



**Financial Statements and Report of Independent  
Certified Public Accountants**

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

**June 30, 2009 and 2008**

**Submitted by  
The Auditor  
State of Hawaii**

July 29, 2010

Ms. Marion Higa  
Office of the Auditor  
State of Hawaii

Dear Ms. Higa:

This is our report on the financial audits of the Hawaii Employer-Union Health Benefits Trust Fund of the State of Hawaii (Trust Fund) as of and for the years ended June 30, 2009 and 2008. Our audits were performed in accordance with the terms of our contract with the State of Hawaii.

#### **OBJECTIVES OF THE AUDITS**

The primary purpose of our audits was to form an opinion on the fairness of the presentation of the Trust Fund's basic financial statements as of and for the years ended June 30, 2009 and 2008. More specifically, the objectives of the audits were as follows:

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

#### **SCOPE OF THE AUDITS**

Our audits were performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants and *Government Auditing Standards*, issued by the Comptroller General of the United States. The scope of our audits included an examination of the transactions and accounting records of the Trust Fund for the years ended June 30, 2009 and 2008.

Ms. Marion Higa  
Office of the Auditor  
State of Hawaii

July 29, 2010

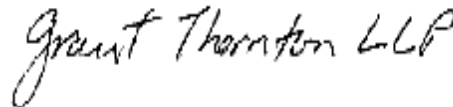
## ORGANIZATION OF THE REPORT

This report is presented in two parts as follows:

- Part I – The financial statements and related notes of the Trust Fund as of and for the years ended June 30, 2009 and 2008 including our opinion on the basic financial statements.
- Part II – Our report on internal control over financial reporting and on compliance and other matters.

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

Very truly yours,



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**PART I**  
**FINANCIAL SECTION**



## Report of Independent Certified Public Accountants

Audit - Tax - Advisory

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We have audited the accompanying statements of net assets – enterprise fund of the Hawaii Employer-Union Health Benefits Trust Fund of the State of Hawaii (Trust Fund) and statements of fiduciary net assets – agency fund as of June 30, 2009 and 2008, and the related statements of revenues, expenses and changes in net assets – enterprise fund, and cash flows – enterprise fund for the years then ended. These financial statements are the responsibility of the Trust Fund’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in note A, the financial statements of the Trust Fund are intended to present the financial position, and the changes in financial position and cash flows, of only that portion of the 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, 2009 and 2008, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

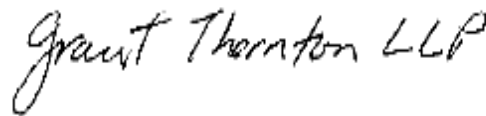
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Trust Fund as of June 30, 2009 and 2008, and the changes in its net assets and its cash flows, where applicable, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

To the Auditor  
State of Hawaii

In accordance with *Government Auditing Standards*, we have also issued a report dated July 29, 2010 on our consideration of the Trust Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Trust Fund's 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 audits.

The Management's Discussion and Analysis on pages 8 through 13 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

As discussed in note B, the Trust Fund retroactively adopted new accounting guidance in the fiscal year 2009 related to financial reporting. As discussed in note N, the accompanying financial statements as of and for the year ended June 30, 2008 have been restated.



Honolulu, Hawaii  
July 29, 2010

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2009 and 2008

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, 2009 and 2008. 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 or a statement of fiduciary net assets – agency fund for multiple-employer OPEB plans that are not administered as trusts or equivalent arrangements.

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

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

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

Additionally, the Trust Fund's Board of Trustees revised the current single and family rate structure to provide lower rates for employees who enroll only one dependent in the Trust Fund health benefit plans, who previously had been paying the same rates as employees with three or more family members. Implementation of the two-



Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2009 and 2008

party rate meant a decrease of over 20% in PPO rates for employees in the two-party category. For single employees, PPO rates decreased by approximately 4-6%, while family rates increased by approximately 1-3% depending upon the plan selected. The two-party rate brought the Trust Fund in line with the approach taken by most private sector employers in the community.

The 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 Nation Insurance Company, Vision Service Plan and for one year (July 1, 2009 through June 30, 2010) for InformedRx (formerly NMHC) and Standard Life Insurance.

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

*Active Employee Healthcare Benefits*

Statements of net assets – enterprise fund: These statements summarize the assets and liabilities and present an overall picture of the financial position.

Statements of revenue, expenses and changes in net assets – enterprise fund: These statements summarize the financial results of the operations for the years.

Statements of cash flows – enterprise fund: These statements identify the sources and uses of cash for the years.

*Retiree Healthcare Benefits*

Statements of fiduciary net assets – agency fund: These statements summarize the financial position of the OPEB plan assets and liabilities reported as an agency fund.

**FINANCIAL HIGHLIGHTS**

Act 245, SLH 2005 (partially codified as HRS Chapter 87D), temporarily authorizes 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. Act 245, SLH 2005 established a VEBA trust three-year pilot program to allow for the analysis of the costs and benefits of a VEBA trust against those of the Trust Fund. Effective March 1, 2006, the Hawaii State Teachers Association (HSTA) implemented the three-year pilot program. As a result, all active HSTA employees were enrolled in the VEBA trust and subsequently canceled from the Trust Fund’s health benefits plans. Act 245 was amended by Act 294, SLH 2007 to extend the repeal date to July 1, 2009 for any VEBA implemented in March 2006. Act 5, First Special Session 2008, amended Act 245, SLH 2005 to extend the sunset date to July 1, 2010. Subsequently, Act 106, SLH 2010 extended the sunset date to December 31, 2010.

In addition, Chapter 87D of the Hawaii Revised Statutes which authorized the establishment of the VEBA, also included the option for HSTA retirees to make a one-time choice to either remain with the Trust Fund or transfer to the HSTA VEBA benefit plans. The option period was from October through November 2006. As a result, approximately 1,400 HSTA retirees transferred to the HSTA VEBA. HSTA employees that retired on or after

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2009 and 2008

March 1, 2006 are required to be enrolled with the HSTA VEBA and do not have the option to enroll with the Trust Fund. The legislation related to the HSTA VEBA will sunset on December 31, 2010 and effective January 1, 2011, the HSTA VEBA participants will enroll in the Trust Fund's health benefit plans.

The Trust Fund collected in the aggregate \$556,423,895 and \$42,519,834 in employer and employee contributions for the health benefit plans and Medicare reimbursements, respectively, and paid carriers in the aggregate \$152,000,168, \$373,522,681 and \$42,519,834 in premiums, self-insured claims and Medicare reimbursements, respectively, for the year ended June 30, 2009. 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 \$5,240,000 for the year ended June 30, 2009. The Trust Fund held \$2,899,087 in reserves for carrier retrospective premiums as of June 30, 2009.

The Trust Fund collected in the aggregate \$550,767,545 and \$40,605,906 in employer and employee contributions for the health benefit plans and Medicare reimbursements, respectively, and paid carriers in the aggregate \$226,817,573, \$341,436,143 and \$40,605,906 in premiums, self-insured claims and Medicare reimbursements, respectively, for the year ended June 30, 2008. The monthly premiums for the Trust Fund's benefit plans include administrative fees that are intended to cover the Trust Fund's administrative expenses. The aggregated administrative fees collected from the employers totaled approximately \$4,971,000 for the year ended June 30, 2008. The Trust Fund held \$2,706,556 in reserves for carrier retrospective premiums as of June 30, 2008.

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

The administrative expenses budgeted for the Trust Fund totaled \$4,655,214 for the year ended June 30, 2009. Actual administrative expenditures for the active employee healthcare benefits totaled \$2,264,192, excluding the loss from the payment methodology of \$284,244 for the year ended June 30, 2009. The expenses included \$1,149,385 for personal services; \$331,724 for consultant services; \$193,892 for equipment; \$186,613 for occupancy; \$41,315 for depreciation; and \$361,263, for other expenses such as office supplies, telephone, travel, copier rental and equipment for the year ended June 30, 2009. Actual administrative expenditures for the retiree healthcare benefits totaled \$1,445,814 excluding the loss from the payment methodology of \$291,834. Administrative fees charged to the employers were \$2,096,114.

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

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2009 and 2008

for the retiree healthcare benefits totaled \$1,577,702 excluding the loss from the payment methodology of \$31,894 and the administrative fees charged to the employers of \$1,988,355.

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

Since HRS Chapter 87A does not contain the same statutory requirements that were in Chapter 87 related to the refund of excess insurance reserves, the Trust Fund recognized the excess insurance reserves for the plan years ended June 30, 2009 and 2008 as revenues rather than premium reserves payable to employers and employees. As a result, the Trust Fund recognized in the aggregate \$1,652,988 and \$61,437,077 in premium gains from VSP vision plans, Royal State National dual-coverage plans, and other for active employee and retiree health benefit plans for the years ended June 30, 2009 and 2008, respectively.

The aggregated net asset value of capital assets was \$6,554,712, \$3,566,954 and \$279,852 at June 30, 2009, 2008 and 2007, respectively. The aggregated depreciation expense totaled \$68,858, \$80,150 and \$340,907 for the year ended June 30, 2009, 2008 and 2007, respectively. 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 Trust Fund has incurred approximately \$6,370,000 and \$3,300,000 in construction-in-progress related to this contract as of June 30, 2009 and 2008, respectively. The new system was subsequently implemented in October 2009.

The adoption of GASB 43 in 2007 resulted in separate reporting of the retiree healthcare benefits for financial statement purposes. The Trust Fund had previously determined its retiree healthcare benefits met the criteria of a trust or equivalent arrangement which resulted in the presentation of a statement of plan net assets and statement of changes in plan net assets. During the fiscal year 2009, GASB released amended guidance affecting the Trust Fund's financial reporting of its retiree healthcare benefits. Under the amended guidance, the Trust Fund determined its retiree healthcare benefits do not meet the criteria of a trust or equivalent arrangement and as such should be reported as an agency fund with presentation of a statement of fiduciary net assets – agency fund. As a result, during the year ended June 30, 2009, the Trust Fund retroactively changed the financial statement presentation of its retiree healthcare benefits. See further discussion in note B to the financial statements.

As a result of the plan operations in the current year, the EUTF utilized previously built-up reserves resulting in a transfer from the Agency Fund into the Enterprise Fund of approximately \$14,800,000.

The 2008 financial statements have been restated as discussed in note N to the financial statements.

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2009 and 2008

A summary of operations and changes in net assets for the enterprise fund for the years ended June 30,:

	2009	2008 As restated	2007
Operating revenues (administrative fees)	\$ 3,144,171	\$ 2,982,532	\$ 1,979,765
Non-operating revenues	1,265,983	24,371,901	2,434,652
Total revenues	4,410,154	27,354,433	4,414,417
Operating expenses and total expenses	2,548,436	2,434,053	2,834,131
Non-operating expenses	49,747,736	37,539,830	-
Total expenses	52,296,172	39,973,883	2,834,131
(Loss) income before transfers	(47,886,018)	(12,619,450)	1,580,286
Transfers	14,770,715	-	(1,745)
DECREASE IN NET ASSETS	<u>\$ (33,115,303)</u>	<u>\$ (12,619,450)</u>	<u>\$ 1,578,541</u>

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

	2009	2008 As restated	2007
Current assets	\$32,475,405	\$58,771,043	\$70,894,793
Capital assets, net of accumulated depreciation of \$2,243,828 in 2009, \$2,202,514 in 2008 and \$2,154,424 in 2007	3,918,835	2,126,180	153,919
Total assets	<u>\$36,394,240</u>	<u>\$60,897,223</u>	<u>\$71,048,712</u>
Current liabilities	\$56,232,332	\$47,628,954	\$45,185,571
Long-term liabilities	78,696	69,754	45,176
Total liabilities	<u>56,311,028</u>	<u>47,698,708</u>	<u>45,230,747</u>
Net assets (deficit)			
Invested in capital assets	3,918,835	2,126,180	153,919
Unrestricted	(23,835,623)	11,072,335	25,664,046
Total (deficit) net assets	<u>(19,916,788)</u>	<u>13,198,515</u>	<u>25,817,965</u>
Total liabilities and net assets	<u>\$36,394,240</u>	<u>\$60,897,223</u>	<u>\$71,048,712</u>

A summary of the Trust Fund's assets and liabilities for the agency fund is shown below as of June 30,:

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2009 and 2008

	2009	2008 As restated	2007
<b>Assets:</b>			
Cash and cash equivalents	\$ 32,159,322	\$ 38,385,715	\$41,912,589
Cash received for pre-funding contributions	93,707,587	34,271,063	-
Receivables	27,041,670	47,217,142	5,833,853
Prepaid expenses	13,576	12,472	13,769
Deposits	10,092,000	10,092,000	10,092,000
Capital assets, net of accumulated depreciation of \$1,822,313 in 2009, \$1,794,769 in 2008 and \$1,762,709 in 2007	2,635,878	1,440,774	125,933
Total assets	\$165,650,033	\$131,419,166	\$57,978,144
<b>Liabilities:</b>			
Premiums and other payables	20,454,708	15,657,808	31,779,064
Amounts held on behalf of employers for benefits	145,195,325	115,761,358	26,199,080
Total liabilities	\$165,650,033	\$131,419,166	\$57,978,144

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

STATEMENTS OF NET ASSETS - ENTERPRISE FUND

As of June 30,

ASSETS	2009	2008 As restated (note N)
	2009	2008 As restated (note N)
<b>CURRENT ASSETS</b>		
Cash and cash equivalents (note B3)	\$ -	\$ 15,786,496
Premiums receivable from individuals, net of allowance of \$239,706 in 2009 and \$244,621 in 2008	(7,366)	68,521
Premiums receivable from State of Hawaii and counties	18,803,200	7,676,639
Premiums reserves held by insurance companies (note D)	885,717	24,134,500
Rebates receivable (note B8)	2,990,269	1,660,040
Accrued interest receivable	475,221	118,139
Prepaid expenses	20,364	18,708
Deposits (note L)	9,308,000	9,308,000
Total current assets	32,475,405	58,771,043
<b>NONCURRENT ASSETS</b>		
Capital assets, net of accumulated depreciation of \$2,243,828 in 2009 and \$2,202,514 in 2008 (notes B2 and C)	3,918,835	2,126,180
Total assets	\$ 36,394,240	\$ 60,897,223
<b>LIABILITIES AND NET ASSETS</b>		
<b>CURRENT LIABILITIES</b>		
Vouchers and contracts payable	\$ 203,105	\$ 144,693
Accrued wages and employee benefits payable (note E)	288,823	167,118
Due to State of Hawaii	8,179	28,274
Retrospective premium payable (note D)	1,843,314	1,723,381
Premiums payable	7,862,528	8,588,506
Benefit claims payable (notes B8 and L)	45,993,413	36,951,791
Compensated absences, current portion (note B4)	32,970	25,191
Total current liabilities	56,232,332	47,628,954
<b>NONCURRENT LIABILITIES</b>		
Compensated absences (note B4)	78,696	69,754
Total liabilities	56,311,028	47,698,708
<b>NET ASSETS (DEFICIT)</b>		
Invested in capital assets	3,918,835	2,126,180
Unrestricted	(23,835,623)	11,072,335
Total (deficit) net assets	(19,916,788)	13,198,515
Total liabilities and net assets	\$ 36,394,240	\$ 60,897,223

The accompanying notes are an integral part of these statements.

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

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

Year ended June 30,

	<u>2009</u>	<u>2008</u> As restated (note N)
Operating revenues		
Administrative fees (note H)	\$ 3,144,171	\$ 2,982,532
Total operating revenues	<u>3,144,171</u>	<u>2,982,532</u>
Operating expenses		
Personal services	1,149,385	1,022,098
Contracted services	331,724	347,827
Loss from payment methodology (note I)	284,244	264,339
Equipment	193,892	242,789
Occupancy (note J)	186,613	136,973
Provision for bad debt	95,779	6,329
Printing and binding	64,313	25,718
Insurance	47,218	44,415
Repairs and maintenance	42,478	208,696
Postage	41,644	31,985
Depreciation	41,315	48,090
Telephone	26,149	8,208
Transportation	16,452	19,557
Rental of equipment	12,656	9,665
Supplies	6,950	11,285
Training	6,693	4,923
Other	931	1,156
Total operating expenses	<u>2,548,436</u>	<u>2,434,053</u>
Operating income	595,735	548,479
Non-operating revenues and expenses		
Increase in premium reserves (note D)	1,265,983	24,371,901
Interest income and other, net of write-down of investments held in State pool of \$1,742,159 in 2009 and \$959,026 in 2008 (note B3)	(715,897)	1,347,443
Excess benefit expense over contributions received of \$219,009,994 in 2009 and \$193,252,085 in 2008 (note L)	<u>(49,031,839)</u>	<u>(38,887,273)</u>
Total non-operating revenues and expenses	<u>(48,481,753)</u>	<u>(13,167,929)</u>
Loss before transfers	(47,886,018)	(12,619,450)
Transfers		
Transfers from agency fund (note M)	<u>14,770,715</u>	<u>-</u>
DECREASE IN NET ASSETS	<u>(33,115,303)</u>	<u>(12,619,450)</u>
Net assets at beginning of the year	<u>13,198,515</u>	<u>25,817,965</u>
Net assets (deficit) at end of year	<u>\$ (19,916,788)</u>	<u>\$ 13,198,515</u>

The accompanying notes are an integral part of these statements.

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

STATEMENTS OF CASH FLOWS - ENTERPRISE FUND

Year ended June 30,

	<u>2009</u>	<u>2008</u> As restated (note N)
Cash flows from operating activities:		
Cash paid to vendors	\$ (1,036,831)	\$ (1,145,987)
Cash paid to employees	(1,010,959)	(893,478)
Cash received from State of Hawaii, counties and individuals for premiums and administrative fees	306,900,201	289,018,735
Cash paid for premiums and benefit payments	(358,431,348)	(324,808,239)
Rebates received related to prescription drug plan	1,634,650	226,969
Reserves returned by insurance carriers	24,294,025	141,805
	<u>(27,650,262)</u>	<u>(37,460,195)</u>
Net cash used in operating activities		
Cash flows from capital and related financing activities:		
Transfer in from the agency fund	14,770,715	-
Purchases of furniture, equipment, and software development	(1,833,970)	(2,020,351)
	<u>12,936,745</u>	<u>(2,020,351)</u>
Net cash provided by (used in) capital and related financing activities		
Cash flows from investing activities:		
Interest received, net of write-down of investments held in State pool	(1,072,979)	1,698,715
	<u>(1,072,979)</u>	<u>1,698,715</u>
Net cash (used in) provided by investing activities		
NET DECREASE IN CASH	(15,786,496)	(37,781,831)
Cash at the beginning of year	<u>15,786,496</u>	<u>53,568,327</u>
Cash at end of year	<u>\$ -</u>	<u>\$ 15,786,496</u>

The accompanying notes are an integral part of these statements.



Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

STATEMENTS OF CASH FLOWS - ENTERPRISE FUND (continued)

Year ended June 30,

	2009	2008 As restated (note N)
Reconciliation of change in net assets to net cash used in operating activities:		
Operating income	\$ 595,735	\$ 548,479
Adjustments to reconcile operating income to net cash used in operating activities:		
Depreciation	41,315	48,090
Net reserves used by non-operating activities	(44,034,366)	(14,687,817)
Decrease (increase) in premiums receivable from individuals	80,802	(26,337)
Increase in allowance for premium receivable from individuals	(4,915)	(10,271)
Increase in premiums receivable from State of Hawaii and counties	(11,126,561)	(310,517)
Decrease (increase) in premium reserves held by insurance companies	23,248,783	(24,000,308)
Increase in rebates receivable	(1,330,229)	(1,660,040)
Increase in prepaid expenses	(1,656)	(1,880)
Increase (decrease) in vouchers and contracts payable	58,412	(48,997)
Increase in accrued wages and employee benefits payable	121,705	111,137
(Decrease) increase in amounts due to State of Hawaii	(20,095)	4,416
Decrease in premiums payable to carriers	(606,045)	(13,515,914)
Increase in benefits claims payable	5,310,132	16,072,281
Increase in compensated absences	16,721	17,483
	<u>\$ (27,650,262)</u>	<u>\$ (37,460,195)</u>

The accompanying notes are an integral part of these statements.

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

STATEMENTS OF FIDUCIARY NET ASSETS - AGENCY FUND

As of June 30,

ASSETS	<u>2009</u>	<u>2008 As restated (note N)</u>
<b>ASSETS</b>		
Cash and cash equivalents(note B3)	\$ 32,159,322	\$ 38,385,715
Cash received for pre-funding contributions (note M)	93,707,587	34,271,063
<b>Receivables</b>		
Premiums receivable from individuals, net of allowance of \$963 in 2009 and \$982 in 2008	3,320	260
Medicare reimbursements receivable from individuals, net of allowance of \$477,171 in 2009 and \$385,128 in 2008	52,404	16,484
Premiums receivable from State of Hawaii and counties	20,928,998	5,864,123
Premiums reserves held by insurance companies (note D)	102,024	37,212,941
Rebates receivable (note B8)	5,634,659	4,044,574
Accrued interest receivable	320,265	78,760
<b>Total receivables</b>	<u>27,041,670</u>	<u>47,217,142</u>
Prepaid expenses	13,576	12,472
Deposits (note L)	10,092,000	10,092,000
Capital assets, net of accumulated depreciation of \$1,822,313 in 2009 and \$1,794,769 in 2008 (notes B2 and C)	<u>2,635,878</u>	<u>1,440,774</u>
<b>Total assets</b>	<u><u>\$ 165,650,033</u></u>	<u><u>\$ 131,419,166</u></u>
<b>LIABILITIES</b>		
Vouchers and contracts payable	\$ 135,404	\$ 95,724
Due to State of Hawaii	60	60
Accrued wages and employee benefits payable (note E)	192,550	111,411
Retrospective premium payable (note D)	1,045,773	983,175
Premiums payable	4,688,210	5,188,911
Benefit claims payable (notes B8 and L)	14,318,267	9,215,230
Compensated absences (note B4)	74,444	63,297
Amounts held on behalf of employers for benefits	<u>145,195,325</u>	<u>115,761,358</u>
<b>Total liabilities</b>	<u><u>\$ 165,650,033</u></u>	<u><u>\$ 131,419,166</u></u>

The accompanying notes are an integral part of these statements.

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS

June 30, 2009 and 2008

NOTE A – FINANCIAL REPORTING ENTITY

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

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

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

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

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

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

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

NOTE A – FINANCIAL REPORTING ENTITY (continued)

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

	2009	2008
Active employees	55,900	55,100
Retirees	38,200	37,600
Spouses	37,300	36,600
Domestic partners	1,100	1,000
Dependents under the age of 19	29,300	29,500
Dependents between the ages of 19 – 23 who are full-time students	8,100	7,600
Disabled dependents	400	400
Total	170,300	167,800

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Measurement Focus and Basis of Accounting and Change in Accounting Principle

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

Effective July 1, 2006, the Trust Fund adopted Governmental Accounting Standards Board Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other than Pensions* (GASB 43). GASB 43 establishes accounting and financial reporting standards for plans that provide other postemployment benefits (OPEB) other than pensions. GASB 43 requires a statement of plan net assets and a statement of changes in plan net assets for defined benefit OPEB plans that are administered as trusts or equivalent arrangements or a statement of fiduciary net assets – agency fund for multiple-employer OPEB plans that are not administered as trusts or equivalent arrangements.

The Trust Fund had previously determined that its retiree healthcare benefits met the criteria of a trust or equivalent arrangement. In the fiscal year 2009, GASB released amended guidance affecting the Trust Fund's financial reporting of its retiree healthcare benefits. Under the amended guidance, the Trust Fund determined its retiree healthcare benefits do not meet the criteria of a trust or equivalent arrangement. As a result, during the year ended June 30, 2009, the Trust Fund retroactively changed the financial statement presentation from presenting a statement of plan net assets and statement of changes in plan net assets to a statement of fiduciary net assets – agency fund. The agency fund reports no plan net assets and the assets accumulated in excess of liabilities is reported as a liability for amounts held on behalf of employers for benefits.

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

1. Measurement Focus and Basis of Accounting (continued)

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

The reporting of active and retiree (including their respective beneficiaries) healthcare benefits provided through the same plan should separate the two benefits for accounting purposes between active and retiree healthcare benefits. Accordingly, the Trust Fund reports the retiree healthcare benefits 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. The Trust Fund administers postemployment healthcare benefits under an agent multiple-employer defined benefit plan as defined by GASB 43.

In 2009 and 2008, the accounting for the active employee healthcare benefits are reported under the statements of net assets – enterprise fund, statements of revenue, expenses and changes in net assets – enterprise fund and statements of cash flows – enterprise fund. The accounting for the retiree healthcare benefits are reported in the statements of fiduciary net assets – agency. For financial reporting purposes, certain assets, liabilities, revenues and expenses have been allocated for the separate accounting of active and retiree healthcare benefits.

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

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

***Basis of accounting – retiree healthcare benefits.*** Agency funds do not have a measurement of focus, and report only assets and liabilities.

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2. 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.

3. Cash and Cash Equivalents

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

The State's investment pool as of June 30, 2009 and 2008 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. As of June 30, 2009 and 2008, the State recorded an adjustment for the decrease in fair values for these investments. The EUTF's allocated share of the adjustment was approximately \$2,904,000 and \$1,598,000 for the years ended June 30, 2009 and 2008, respectively for a total adjustment of approximately \$4,502,000 as of June 30, 2009. These adjustments were recorded as a reduction of cash and interest income.

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

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3. Cash and Cash Equivalents (continued)

Cash includes the following as of June 30,:

	Active	Retiree	Total
<b>2009</b>			
Category 1 investments	\$ –	\$ 93,707,587	\$ 93,707,587
Cash	–	32,159,322	32,159,322
	\$ –	\$125,866,909	\$125,866,909
<b>2008</b>			
Category 1 investments	\$ 9,000,000	\$ 6,000,000	\$ 15,000,000
Cash	6,786,496	66,656,778	73,443,274
	\$15,786,496	\$ 72,656,778	\$ 88,443,274

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

4. Compensated Absences

All employees earn vacation at the rate of one and three-quarters working days for each month of service. Vacation days may be accumulated to a maximum of 90 days. Employees are entitled to receive cash payment for accumulated vacation upon termination. The accompanying financial statements present the cost of accumulated unpaid vacation as a liability. A reconciliation of changes in aggregate liabilities for accumulated vacation is as follows for the year ended June 30,:

	2009	2008
Balance at beginning of year	\$158,242	\$140,840
Additions	110,295	95,624
Reductions	(82,427)	(78,222)
Balance at end of year	186,110	158,242
Less current portion	51,045	41,985
	\$135,065	\$116,257

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

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4. Compensated Absences (continued)

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, 2009 and 2008 relating to the Trust Fund approximated \$555,000 and \$502,000, respectively.

5. Use of Estimates

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

6. Receivables

Receivables consists primarily of amounts due from employers and employees for health benefits premium contributions, as well as amounts due from individuals for Medicare Part B reimbursements. The employee receivables are reported as net receivables and were based on management's estimate of amounts considered collectible. Management considered receivables outstanding for more than 60 days by employees who are no longer employed by State or Counties to be uncollectible. An allowance for employer receivables is not considered necessary based on past collection experience. The Medicare reimbursement receivables from individuals are reported as net receivables and were based on management's estimate of amounts considered collectible. Management considered receivables from individuals who are deceased and do not have a surviving spouse enrolled in Medicare Part B to be uncollectible.

7. Risk Management

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

8. Benefits Claims Expense

The benefits claims expense relates to the self-funded medical and prescription drug plans and includes the ultimate net cost of all reported claims incurred through June 30, 2009 and 2008 for retiree employee healthcare benefits. For active employee healthcare benefits, the benefits claims expense also includes an



Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

8. Benefits Claims Expense (continued)

additional estimate for unreported claims that have been incurred as of June 30, 2009 and 2008. Management has made certain assumptions based on currently available information and industry statistics in determining the benefits claim expense. Accordingly, the ultimate costs may vary significantly from the estimated amounts reported in the financial statements. Management believes that, given the inherent variability in benefits claim expense, such aggregate liabilities are within a reasonable range of adequacy. Such estimates are based on estimated claims cost reported prior to June 30, 2009 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 of approximately \$60,300,000 and \$46,200,000 as of June 30, 2009 and 2008, respectively based on the Trust Fund's consulting actuary's estimate for the liability for unpaid claims. These amounts includes administrative fees payable to the contracted plan administrator for services provided and benefit claims incurred as of June 30, 2009 and 2008.

NOTE C – CAPITAL ASSETS

The aggregated capital asset activity for the years ended June 30, 2009 and 2008 were as follows:

	Balance at July 1, 2008	Increases	Decreases	Balance at June 30, 2009
Capital assets being depreciated				
Office furniture and equipment	\$ 4,240,115	\$ 14,668	\$ –	\$ 4,254,783
Less accumulated depreciation	(3,997,283)	(68,858)	–	(4,066,141)
	242,832	(54,190)	–	188,642
Software development in progress	3,324,122	3,041,949	–	6,366,071
Capital assets, net	<u>\$ 3,566,954</u>	<u>\$2,987,759</u>	<u>\$ –</u>	<u>\$ 6,554,713</u>

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

June 30, 2009 and 2008

NOTE C – CAPITAL ASSETS (continued)

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

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS

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

For the years ended June 30, 2009 and 2008, all of the carriers use experience ratings in determining the premium rates except for Kaiser Foundation Health Plan and Mutual Benefits Association of Hawaii and for the medical and prescription drug plans which became self-funded beginning July 1, 2007. The carriers that have experience rating contract perform a preliminary and final annual accounting for each plan year to determine the premium surplus or underwriting loss. If in a plan year the earned premium exceeds total charges (net incurred and paid claims plus retention and the incurred reserve), the premium surplus will be held in a rate stabilization reserve or, at the option of the Board, the entire difference will be refunded to the Trust Fund. If there is an underwriting loss in the first plan year, the loss will be offset against any premium surplus from the second plan year. If there is a premium surplus in the first plan year and an underwriting loss in the second plan year, the premium surplus will be offset against the underwriting loss, if the premium surplus was held in a rate stabilization reserve. Premium surpluses refunded to the Trust Fund are not available to offset underwriting losses in subsequent plan years. If the initial two-year term is extended, the current premium surplus held in a rate stabilization reserve or underwriting loss will roll forward and be used to offset future surpluses or losses.

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

For self-funded plans the Trust Fund pays administrative fees to the contractor and reimburses the contractor only for claims paid instead of a premium to the carrier.

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

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

Health Maintenance Organization

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

Medical and Prescription Drug Benefits

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

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

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

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

June 30, 2009 and 2008

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

Medical and Prescription Drug Benefits (continued)

As of June 30, 2009 and 2008, the Trust Fund had the following financial experience related to the plans provided by HMSA for the plan years ended June 30, 2004 through 2007:

	Active employees	Retirees	Total
<u>Medical plans:</u>			
Amounts held by insurance carrier at July 1, 2007	\$ 10,455,641	\$ 14,765,972	\$ 25,221,613
Additional underwriting gain based on final accounting for plan year ended June 30, 2007	57,117	31,794	88,911
Interest	218,223	691,936	910,159
Amounts held by insurance carrier at June 30, 2008	10,730,981	15,489,702	26,220,683
Interest	24,826	83,047	107,873
Amounts refunded to the Trust Fund for plan years ended June 30, 2005 through June 30, 2007	(10,755,807)	(15,572,749)	(26,328,556)
Amounts held by insurance carrier at June 30, 2009	\$ –	\$ –	\$ –
Final underwriting gain for plan year ended June 30, 2004	\$ 7,052,188	\$ 4,233,158	\$ 11,285,346
Final underwriting gain for plan year ended June 30, 2005	11,875,407	15,835,063	27,710,470
Final underwriting gain for plan year ended June 30, 2006	1,314,022	1,788,553	3,102,575
Final underwriting loss for plan year ended June 30, 2007	(3,172,647)	(3,805,160)	(6,977,807)
Cumulative underwriting gain at June 30, 2008 and 2009	<u>\$ 17,068,970</u>	<u>\$ 18,051,614</u>	<u>\$ 35,120,584</u>
	Active employees	Retirees	Total
<u>Prescription drug plans</u>			
Amounts held by insurance carrier at July 1, 2007	\$ 10,204,080	\$ 20,102,081	\$ 30,306,161
Additional underwriting gain based on final accounting for plan year ended June 30, 2007	218,992	45,467	264,459
Interest	852,176	980,771	1,832,947
Amounts held by insurance carrier at June 30, 2008	11,275,248	21,128,319	32,403,567
Interest	95,185	118,760	213,945
Amounts refunded to the Trust Fund for plan years ended June 30, 2005 through June 30, 2007	(11,370,433)	(21,247,079)	(32,617,512)
Amounts held by insurance carrier at June 30, 2009	\$ –	\$ –	\$ –
Final underwriting gain for plan year ended June 30, 2004	\$ 9,822,838	\$ 13,271,969	\$ 23,094,807
Final underwriting gain for plan year ended June 30, 2005	10,334,757	13,103,593	23,438,350
Final underwriting gain for plan year ended June 30, 2006	2,444,448	3,909,988	6,354,436
Final underwriting (loss) gain for plan year ended June 30, 2007	(3,374,106)	2,035,925	(1,338,181)
Cumulative underwriting gain at June 30, 2008 and 2009	<u>\$ 19,227,937</u>	<u>\$ 32,321,475</u>	<u>\$ 51,549,412</u>

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

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

Medical and Prescription Drug Benefits (continued)

	Active employees	Retirees	Total
<u>Combined medical and prescription drug plans</u>			
Amounts held by insurance carrier at July 1, 2007	\$ 20,659,721	\$ 34,868,053	\$ 55,527,774
Additional underwriting gain based on final accounting for plan year ended June 30, 2007	276,109	77,261	353,370
Interest	1,070,399	1,672,707	2,743,106
Amounts held by insurance carrier at June 30, 2008	22,006,229	36,618,021	58,624,250
Interest	120,011	201,807	321,818
Amounts refunded to the Trust Fund for plan years ended June 30, 2005 through June 30, 2007	(22,126,240)	(36,819,828)	(58,946,068)
Amounts held by insurance carrier at June 30, 2009	\$ –	\$ –	\$ –
Final underwriting gain for plan year ended June 30, 2004	\$ 16,875,026	\$ 17,505,127	\$ 34,380,153
Final underwriting gain for plan year ended June 30, 2005	22,210,164	28,938,656	51,148,820
Final underwriting gain for plan year ended June 30, 2006	3,758,470	5,698,541	9,457,011
Final underwriting loss for plan year ended June 30, 2007	(6,546,753)	(1,769,235)	(8,315,988)
Cumulative underwriting gain at June 30, 2008 and 2009	\$ 36,296,907	\$ 50,373,089	\$ 86,669,996

The Trust Fund entered into a contract with HMSA to provide claims administration services for 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 two years through June 30, 2011. The amounts paid for claims and administrative services to HMSA are reconciled with the payments made to HMSA and any remaining surplus or deficit will be remitted to/owed from the Trust Fund.

As of June 30, 2009 and 2008, the Trust Fund experienced the following:

	Active employees	Retirees	Total
Estimated underpayment of benefit claims paid and administrative fees owed as of and for plan year ended June 30, 2008	\$ (71,828)	\$(50,529)	\$(122,357)
Amounts paid to claims administrator	71,828	50,529	122,357
Final overpayment of benefit claims paid and administrative fees for plan year ended June 30, 2008	58,952	–	58,952
Amounts held by claims administrator for plan year ended June 30, 2008 as of June 30, 2009	\$ 58,952	\$ –	\$ 58,952
Estimated overpayment of benefit claims paid and administrative fees for plan year ended June 30, 2009	204,507	46,106	250,613
Total amounts held by claims administrator as of June 30, 2009	\$263,459	\$ 46,106	\$ 309,565

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

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

Vision Care Benefits

The Trust Fund entered into a contract with Vision Service Plan (VSP) to provide vision care benefits for active employees and retirees for the period July 1, 2003 through June 30, 2005 and subsequently exercised its option to extend the contract for an additional two years through June 30, 2007.

The Trust Fund entered into a contract for the period July 1, 2007 through June 30, 2009 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.

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

The Trust Fund had the following financial experience related to the vision care plans provided by VSP:

	Active employees	Retirees	Total
<u>Plan year ended June 30, 2007</u>			
Estimated underwriting gain(loss) as of June 30, 2007	\$ 39,646	\$ (4,446)	\$ 35,200
Additional underwriting gain as of June 30, 2008	234,166	151,777	385,943
Final underwriting gain held by insurance carrier at June 30, 2008, prior to retrospective premiums	273,812	147,331	421,143
2007 retrospective premiums	229,788	149,421	379,209
Final underwriting gain for plan year ended June 30, 2007	\$ 503,600	\$ 296,752	\$ 800,352
Final underwriting gain(loss) for plan year ended June 30, 2004	\$ 545,197	\$ (43,778)	\$ 501,419
Final underwriting gain for plan year ended June 30, 2005	632,130	7,049	639,179
Final underwriting gain for plan year ended June 30, 2006	295,038	340,390	635,428
Final underwriting gain for plan year ended June 30, 2007	503,600	296,752	800,352
Cumulative underwriting gain at June 30, 2008 and 2009 for plan years ended June 30, 2004 through 2007	\$1,975,965	\$ 600,413	\$ 2,576,378
<u>Plan year ended June 30, 2008</u>			
Estimated and final underwriting gain(loss), prior to retrospective premiums	\$ 88,318	\$(186,250)	\$ (97,932)
2008 retrospective premiums	253,341	137,237	390,578
Final underwriting gain(loss) as of June 30, 2008 and 2009 and cumulative estimated underwriting gain(loss) as of June 30, 2008	\$ 341,659	\$ (49,013)	\$ 292,646

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

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

Vision Care Benefits (continued)

	Active employees	Retirees	Total
<u>Plan year ended June 30, 2009</u>			
Estimated underwriting gain (loss), prior to retrospective premiums	\$ 4,741	\$ (476,368)	\$ (471,627)
2009 retrospective premiums	262,672	138,182	400,854
Estimated underwriting gain (loss), subject to final accounting as of June 30, 2009	\$ 267,413	\$(338,186)	\$ (70,773)
Cumulative estimated underwriting gain(loss) for the plan years ended June 30, 2008 through 2009 as of June 30, 2009	\$ 609,072	\$ (387,199)	\$ 221,873

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

	Active employees	Retirees	Total
As of June 30, 2009 for plan year ended June 30, 2008	\$253,341	\$ –	\$253,341
As of June 30, 2008 for plan year ended June 30, 2007	\$229,788	\$149,421	\$379,209

Dental Benefits

The Trust Fund entered into a contract with Hawaii Dental Service (HDS) to provide dental benefits for active employees and retirees for the period July 1, 2003 through June 30, 2005 and subsequently exercised its option to extend the contract for an additional two years through June 30, 2007.

The Trust Fund entered into a contract with HDS for the period July 1, 2007 through June 30, 2009 and subsequently exercised its option to extend the contract for an additional two years through June 30, 2011. The contracts include a ten percent (10%) retrospective premium agreement for both active employees and retirees. Under these agreements, the Trust Fund will pay HDS ninety percent (90%) of the premiums due each month.

At the end of the plan year, if claims and retention exceed 90% of the premiums due for the plan year, the Trust Fund will pay HDS the amount of the excess up to the withheld ten percent (10%). Since HDS is still allowed to receive the retrospective premium if they experience losses for the plan year based on the final accounting, a payable to HDS was recorded.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

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

Dental Benefits (continued)

The Trust Fund had the following financial experience related to the dental care plans provided by HDS:

	Active employees	Retirees	Total
<u>Plan year ended June 30, 2007</u>			
Estimated underwriting (loss)gain, prior to retrospective premiums	\$(1,596,605)	\$ 406,453	\$(1,190,152)
Additional underwriting gain based on final accounting	143,651	32,554	176,205
Interest	–	883	883
2007 retrospective premiums	3,088,247	1,767,638	4,855,885
Final underwriting gain	<u>\$ 1,635,293</u>	<u>\$ 2,207,528</u>	<u>\$ 3,842,821</u>
Cumulative underwriting (loss)gain for the plan years ending June 30, 2004 through 2007:			
Final underwriting loss for plan year ended June 30, 2004	\$(2,069,104)	\$(1,141,373)	\$(3,210,477)
Final underwriting loss for plan year ended June 30, 2005	(1,179,107)	(674,674)	(1,853,781)
Final underwriting loss for plan year ended June 30, 2006	(415,414)	(184,851)	(600,265)
Final underwriting gain for plan year ended June 30, 2007	1,635,293	2,206,645	3,841,938
As of June 30, 2008 and 2009	<u>\$(2,028,332)</u>	<u>\$ 205,747</u>	<u>\$(1,822,585)</u>
<u>Plan year ended June 30, 2008</u>			
Estimated underwriting loss, prior to retrospective premiums	\$(2,436,457)	\$(1,045,828)	\$(3,482,285)
Additional underwriting gain based on final accounting	17,863	10,233	28,096
2008 retrospective premiums paid in 2009	1,470,040	845,938	2,315,978
Final underwriting loss	<u>\$ (948,554)</u>	<u>\$ (189,657)</u>	<u>\$(1,138,211)</u>
<u>Plan year ended June 30, 2009</u>			
Estimated underwriting loss, prior to retrospective premiums	\$(2,182,807)	\$ (315,032)	\$(2,497,839)
2009 retrospective premiums	1,580,642	907,591	2,488,233
Estimated underwriting loss, subject to final accounting	<u>\$ (602,165)</u>	<u>\$ 592,559</u>	<u>\$ (9,606)</u>
Cumulative estimated underwriting (loss) gain for plan years ending June 30, 2009 and 2008:			
As of June 30, 2009	<u>\$(1,550,719)</u>	<u>\$ 402,902</u>	<u>\$(1,147,817)</u>
As of June 30, 2008	<u>\$ (966,417)</u>	<u>\$(199,890)</u>	<u>\$(1,166,307)</u>



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

June 30, 2009 and 2008

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

Life Insurance Benefits

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

As of June 30, 2009, the Trust Fund had the following financial experience related to the group life insurance contract with Aetna:

	Active employees	Retirees	Total
Amounts held by insurance carrier at July 1, 2007	\$ 2,194,235	\$ 308,288	\$ 2,502,523
Interest	46,174	6,296	52,470
Amounts held by insurance carrier at June 30, 2008	2,240,409	314,584	2,554,993
Additional underwriting loss for the plan year June 30, 2007	(167,957)	(17,707)	(180,664)
Amounts refunded to the Trust Fund for plan years June 30, 2005, 2006 and 2007	(1,767,034)	(240,959)	(2,007,993)
Amounts held by insurance carrier at June 30, 2009	<u>\$ 310,418</u>	<u>\$ 55,918</u>	<u>\$ 366,336</u>
Final underwriting gain for plan year ended June 30, 2004	\$ 760,037	\$ 92,741	\$ 852,778
Final underwriting gain for plan year ended June 30, 2005	989,272	181,354	1,170,626
Final underwriting gain for plan year ended June 30, 2006	817,581	236,971	1,054,552
Final underwriting gain (loss) for plan year ended June 30, 2007	284,916	(101,954)	183,322
Cumulative final underwriting gain at June 30, 2009	<u>\$ 2,851,806</u>	<u>\$ 409,472</u>	<u>\$ 3,261,278</u>
Cumulative estimated underwriting gain at June 30, 2008	<u>\$ 3,014,763</u>	<u>\$ 427,179</u>	<u>\$ 3,441,942</u>

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 two years through June 30, 2011. As of June 30, 2009, the Trust Fund had the following financial experience related to the group life insurance contract with Standard:

	Active employees	Retirees	Total
<u>Plan year ended June 30, 2008</u>			
Estimated underwriting gain (loss)	\$ 175,852	\$ (44,730)	\$ 131,122
Additional underwriting (loss) gain	(36,244)	36,244	-
Final underwriting gain (loss)	<u>\$ 139,608</u>	<u>\$ (8,486)</u>	<u>\$ 131,122</u>

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

June 30, 2009 and 2008

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

Life Insurance Benefits (continued)

	Active employees	Retirees	Total
<u>Plan year ended June 30, 2009</u>			
Estimated underwriting loss, subject to final accounting	\$(630,452)	\$(506,869)	\$(1,137,321)
Cumulative estimated underwriting loss as of June 30, 2009	\$(490,824)	\$(515,375)	\$(1,006,199)

Dual-Coverage Medical and Prescription Drug Benefits

The Trust Fund entered into a contract with Royal State National Insurance Company, Ltd. (RSN) to provide active employees with dual-coverage medical and prescription drug benefits for the period February 1, 2004 through June 30, 2005 and subsequently exercised its option to extend the contract for an additional two years through June 30, 2007.

The Trust Fund had the following financial experience related to the dual-coverage medical and prescription drug plans provided by RSN:

Final underwriting gain for plan year ended June 30, 2004	\$ 45,862
Final underwriting gain for plan year ended June 30, 2005	166,202
Final underwriting gain for plan year ended June 30, 2006	103,252
Final underwriting gain for plan year ended June 30, 2007, held by insurance carrier as of June 30, 2008	87,425
Cumulative underwriting gain for plan years ending June 30, 2004 through June 30, 2007 as of June 30, 2008	\$ 402,741

The Trust Fund entered into a new contract with Royal 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 Trust Fund had the following financial experience related to the dual-coverage medical and prescription drug plans provided by RSN:

Estimated underwriting gain for plan year ended June 30, 2008, subject to final accounting	\$ 341,952
Additional underwriting loss	(30,112)
Final underwriting gain for plan year ended June 30, 2008, held by insurance carriers as of June 30, 2009	\$ 311,840
Estimated underwriting gain at June 30, 2009 for plan year ended June 30, 2009, subject to final accounting	\$ 380,873
Cumulative estimated underwriting gain as of June 30, 2009	\$ 692,713

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

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

All Contracts

Following is a summary of the premium reserves and interest available to offset underwriting losses for the plan years July 1, 2007 through June 30, 2009 held by insurance carriers as of June 30, 2009 and 2008:

	Active employees	Retirees	Total
<u>As of June 30, 2009</u>			
<u>For plan year ended June 30, 2009:</u>			
VSP – Vision contract	\$ 4,741	\$ –	\$ 4,741
HDS – Dental contract	–	592,559	592,559
RSN – Dual coverage contract	380,873	–	380,873
<u>For plan year ended June 30, 2008:</u>			
VSP – Vision contract	88,318	–	88,318
Standard – Life insurance contract	139,628	–	139,628
	<u>\$613,560</u>	<u>\$592,559</u>	<u>\$1,206,119</u>
<u>As of June 30, 2008</u>			
<u>For plan year ended June 30, 2008:</u>			
VSP – Vision contract	\$ 88,318	\$ –	\$ 88,318
Standard – Life insurance contract	175,852	–	175,852
RSN – Dual coverage contract	341,952	–	341,952
	<u>\$606,122</u>	<u>\$ –</u>	<u>\$ 606,122</u>

Following is a summary of the premium reserves not available to offset underwriting losses in subsequent years held by insurance companies reflected as premium reserves held by insurance companies as of June 30, 2009 and 2008:

	Active employees	Retirees	Total
<u>As of June 30, 2009</u>			
<u>For plan years ended June 30, 2004 - 2007:</u>			
Aetna – Life insurance contract	\$310,418	\$ 55,918	\$ 366,336
<u>For plan years ended June 30, 2008:</u>			
HMSA – Self-insured contract	58,952	–	58,952
RSN – Dual coverage contract	311,840	–	311,840
<u>For plan years ended June 30, 2009:</u>			
HMSA – Self-insured contract	204,507	46,106	250,613
	<u>\$885,717</u>	<u>\$102,024</u>	<u>\$ 987,741</u>

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

June 30, 2009 and 2008

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

All Contracts (continued)

	Active employees	Retirees	Total
<u>As of June 30, 2008</u>			
<u>For plan years ended June 30, 2004 – 2007:</u>			
HMSA – Medical contract	\$10,730,981	\$15,489,702	\$26,220,683
HMSA – Prescription drug contract	11,275,248	21,128,319	32,403,567
VSP – Vision contract	273,812	147,331	421,143
Aetna – Life insurance contract	1,767,034	240,959	2,007,993
HDS – Dental contract	–	206,630	206,630
RSN – Dual coverage contract	87,425	–	87,425
	<u>\$24,134,500</u>	<u>\$37,212,941</u>	<u>\$61,347,441</u>

Following is a summary of retrospective premium payable as of June 30, 2009 and 2008:

	Active employees	Retirees	Total
<u>As of and for plan year ended June 30, 2009:</u>			
VSP – Vision contract	\$ 262,672	\$ 138,182	\$ 400,854
HDS – Dental contract	1,580,642	907,591	2,488,233
	<u>\$ 1,843,314</u>	<u>\$ 1,045,773</u>	<u>\$ 2,889,087</u>
<u>As of and for plan year ended June 30, 2008:</u>			
VSP – Vision contract	\$ 253,341	\$ 137,237	\$ 390,578
HDS – Dental contract	1,470,040	845,938	2,315,978
	<u>\$ 1,723,381</u>	<u>\$ 983,175</u>	<u>\$ 2,706,556</u>

Following is a summary of the increase in premium reserves for the year ended June 30, 2009 and 2008:

	Active employees	Retirees	Total
<u>As of June 30, 2009</u>			
<u>Plan years ended June 30, 2004 – 2007:</u>			
HMSA – medical and prescription drug	\$ 120,011	\$ 201,807	\$ 321,818
Aetna – Life insurance contract	310,418	55,918	366,336
<u>Plan year ended June 30, 2008:</u>			
HMSA – Self-insured contract	58,952	–	58,952
RSN – Dual coverage contract	311,840	–	311,840
VSP – Vision contract	253,341	–	253,341
<u>Plan year ended June 30, 2009:</u>			
HMSA – Self-insured contract	204,507	46,106	250,613
Other	5,338	84,750	90,088
	<u>\$ 1,265,983</u>	<u>\$ 387,005</u>	<u>\$ 1,652,988</u>

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

June 30, 2009 and 2008

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

All Contracts (continued)

	Active employees	Retirees	Total
<u>As of June 30, 2008:</u>			
<u>Plan years ended June 30, 2004 – 2007:</u>			
HMSA – medical and prescription drug contract	\$22,006,229	\$36,618,021	\$58,624,250
VSP – Vision contract	503,600	296,752	800,352
Aetna – Life insurance contract	1,767,034	240,959	2,007,993
HDS – Dental contract	–	206,630	206,630
RSN – Dual coverage contract	87,425	–	87,425
Other	7,613	82,023	89,636
	\$24,371,901	\$37,444,385	\$61,816,286

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

NOTE E – RETIREMENT BENEFITS

1. Employees' Retirement System

Plan Description

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

The ERS consists of a contributory plan and a noncontributory plan. Employees covered by Social Security on June 30, 1984 were given the option of joining the noncontributory plan or remaining in the contributory plan. All new employees hired after June 30, 1984, who are covered by Social Security, are generally required to join the noncontributory plan. Both plans provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

NOTE E – RETIREMENT BENEFITS (continued)

1. Employees' Retirement System (continued)

Plan Description

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

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

The employer contribution rate for June 30, 2009 and 2008 was 15% and 13.75%, respectively.

The Trust Fund's share of the aggregated pension expense was approximately \$186,000 and \$151,000 for the years ended June 30, 2009 and 2008, respectively and are included in the financial statements.

2. Post-Retirement Health Care and Life Insurance Benefits

Plan Description

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

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

NOTE E – RETIREMENT BENEFITS (continued)

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

Plan Description (continued)

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

Annual OPEB Cost and Net OPEB Obligation

The Trust Fund's annual other postemployment (OPEB) cost (expense) is allocated by the State based on the Trust Fund's proportionate share of contributions for retiree health benefits and was calculated at .05% of the State's annual required contribution (ARC) for the years ended June 30, 2009 and 2008. The ARC is an amount actuarially determined in accordance with GASB Statement 45 which was implemented effective July 1, 2007.

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NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

NOTE E – RETIREMENT BENEFITS (continued)

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

Annual OPEB Cost and Net OPEB Obligation (continued)

The following table shows the components of the annual OPEB cost for the year, the amount contributed to the plan, and changes in the Trust Fund's net OPEB obligation.

	2009	2008
Annual required contribution	\$ 284,120	\$260,951
Interest on net OPEB obligation	11,138	–
Adjustment to annual required contribution	(9,961)	–
Annual OPEB cost	285,297	260,951
Contributions made	(106,521)	(93,803)
Increase in net OPEB obligation	178,776	167,148
Net OPEB obligation at beginning of year	167,148	–
Net OPEB obligation at end of year	\$ 345,924	\$167,148

The percentage of annual OPEB cost contributed was 36.1% and 35.9% for the years ended June 30, 2009 and 2008, respectively.

Actuarial Methods and Assumptions

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.



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

June 30, 2009 and 2008

NOTE E – RETIREMENT BENEFITS (continued)

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

Actuarial Methods and Assumptions (continued)

Additional information as of the latest actuarial valuation follows:

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

(1) Includes an inflation assumption of 3%.

NOTE F – COMMITMENTS AND CONTINGENCIES

1. Deferred Compensation

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

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

2. Litigation

On 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

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

June 30, 2009 and 2008

NOTE F – COMMITMENTS AND CONTINGENCIES (continued)

2. Litigation (continued)

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 retiree health benefits reasonably approximate those of active workers.

3. Reserve for Encumbrances

The aggregated reserve for outstanding encumbrances as of June 30, 2009 and 2008 amounted to approximately \$200,000 and \$8,310,000 respectively.

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

NOTE G – RISK MANAGEMENT

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

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

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

NOTE H – ADMINISTRATIVE FEES

The activities of the Trust Fund were principally supported through administrative fees for services. The administrative fees are assessed each pay period and vary depending upon the type of bargaining agreements. For the years ended June 30, 2009 and 2008, the aggregated administrative fees amounted to approximately \$5,240,000 and \$4,970,000, respectively.

NOTE I – CARRIER PAYMENT METHODOLOGY

Premiums paid to the carriers are calculated on a monthly basis by multiplying the total number of active employees and retirees enrolled in the various plans on the last day of the month by the premium rates set forth in the contract agreements, whereas employer and employee billings are calculated on a semi-monthly basis. As a result, the Trust Fund recognizes a gain or loss between the total premiums actually collected from the employers and employees and the total premiums actually paid to the carriers. For the year ended June 30, 2009 and 2008, the Trust Fund recognized aggregated losses of approximately \$576,000 and \$66,000, respectively.

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

NOTE J – 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 addition to minimum rent, the lease provides for the payment of common area maintenance charges. At June 30, 2009, the aggregated minimum rental commitment under the noncancelable operating lease is as follows:

Year ending June 30,	Amount
2010	\$ 316,000
2011	318,000
2012	318,000
2013	318,000
2014	318,000
Thereafter	106,000
	\$1,694,000

The aggregated rent expense for the year ended June 30, 2009 and 2008 was \$311,022 and \$228,289, respectively.

NOTE K – FUNDED STATUS AND FUNDING PROGRESS – OPEB PLAN

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.

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

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

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

NOTE L – BENEFIT CLAIMS EXPENSE

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

	Active employees	Retirees	Total
<b>2009</b>			
Balance at beginning of year	\$ 36,951,791	\$ 9,215,230	\$ 46,167,021
Claims incurred related to current year	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 related to current year	(262,907,460)	(182,168,597)	(445,076,057)
Balance at end of year	\$ 45,993,413	\$ 14,318,267	\$ 60,311,680
<b>2008</b>			
Balance at beginning of year	\$ –	\$ –	\$ –
Claims incurred related to current year	222,333,349	141,275,040	363,608,389
Contractor processing administrative fees related to current year	11,693,018	12,301,757	23,994,775
Paid related to current year	(197,074,576)	(144,361,567)	(341,436,143)
Balance at end of year	\$ 36,951,791	\$ 9,215,230	\$ 46,167,021

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

NOTE L – BENEFIT CLAIMS EXPENSE (continued)

According to the terms of contracts with HMSA and NMHCS, 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, 2009 and 2008 are as follows:

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

NOTE M – SUMMARY OF CONTRIBUTIONS AND BENEFIT EXPENSE

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

	Active employees	Retirees	Total
<b>2009</b>			
<b>Required contributions</b>			
<b>Employer</b>			
State of Hawaii	\$135,936,871	\$188,321,003	\$324,257,874
City & County of Honolulu	33,145,490	48,452,690	81,598,180
County of Hawaii	9,141,149	9,976,081	19,117,230
County of Maui	9,068,244	8,334,983	17,403,227
County of Kauai, including Department of Water	4,318,567	4,869,345	9,187,912
Board of Water Supply – Honolulu	2,120,392	4,005,663	6,126,055
Hawaii Department of Water Supply	678,133	538,307	1,216,440
	194,408,846	264,498,072	458,906,918
<b>Employee</b>	123,542,029	554,604	124,096,633
	<u>317,950,875</u>	<u>265,052,676</u>	<u>583,003,551</u>
<b>Pre-funding contributions</b>			
<b>Employer</b>			
Board of Water Supply – Honolulu	–	1,200,000	1,200,000
County of Hawaii	–	14,950,000	14,950,000
County of Kauai, including Department of Water	–	704,000	704,000
Board of Water Supply – Honolulu	–	1,848,077	1,848,077
City & County of Honolulu	–	40,110,047	40,110,047
	–	58,812,124	58,812,124
Subtotal – required and pre-funding contributions	317,950,875	323,864,800	641,815,675
Less: amounts received for administrative fees	3,144,171	2,096,114	5,240,285
Total contributions received for benefit payments	<u>\$314,806,704</u>	<u>\$321,768,686</u>	<u>\$636,575,390</u>

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

NOTE M – SUMMARY OF CONTRIBUTIONS AND BENEFIT EXPENSE (continued)

	Active employees	Retirees	Total
<b>2008</b>			
<b>Required contributions</b>			
<b>Employer</b>			
State of Hawaii	\$121,328,232	\$186,139,842	\$307,468,074
City & County of Honolulu	30,225,661	48,340,493	78,566,154
County of Hawaii	8,202,741	9,892,207	18,094,948
County of Maui	8,060,676	8,091,914	16,152,590
County of Kauai, including Department of Water	3,887,291	4,889,204	8,776,495
Board of Water Supply – Honolulu	1,881,689	4,029,345	5,911,034
Hawaii Department of Water Supply	590,290	544,923	1,135,213
	174,176,580	261,927,928	436,104,508
<b>Employee</b>	115,189,280	460,793	115,650,073
	289,365,860	262,388,721	551,754,581
<b>Pre-funding contributions</b>			
<b>Employer</b>			
Board of Water Supply – Honolulu	–	2,000,000	2,000,000
County of Hawaii	–	13,613,063	13,613,063
County of Maui	–	12,208,000	12,208,000
County of Kauai, including Department of Water	–	6,450,000	6,450,000
	–	34,271,063	34,271,063
Subtotal – required and pre-funding contributions	289,365,860	296,659,784	586,025,644
Less: amounts received for administrative fees	2,982,532	1,988,355	4,970,887
Total contributions received for benefit payments	\$286,383,328	\$294,671,429	\$581,054,757

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 \$14,770,715.

Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

NOTE M – SUMMARY OF CONTRIBUTIONS AND BENEFIT EXPENSE (continued)

The Trust Fund holds pre-funding contributions on behalf of the employers in a separate account in the agency fund and allocates any interest earned related to those the pre-funding contributions based on accumulated amounts to date. The cumulative contributions and interest held by the Trust Fund for pre-funding contributions are as follows as of June 30,:

	2009	2008
Board of Water Supply – Honolulu	\$ 3,243,760	\$ 2,000,000
County of Hawaii	28,813,943	13,613,063
County of Maui	12,413,426	12,208,000
County of Kauai, including Department of Water	7,263,347	6,450,000
Hawaii County Board of Water Supply	1,863,064	–
City & County of Honolulu	40,110,047	–
	\$ 93,707,587	\$ 34,271,063

NOTE N – RESTATEMENT

Net assets of the Enterprise Fund and amounts held on behalf of employers for benefits of the Agency Fund at June 30, 2008 have been restated to reflect the recognition of rebates due to the Trust Fund of \$5,704,614 and of losses related to the other than temporary impairment of the auction rate securities in the State's investment pool of \$1,598,377. A breakdown of the restatement was as follows:

	Net assets of Enterprise Fund	Amounts held on behalf of employers of Agency Fund	Total
Recognition of rebates due to the Trust Fund	\$1,660,040	\$4,044,574	\$5,704,614
Recognition of other than temporary impairment of auction rate securities	\$ 959,026	\$639,351	\$1,598,377

In addition, reclassifications were made to certain amounts in the statements of revenue, expenses and changes in net assets – enterprise fund. Amounts previously presented as interest income of \$226,969 were reclassified to excess benefit expense over contributions received and amounts previously presented as loss from payment methodology of \$229,788 were reclassified to increase in premium reserves.



Hawaii Employer-Union Health Benefits Trust Fund  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2009 and 2008

NOTE N – RESTATEMENT (continued)

The effects of the restatement were as follows:

	2008	
	As previously reported	As restated
<b>Statement of Net Assets – Enterprise Fund</b>		
Cash and cash equivalents	\$ 16,745,522	\$ 15,786,496
Rebates receivable	–	1,660,040
Total current assets	58,070,029	58,771,043
Total assets	60,196,209	60,897,223
Total net assets	12,497,501	13,198,515
<b>Statement of Revenues, Expenses and Changes in Net Assets – Enterprise Fund</b>		
Interest income and other	2,533,438	1,347,443
Excess benefit expense over contributions received	(40,774,282)	(38,887,273)
Total non-operating revenues and expenses	(14,098,731)	(13,167,929)
Decrease in net assets	(13,320,464)	(12,619,450)
<b>Statement of Fiduciary Net Assets – Agency Fund</b>		
Cash and cash equivalents	39,025,066	38,385,715
Rebates receivable	–	4,044,574
Total receivables	43,172,568	47,217,142
Total assets	128,013,943	131,419,166
Amounts held on behalf of employers for benefits	112,356,135	115,761,358
Total liabilities	\$ 128,013,943	\$ 131,419,166

**PART II**

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



**Report on Internal Control Over Financial Reporting and Compliance and Other Matters based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards***

Audit - Tax - Advisory

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To the Auditor  
State of Hawaii

We have audited the financial statements of the Hawaii Employer-Union Health Benefits Trust Fund of the State of Hawaii (Trust Fund), as of and for the year ended June 30, 2009, and have issued our report thereon dated July 29, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America established by the American Institute of Certified Public Accountants and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**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 an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Trust Fund's internal control over financial reporting. Accordingly, we express no such opinion.

A deficiency in internal control over financial reporting 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 combination of deficiencies, in internal control over financial reporting, 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 would not necessarily identify all deficiencies in internal control over financial reporting that might be material weaknesses. However, we identified a deficiency in internal control over financial reporting, described in the accompanying schedule of findings and responses as item 09-01, that we consider to be a material weakness in the Trust Fund's internal control over financial reporting.

Our audit was also not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We identified a deficiency in internal control over financial reporting, described in the

To the Auditor  
State of Hawaii

accompanying schedule of findings and responses as item 09-02, that we consider to be a significant deficiency in the Trust Fund's internal control over financial reporting.

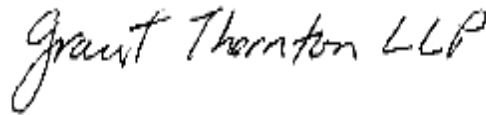
**Compliance and Other Matters**

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

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

We noted certain matters that we reported to the Board of Trustees and management of the Trust Fund in a separate letter dated July 29, 2010.

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



Honolulu, Hawaii  
July 29, 2010

State of Hawaii  
Hawaii Employer-Union Health Benefits Trust Fund

SCHEDULE OF FINDINGS AND RESPONSES

June 30, 2009

**09-01: Prior-Period Adjustments**

**Criteria:** As a result of audit procedures performed, we brought to management's attention adjustments to correct the prior year financial statements. The statement of net assets – enterprise fund and related statements of revenue, expenses and changes in net assets – enterprise fund and cash flows – enterprise fund have been restated regarding cash and cash equivalents, rebates receivable, interest income and other and excess benefit over contributions received. Cash and cash equivalents and rebates receivable related to retiree healthcare benefits have been restated.

**Condition:** Subsequent to the previous issuance of the audit for the years ended June 30, 2008 and 2007, the State of Hawaii issued a comptroller's memorandum as a result of failed auction rate securities which reduced the value of the Trust Fund's balance in the State's investment pool. The total amount of this adjustment was approximately \$1,600,000.

The year ended June 30, 2008 was the first year that the Trust Fund self-funded their medical and prescription drug plans. The Trust Fund's contract with its third-party administrator entitles the Trust Fund to rebates from pharmaceutical manufacturers related to claims paid by the Trust Fund and processed by the third-party administrator. Rebates of approximately \$5,700,000 should have been recognized during the year ended June 30, 2008.

**Context:** The restated balances at June 30, 2008 were as follows:

Statement of Net Assets – Enterprise Fund	
Cash and cash equivalents	\$ 15,786,496
Rebates receivable	1,660,040
Total current assets	58,771,043
Total assets	60,897,223
Total net assets	13,198,515
Statement of Revenues, Expenses and Changes in Net Assets – Enterprise Fund	
Interest income and other	1,347,443
Excess benefit expense over contributions received	(38,887,273)
Total non-operating revenues	(13,167,929)
Decrease in net assets	(12,619,450)
Statement of Fiduciary Net Assets – Agency Fund	
Cash and cash equivalents	38,385,715
Rebates receivable	4,044,574
Total receivables	47,217,142
Total assets	131,419,166
Amounts held on behalf of employers for benefits	115,761,358
Total liabilities	\$ 131,419,166

State of Hawaii  
Hawaii Employer-Union Health Benefits Trust Fund

SCHEDULE OF FINDINGS AND RESPONSES (continued)

June 30, 2009

**Cause:** The finding described above was primarily due to lack of receipt of information on the auction-rate securities write-down and due to oversight.

**Effect:** The balances were either understated or overstated on the separate financial statements for the active and retiree healthcare benefits at June 30, 2008.

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

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

**09-02: Financial Statement Reporting**

**Criteria:** As a result of audit procedures performed, we brought to management's attention amended guidance released by GASB in the fiscal year 2009 regarding GASB 43 affecting the Trust Fund's financial reporting of its retiree healthcare benefits. GASB 43 requires a statement of plan net assets and a statement of changes in plan net assets for defined OPEB plans that are administered as trusts or equivalent or a statement of fiduciary net assets – agency fund for multiple-employer OPEB plans that are not administered as trusts or equivalent arrangements.

**Condition:** Previously, management had determined that its retiree healthcare benefits met the criteria of a trust or equivalent arrangement. After reviewing the amended guidance on GASB 43, management determined that the retiree healthcare benefits do not meet the criteria of a trust or equivalent arrangement. As a result, during the year ended June 30, 2009, the Trust Fund retroactively changed the financial statement presentation of its retiree healthcare benefits.

**Context:** The statement of fiduciary net assets as of June 30, 2008, after the retroactive change is as follows:

Statement of Fiduciary Net Assets – Agency Fund	
Cash and cash equivalents	38,385,715
Rebates receivable	4,044,574
Total receivables	47,217,142
Total assets	131,419,166
Amounts held on behalf of employers for benefits	115,761,358
Total liabilities	\$ 131,419,166

**Cause:** The finding described above was primarily due to lack of information related to the amended GASB guidance and due to oversight.

**Effect:** The financial statement presentation of retiree healthcare benefits was retroactively changed from presenting a statement of plan net assets and statement of changes in plan net assets to a statement of fiduciary net

State of Hawaii  
Hawaii Employer-Union Health Benefits Trust Fund

SCHEDULE OF FINDINGS AND RESPONSES (continued)

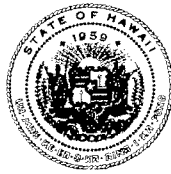
June 30, 2009

assets – agency fund. The agency fund reports no plan net assets and the assets accumulated in excess of liabilities is reported as a liability for amounts held on behalf of employers for benefits.

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

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

LINDA LINGLE  
GOVERNOR



**STATE OF HAWAII**  
**HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND**  
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VACANT

**ADMINISTRATOR**  
VACANT

July 28, 2010

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

Dear Grant Thornton:

Thank you for the opportunity to respond to the audit report of the Hawaii Employer-Union Health Benefits Trust Fund (EUTF) for the fiscal year ended June 30, 2009. The following are the EUTF's responses and corrective action plans for the audit findings.

#### **09-01 Prior Period Adjustments (Material Weakness)**

##### **Auditor Recommendation:**

Recommend that management ensure that all transactions in the Trust Fund's financial statement are properly reported in accordance with generally accepted accounting standards in the United States of America.

##### **Corrective Action Plan:**

The EUTF began offering self-funded medical and prescription drug plans effective July 1, 2007. Under self-funded arrangements, the EUTF pays administrative fees and actual claims incurred to the contractor instead of premiums. The contract entitled the EUTF to receive rebates from pharmaceutical manufacturers related to actual claims paid. At that time, the EUTF was unaware that it would take approximately 6 months to receive the rebates. The EUTF now understands the process and have implemented a process to ask the contractor for estimates of rebates that EUTF will receive. This will ensure that the EUTF will properly record the rebates in the correct period.

Subsequent to the issuance of the audited financial statements for the year ended June 30, 2008, the EUTF received a memorandum from the Comptroller establishing the State's policy regarding accounting adjustments to cash in the state treasury that are reported on the EUTF's financial statements, to reflect a write-down of the State's investments related to Auction Rate Securities. The EUTF is now following up with the Comptroller's office to receive the proper valuation adjustment amounts for auction rate securities to properly reflect the transaction in our financial statement.



**09-02 Financial Statement Reporting (Significant Deficiency)**

**Auditor Recommendation:**

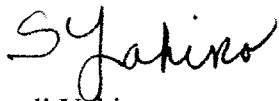
Recommend that management ensure that all transactions in the Trust Fund's financial statements are properly reported in accordance with generally accepted accounting standards in the United States of America.

**Corrective Action Plan:**

As stated in the Schedule of Findings and Responses, Governmental Accounting Standards Board (GASB) issued an amended guidance in fall of 2008 regarding GASB 43 affecting the EUTF's financial reporting for its retiree healthcare benefits. The EUTF was unaware of this amendment. The EUTF accounting staff will need to improve their knowledge of GASB 43 as related to the EUTF. The EUTF can access and order GASB information and communications such as technical inquiries, implementation guides and publications at the GASB website. The EUTF may also be able to attend conferences or seminars related to GASB 43 issues.

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

Sincerely,



Sandi Yahiro  
Acting Assistant Administrator



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