund's application of GASB 10, and noted that management had not appropriately applied the requirements of GASB 10 related to the Trust Fund's self-insurance activities. Prior to fiscal year 2010, the Trust Fund reported premium revenues and benefit claims expense as a net nonoperating revenue or expense for its self-insurance activities. The criteria of GASB 10 requires this activity to be reported as operating revenues and expenses if the risk of loss for claims has transferred from the participant agencies to the Trust Fund. Through our discussions with management and review of the key documents and billing practices, it appears the risk of loss has transferred to the Trust Fund for self-insured programs. For fiscal year 2010, premium revenues of $253 million were reported as operating revenues and benefit claims expenses of $248 million were reported as operating expenses.

Cause

Management was not aware of the GASB 10 reporting requirements for the Trust Fund's self-insurance activities.

Effect

In prior years, the self-insurance related gross revenues and expenses were reported net as non-operating revenues. For fiscal year 2010, premium revenues of $253 million were reported as operating revenues and benefit claims expenses of $248 million were reported as operating expenses.

Recommendation

We recommend that management identify the key financial reporting standards and periodically review the requirements to determine that financial information is properly accounted for and adequately disclosed. In addition, when changes occur in insurance programs or other activity administered by the Trust Fund, management should identify and review the appropriate accounting and financial reporting standards to determine the impact of the changes.

Management's Response

Management will improve on identifying the impact that changes occurring in Trust Fund insurance programs or other activities have on the appropriate accounting and financial reporting. Management will also improve on its knowledge of GASB Statement No. 10 as it relates to the Trust Fund. It will purchase GASB information and communications such as standards, implementation guides and other publications from the GASB website.

2010-01 Financial Reporting For Self-Insurance Activity (Continued)

Status

Implemented. The Trust Fund has purchased the GASB the Comprehensive Implementation Guide Questions and Answers and Codification of Governmental Accounting and Financial Reporting Standards.

2010-02 Risk Assessment and Financial Reporting

Criteria

The Trust Fund has a fiduciary responsibility as a steward of public funds. In order to fulfill this responsibility, the Trust Fund has designed and implemented internal controls that serve as the first line of defense in safeguarding assets. Additionally, these controls are designed to ensure: (1) effective and efficient operations; (2) reliable financial reporting; and (3) compliance with applicable laws and regulations.

In 1992 the Committee on Sponsoring Organizations of the Treadway Commission (COSO) established a nationally recognized framework for internal control in its *Internal Control – Integrated Framework* and its related *Guidance for Smaller Public Companies: Reporting on Internal Controls over Financial Reporting*. The COSO framework establishes five elements of internal control: (1) Control Environment; (2) Risk Assessment; (3) Control Activities; (4) Information and Communication; and (5) Monitoring. These elements provide a common framework against internal control systems can be assessed and improved. Risk Assessment and Monitoring are integral parts of internal control and management should periodically evaluate the risks and monitor the changes facing the Trust Fund. This process involves evaluating both previously identified risks and potential new risks and providing assurance that: (1) controls are designed properly to address significant risks; and (2) controls are operating effectively.

In March 2006, the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) adopted a set of eight Statements of Auditing Standards (SAS No. 104 through 111), which, among other things, require auditors to assess an organization's design of controls and determine whether the controls have been placed in operation for all elements of internal control over financial reporting. If controls do not exist, are poorly designed or not operating effectively, the auditor must evaluate the control deficiency and report the deficiency to management, including whether the control deficiency is a significant deficiency or material weakness. These standards were incorporated in the *Government Auditing Standards (July 2007 Revision)* issued by the Comptroller General of the United States and became effective in fiscal year 2008.

Condition

During our audit, we noted that the Trust Fund does not have a formal risk assessment or monitoring process and does not have current policies and procedures documented.

2010-02 Risk Assessment and Financial Reporting (Continued)

Cause

Management has experienced recent turnover in key positions and, as a result, there were limited resources to properly evaluate the Trust Fund's internal controls over financial reporting and document current policies and procedures.

Effect

By not formalizing a risk assessment or monitoring process over financial reporting and not having current documentation of policies and procedures, the Trust Fund is at risk of not identifying deficiencies in the design and operation of the internal controls over financial reporting, which may result in a misstatement in the financial statements not being prevented, or detected and corrected on a timely basis. In addition, if the Trust Fund experiences additional employee turnover, there is a risk that key controls may be missed and/or new employees will not have documentation of proper policies and procedures to ensure that they can carry out their expected function adequately and efficiently.

Recommendation

We recommend that the Trust Fund perform a comprehensive risk assessment analysis, conduct monitoring procedures and document its risk assessment and internal control policies and procedures over its significant transaction cycles. Furthermore, we recommend the Trust Fund review the COSO *Internal Control – Integrated Framework* and its related *Guidance for Smaller Public Companies: Reporting on Internal Controls over Financial Reporting* and adopt the best practices outlined therein. Finally the Trust Fund should periodically report to the Board of Trustees on the results of its risk assessment.

Management's Response

The Trust Fund will be completing the State's Department of Accounting and General Services Self-Assessment of Internal Controls Questionnaire for State Departments and Agencies. After completing the questionnaire, risk controls will be identified and procedures will be documented. If there are any internal control deficiencies identified, the Trust Fund will develop a corrective action plan for each deficiency identified. The Trust Fund will periodically report to the Board of Trustees on the results of its risk assessment.

Status

In process. The Trust Fund's management staff is in the process of completing the State's Department of Accounting and General Services Self-Assessment of Internal Controls Questionnaire.

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