ANNUAL REPORT

FISCAL YEAR 2006-07

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

December 2007

This report presents an overview of the activities of the Hawaii Employer-Union Health Benefits Trust Fund ("EUTF") for the fiscal year 2006 - 2007. The EUTF is administratively attached to the Department of Budget and Finance. The EUTF's office is located at Suite 1520, City Financial Tower, Honolulu, Hawaii.

OVERVIEW

Chapter 87A of the Hawaii Revised Statutes established a trust fund known as the Hawaii Employer-Union Health Benefits Trust Fund. The EUTF is the state agency that provides eligible state and county employees and retirees and their eligible dependents with health and life insurance benefits. The EUTF replaced the Hawaii Public Employees Health Fund ("PEHF"), effective July 1, 2003.

TRUST FUND ORGANIZATION

Board of Trustees

The EUTF is administered by a board of trustees ("Board"). The Board is responsible for determining the nature and scope of the benefit plans offered, negotiating and entering into contracts with insurance carriers and plan administrators, establishing eligibility criteria and management policies for the EUTF, and overseeing all EUTF activities.

There are ten trustees, five representing the public employers and five representing employee-beneficiaries, including a retiree representative. The current trustees are shown below:

Employer Trustees
- Barbara Annis
- Darwin Ching
- Marie Laderta
- Lawrence Reifurth
- Stanley Shiraki

Employee-Beneficiary Trustees
- George Kahoohanohano, SHOPO
- Guy Fujio, HFFA
- Elizabeth Ho, AFSCME
- Gerald Machida, Retirees
- John Radcliffe, UHPA

Board officers currently are Gerald Machida, Chairperson, George Kahoohanohano, Vice-Chairperson and Marie Laderta, Secretary-Treasurer. The officers serve a one-year term beginning July 1 of each year.

During the period covered by this report, the Board has used both standing and temporary committees to facilitate its administration of the EUTF. The two standing committees are the Administrative Committee and the Benefits Committee. The Administrative Committee considers matters pertaining to the administration and operation of the EUTF, e.g., development of budget, organization of staff, setting of personnel policies, evaluation of EUTF systems, and consideration of use of third party administration services. The Benefits Committee considers matters pertaining to the design and procurement of the EUTF's health and life insurance benefit plans.

Administrator and Staff

The day-to-day administration of the EUTF is managed by an administrator who reports to and is responsible to the Board. The administrator is James Williams who was hired in November 2004. The EUTF administrator and new staff positions are exempt from civil service.

The administrator is assisted in managing the EUTF by an assistant administrator, a financial management officer, and an information systems analyst. EUTF staff has a total of 30 employees (including management staff and the Administrator).

The EUTF has three branches: the Financial Services Branch, Information Systems Branch, and Member Services Branch. A health benefits program manager oversees the Member Services Branch and is supported by employees assigned to customer service duties that include answering phones and e-mails from members and handling all processing for retirees and the other employees process all active employee enrollment submissions. The financial management officer is supported by two accountants and three account clerks, who reconcile employee accounts, collect employer/employee contribution for health benefits and process all payments. The EUTF information systems analyst provides internal IT support services, fulfills HIPAA security responsibilities, and coordinates additional support services provided by DAGS/ICSD and is supported by one IS specialist.

Advisors and Consultants

The Board utilized the services of Garner Consulting as its benefits plan consultant until June 27, 2007. Garner Consulting was the EUTF's consultant for 5 years. A request for proposal for benefit plan consulting services was issued in March 2007 and the contract was awarded to Aon Consulting in June 2007 with an effective contract start date of June 28, 2007. Aon Consulting is among the top global human capital and management consulting firms, providing a complete array of consulting, outsourcing and insurance brokerage services. The Honolulu office staffed by 11 consultants and support staff, focuses on the delivery of employee benefit programs consistent with Hawaii statutes.

The Board also has employed professional consultants and advisors on certain specific issues of importance to the EUTF. Business Solutions Technologies (BST) was retained to assist the EUTF with on-going support of the PeopleSoft health fund information management system (PeopleSoft/HFIMS). Segal was retained to conduct a claims audit for the HMSA medical and prescription drug plans. An advisor seat was purchased from Gartner, Inc which offers a cost-effective way for EUTF to obtain valuable technical research, information and reports to support critical information technology needs. Gartner, Inc. conducted a feasibility study project which resulted in a report to the Board that recommended a commercial off-the-shelf solution to replace the

PeopleSoft/HFIMS. Gartner, Inc. currently is assisting EUTF staff with its procurement process of the recommended solution.

ADMINISTRATIVE RULES

The EUTF operates according to administrative rules originally adopted in February 2003. The administrative rules were formulated to meet the requirements of Chapter 87A, Hawaii Revised Statutes, and the health and other benefit plans established by the EUTF. In addition, they were designed to increase administrative efficiencies and reduce the EUTF's administrative costs. For example, the rules set the effective dates for initial enrollments, changes in enrollment, and cancellations of enrollment in the EUTF's health benefit plans so as to facilitate automated handling of such activities. After a general review by the staff and Board, the administrative rules were revised in July 2006.

HEALTH AND LIFE INSURANCE BENEFIT PLANS

During fiscal year 2006-2007, the EUTF provided health and life insurance benefits through contracts with the following organizations:

- Hawaii Medical Service Association (HMSA)
- Kaiser Permanente (Kaiser)
- Hawaii Dental Service (HDS)
- Vision Service Plan (VSP)
- Mutual Benefit Association of Hawaii/ChiroPlan Hawaii, Inc. (ChiroPlan)
- Royal State National Insurance Company, Ltd. (Royal State)
- Aetna Life Insurance Company (Aetna)

HMSA and Kaiser provided medical plan coverage for State and County active employees and retirees. HMSA offered the Preferred Provider Option (PPO) plan and Kaiser offered the Health Maintenance Organization (HMO) plan. HDS and VSP provided the regular and supplemental dental and vision plans respectively for active employees and the regular dental and vision plans for retirees. Aetna provided the life insurance plan for active employees and retirees. Contracts with these organizations expired on June 30, 2007. As described in the section of this report entitled New and Revised Health Benefit Plan Options (July 1, 2007), the EUTF has entered into new contracts for health and life insurance benefit plans for fiscal year 2007-2008.

For both active employees and retirees, the health benefit plans provided by the EUTF during the fiscal year were available to domestic partners and full-time students up to the age of 24. No additional premium was required for student coverage under the family option. Active employees also received chiropractic benefits through ChiroPlan Hawaii which was offered in combination with any of the medical plans offered.

All active employees who have medical coverage through private sector or federal government plans were eligible to enroll in either of two Supplemental Medical Plans. The Royal State National Insurance Company, Ltd offered a dual coverage medical reimbursement plan, and HMSA offered a fee-for-service dual coverage plan.

The table below shows active employees' enrollment as of June 30, 2007.

Type of Benefit Plans	**Type of Coverage**		**Grand Total**
MEDICAL	**Self**	**Family**	
Regular Plans			
HMSA	17,288	15,107	32,395
Kaiser	4,859	4,120	8,979
Dual Plans			
HMSA Dual Plan	285	409	694
Royal State Dual Plan	109	378	487
Prescription Drug Only			
HMSA	52	92	144
Total Medical	22593	20,106	42,699
DENTAL			
Regular Plan			
HDS	20,742	23,227	43,969
Dual Plan			
HDS Dual	305	1,174	1,479
Total Dental	21,047	24,401	45,448
VISION			
Regular Plan			
VSP	20,608	21,180	41,788
Dual Plan			
VSP	242	959	1,201
Total Vision	20, 850	22,139	42,989
LIFE INSURANCE			
Aetna	53,153		53,153

The table below shows retirees' enrollment as of June 30, 2007

Health Plans	Type of Coverage		Grand Total
MEDICAL	**Self**	**Family**	
HMSA Non-Medicare	3,159	4,491	7,605
HMSA With Medicare	13,203	8,149	21,352
Kaiser Non-Medicare	796	971	1,767
Kaiser With Medicare	3,229	1,659	4,888
Total Medical	20,387	15,270	36,657
DENTAL			
HDS	20,260	15,031	35,291
VISION			
VSP	20,213	15,320	35,533
LIFE INSURANCE			
Aetna	31,622	-	31,622

OPERATIONS

During fiscal year 2007, the EUTF implemented several major policy and program changes as follows:

- Option for Bargaining Unit 5 retirees to transfer to HSTA VEBA (January 1, 2007)
- Medicare Part D Prescription Drug Plan (January 1, 2007)
- New and Revised Health Benefit Plan Options (July 1, 2007)

These implementations challenged EUTF resources, staff capabilities and communications processes.

<u>Option for Bargaining Unit 5 retirees to transfer to HSTA VEBA (January 1, 2007)</u>

The HSTA VEBA program implemented in March of 2006 established programs for the bargaining unit 5 members previously enrolled with the EUTF. Under the law, bargaining unit 5 retirees were to be offered a one-time option to enroll in the HSTA VEBA. On January 1, 2007, just over 1,000 retirees plus their dependents made the transfer from the EUTF to the HSTA VEBA. Nearly 5,500 HSTA retirees chose to remain with the EUTF.

<u>Medicare Part D Prescription Drug Plan (January 1, 2007)</u>

In November 2006, the EUTF Board of Trustees approved implementation of the Medicare Part D prescription drug program for all eligible retired and spouses enrolled with the EUTF. The Board's decision was made with the intent of capturing greater federal subsidies, while maintaining the same benefit level in the Medicare retirees' prescription drug plan. This implementation presented several challenges, including the short lead time and the discovery that the Centers for Medicare and Medicaid Services' (CMS) rules and guidelines for the

Part D program were not clear (and continue to be revised and reinterpreted). Communication with retirees about the program is an ongoing process. One of the requirements to be eligible for Part D is an accurate HICN (Medicare number) which was not previously routinely collected nor maintained by the EUTF or its predecessor. Since the Part D program falls under the jurisdiction of CMS, the EUTF was required to collect and report the HICN for all Medicare retirees and to adhere to CMS's policies regarding eligibility data.

New and Revised Health Benefit Plan Options (July 1, 2007)

The most significant change to the EUTF operations was the preparation for the implementation of the additional health benefit plans, including open enrollment and implementation effective July 1, 2007. After a rigorous procurement process the EUTF Board of Trustees approved new health benefits options for FY 2007-2008, including an additional PPO plan, two new HMO plans and a new High Deductible Health Plan. The Board approved a shift to self-funded financing for most of the medical and prescription drug plans. Two new third party administrators were selected—one for the PPO medical plan and the other for the prescription drug plan.

Ongoing Programs and General Operations

The EUTF participates with the major State departments and counties which host pre-retirement, orientation and other informational sessions during the year. Over 3,000 interested employees attended these sessions. The EUTF continued the program to provide on-site retirement counseling in conjunction with the Employee Retirement System's periodic group retirement counseling sessions. During these sessions, the employee receives counseling from the ERS counselors regarding their retirement benefits and is counseled by the EUTF staff on their retirement health and life insurance benefits. This collaboration provides a valuable service to our employees planning to retire.

During FY2007, the EUTF Customer Service staff faced significant challenges that resulted from the programs noted above. From July 1, 2006 – June 30, 2007, the EUTF Customer Service line received nearly 50,000 incoming telephone calls. In addition, the Customer Service staff made 10,400 outgoing calls. In addition, the same staff processed over 20,000 retiree enrollment-related forms, processed, printed and mailed over 5,900 COBRA election notices, 20,000 confirmation notices, 6,000 retiree related notices and other project notices or letters such as the special enrollment and responses to retiree requests.

The Enrollment staff received and imaged 62,101 documents during FY2007. Of the documents received and imaged, the staff processed all but 3,522 documents for a completion rate of 91% by July 2007. Enrollment related documents which affected an employee or retiree's benefit plans or coverage total nearly 74% of all documents submitted. Other documents dealt with change of address, correction or clarification of data submitted, removal of dependents from plans and other miscellaneous categories.

Open Enrollment was held from April 16, 2007 to May 18, 2007. The open enrollment preparation for 2007 was a significant challenge for the EUTF, and the EUTF engaged the benefit consultant to conduct open enrollment sessions both for employer (personnel) representatives and for employees and retirees. With the assistance and cooperation of the insurance carriers/plan administrators, the consultant developed and produced a CD that included presentations by each of the health benefit carriers. The CD enabled the EUTF to standardize and transfer the open enrollment presentation. With the increase in health benefit options, it was imperative that a thorough presentation be developed and communicated with the employer representatives. Over 450 personnel and financial officers attended the 15 training sessions conducted on the four major islands. From April 16 – May 16, 2007, 92 open enrollment informational sessions for employees and retirees were held on the four major islands plus Molokai and Lanai. About 8,000 employees and retirees attended these sessions. As a result of the communication efforts, the EUTF received and processed nearly 9,700 open enrollment changes from the active employees and 1,650 from the retirees.

FISCAL YEAR 2007

During FY 2007, the EUTF collected $532,914,628 in employer and employee contributions for health benefit plans and paid carriers $490,982,043 in premiums. Medicare Part B reimbursements paid to retirees amounted to $38,064,776. The above amounts are presented on an accrual basis and do not include retrospective premium amounts of approximately $40 million due to HMSA, HDS and VSP.

An annual audit of the EUTF, as required by Chapter 87A-25(2), was conducted for the plan year July 1, 2006 through June 30, 2007 by Grant Thornton LLP. This audit report includes Government Accounting Standards Board Statement No. 43 (GASB 43), Financial Reporting for Post-employment Benefit Plans Other Than Pension Plans. The EUTF financial reports as presented in the Audit Report were approved by the EUTF Board of Trustees on November 29, 2007 and are attached to and incorporated in this report.

Financial statements and report of independent certified public accountants

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

June 30, 2007

Grant Thornton

Accountants and Business Advisors

December 19, 2007

Board of Trustees
Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

Dear Ladies and Gentlemen:

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

OBJECTIVES OF THE AUDIT

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

1. To provide a basis for an opinion on the fairness of the presentation of the basic financial statements of the Trust Fund.

2. To determine whether expenditures and other disbursements have been made and all revenues and other receipts to which the Trust Fund is entitled have been collected and accounted for in accordance with the laws, rules and regulations, and policies and procedures of the State of Hawaii.

3. To determine whether the Trust Fund has complied with the laws and regulations that may have a material effect on the basic financial statements.

SCOPE OF THE AUDIT

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

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Board of Trustees
Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii
December 19, 2007

ORGANIZATION OF THE REPORT

This report is presented in two parts as follows:

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

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

Very truly yours,

Grant Thornton LLP

C O N T E N T S

PART I

FINANCIAL SECTION

Report of Independent Certified Public Accountants

Board of Trustees
Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

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

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

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

As discussed in note A, the Trust Fund adopted Governmental Accounting Standards Board Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other than Pensions*.

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State of Hawaii

In accordance with *Government Auditing Standards*, we have also issued a report dated December 14, 2007 on our consideration of the Trust Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 8 through 12 and the schedules of funding progress and employer contributions on page 43 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Grant Thornton LLP

Honolulu, Hawaii
December 14, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2007

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

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

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

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

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

Active Employee Healthcare Benefits

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

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

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

Retiree Healthcare Benefits

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

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

FINANCIAL HIGHLIGHTS

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

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

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

The administrative expenses budgeted for the Trust Fund totaled approximately $4,466,300 for the year ended June 30, 2007. Actual administrative expenditures for the active employee healthcare benefits totaled $2,199,941, excluding the loss from the payment methodology of approximately $634,190 for the years 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 year ended June 30, 2007 as revenues rather than premium reserves payable to employers and employees. As a result, the Trust Fund recognized in the aggregate $773,742 in premium gains from VSP vision plans, Royal State National dual-coverage plans, and other for active employee and retiree health benefit plans.

The aggregated net asset value of capital assets was $279,852 at June 30, 2007. The aggregated depreciation expense totaled $340,907 for the year ended June 30, 2007.

The adoption of GASB 43 in 2007 resulted in separate reporting of the active employee and retiree healthcare benefits for financial statement purposes. As 2007 was the first year of such reporting, the summary financial results are presented as of and for the fiscal year ended June 30, 2007 only.

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

Operating revenues (administrative fees)	$ 1,979,765
Non-operating revenues	2,434,652
Total revenues	4,414,417
Operating expenses and total expenses	2,834,131
Income before transfers	1,580,286
Transfers	(1,745)
INCREASE IN NET ASSETS	$ 1,578,541

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

Current assets	$70,894,793
Capital assets	153,919
Total assets	$71,048,712
Current liabilities	45,185,571
Long-term liabilities	45,176
Total liabilities	45,230,747
Net assets	
Invested in capital assets	153,919
Unrestricted	25,664,046
Total net assets	25,817,965
Total liabilities and net assets	$71,048,712

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

Additions:	
Contributions, including administrative fees of $1,619,808	$ 242,980,561
Interest	1,637,675
Increase in premium reserves	340,692
Total additions	244,958,928
Deductions:	
Benefits	(241,360,754)
Administrative expenses	(2,339,027)
Total deductions	(243,699,781)
Increase in plan net assets	$ 1,259,147

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

Assets:	
Cash	$39,096,983
Receivables	8,649,459
Prepaid expenses	13,769
Deposits	10,092,000
Capital assets, net	125,933
Total assets	57,978,144
Liabilities:	
Premiums and other payables	31,779,064
Total liabilities	31,779,064
Net Assets held in Trust for Other Postemployment Benefits	$26,199,080

Economic Outlook

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 will give employees the opportunity to participate in Health Savings Accounts, two additional Health Maintenance Organization (HMO) plans, and an additional PPO plan.

Beginning July 1, 2007, the Trust Fund will offer 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 the self-funded medical and prescription drug plans will be lower than their counterparts during the 2008 plan year. For active employee plans, Kaiser rates will increase by an average of 6.6%, Hawaii Dental Service rates will decrease by 6.0%, and Vision Service Plan rates will increase by 7.9%.

In addition, the Trust Fund's Board of Trustees has decided to revise the current single and family rate structure to provide lower rates for employees who enroll only one dependent in Trust Fund health benefit plans, who previously had been paying the same rates as employees with three or more family members. Implementation of the two-party rate will mean a decrease of over 20% in Preferred Provider Organization (PPO) rates for employees in the two-party category. For single employees, PPO rates will decrease by approximately 4-6%, while family rates will increase by approximately 1-3% depending upon the plan selected. The two-party rate will bring the Trust Fund in line with the approach taken by most private sector employers in the community.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

STATEMENT OF NET ASSETS - ENTERPRISE FUND

June 30, 2007

ASSETS

CURRENT ASSETS	
Cash (note B3)	$ 56,383,933
Premiums receivable from individuals, net of allowance $234,350	31,913
Premiums receivable from State of Hawaii and counties	4,550,516
Premiums reserves held by insurance companies (note D)	134,192
Accrued interest receivable	469,411
Prepaid expenses	16,828
Deposits (note M)	9,308,000
Total current assets	70,894,793
NONCURRENT ASSETS	
Capital assets, net of accumulated depreciation $2,154,424 (notes B2 and C)	153,919
Total assets	$ 71,048,712

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES	
Vouchers and contracts payable	$ 193,690
Accrued wages and employee benefits payable	55,981
Due to State of Hawaii	23,858
Retrospective premium payable (note D)	22,775,336
Premiums payable	22,104,420
Compensated absences, current portion (note B4)	32,286
Total current liabilities	45,185,571
NONCURRENT LIABILITIES	
Compensated absences (note B4)	45,176
Total liabilities	45,230,747
NET ASSETS	
Invested in capital assets	153,919
Unrestricted	25,664,046
Total net assets	25,817,965
Total liabilities and net assets	$ 71,048,712

The accompanying notes are an integral part of this statement.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

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

Year ended June 30, 2007

Operating revenues	
Administrative fees (note I)	$ 1,979,765
Total operating revenues	1,979,765
Operating expenses	
Personal services	758,915
Loss from payment methodology (note J)	634,190
Repairs and maintenance	353,140
Contracted services	328,217
Equipment	262,433
Depreciation	187,499
Occupancy (note K)	123,593
Insurance	54,416
Printing and binding	46,012
Postage	24,763
Provision for bad debt	23,763
Transportation	11,871
Rental of equipment	8,675
Telephone	6,499
Supplies	5,429
Training	3,290
Dues and subscriptions	823
Other	603
Total operating expenses	2,834,131
Operating loss	(854,366)
Non-operating revenues	
Increase in premium reserves (note D)	433,050
Interest income and other	2,001,602
Total non-operating revenues	2,434,652
Income before transfers	1,580,286
Transfers	
Transfer to other government agencies	(1,745)
INCREASE IN NET ASSETS	1,578,541
Net assets at beginning of the year	24,239,424
Net assets at end of year	$ 25,817,965

The accompanying notes are an integral part of this statement.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

STATEMENT OF CASH FLOWS - ENTERPRISE FUND

Year ended June 30, 2007

Cash flows from operating activities:	
Cash paid to vendors	$ (1,074,030)
Cash paid to employees	(770,455)
Cash received from State of Hawaii, counties and individuals for premiums and administrative fees	290,182,664
Cash paid for premiums	(271,780,623)
Cash paid for premium deposit for self-funded plans	(9,308,000)
Reserves returned by insurance carriers	147,593
Transfer of vacation credits to other governmental agency	(1,745)
Net cash provided by operating activities	7,395,404
Cash flows from investing activities:	
Interest received	1,814,068
Purchases of furniture and equipment	(27,798)
Net cash provided by investing activities	1,786,270
NET INCREASE IN CASH	9,181,674
Cash at the beginning of year	47,202,259
Cash at end of year	$ 56,383,933

The accompanying notes are an integral part of this statement.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

STATEMENT OF CASH FLOWS - ENTERPRISE FUND (continued)

Year ended June 30, 2007

Reconciliation of change in net assets to net cash provided by operating activities:		
Operating loss	$	(854,366)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation		187,499
Reserves provided by operating activities		329,293
Decrease in premiums receivable from individuals		57,257
Decrease in premiums receivable from State of Hawaii and counties		(30,566)
Decrease in premium reserves held by insurance companies		13,401
Increase in accrued interest receivable		(172,160)
Decrease increase in prepaid expenses		15,711
Increase in deposits		(9,308,000)
Increase in vouchers and contracts payable		118,382
Decrease in accrued wages and employee benefits payable		(10,494)
Increase in amounts due to State of Hawaii		15,892
Increase in premiums payable to carriers		17,042,508
Decrease in compensated absences		(8,953)
Net cash provided by operating activities	$	7,395,404

The accompanying notes are an integral part of this statement.

Hawaii Employer-Union Health Benefits Trust Fund
State of Hawaii

STATEMENT OF PLAN NET ASSETS

June 30, 2007

ASSETS

ASSETS	
Cash (note B3)	$ 39,096,983
Receivables	
Premiums receivable from individuals, net of allowance $705	96
Medicare reimbursements receivable from individuals, net of allowance $253,792	29,238
Premiums receivable from State of Hawaii and counties	8,046,720
Premiums reserves held by insurance companies (note D)	189,342
Accrued interest receivable	384,063
Total receivables	8,649,459
Prepaid expenses	13,769
Deposits (note M)	10,092,000
Capital assets, net of accumulated depreciation (notes B2 and C)	125,933
Total assets	57,978,144
LIABILITIES	
Vouchers and contracts payable	158,474
Due to State of Hawaii	67
Accrued wages and employee benefits payable	45,803
Retrospective premium payable (note D)	16,881,900
Premiums payable	14,629,442
Compensated absences (note B4)	63,378
Total liabilities	31,779,064
NET ASSETS HELD IN TRUST FOR OTHER POSTEMPLOYMENT BENEFITS	$ 26,199,080

The accompanying notes are an integral part of this statement.

Hawaii Employer - Union Health Benefits Trust Fund
State of Hawaii

STATEMENT OF CHANGES IN PLAN NET ASSETS

Year ended June 30, 2007

ADDITIONS	
Contributions	
Employer, including administrative fees of $1,619,808 (note I)	$ 242,697,193
Plan member	283,368
Total contributions	242,980,561
Investment income	
Interest	1,637,675
Increase in premium reserves (note D)	340,692
Total additions	244,958,928
DEDUCTIONS	
Benefits	(241,360,754)
Administrative expenses (operating)	(2,339,027)
Total deductions	(243,699,781)
NET INCREASE	1,259,147
NET ASSETS HELD IN TRUST FOR OTHER POSTEMPLOYMENT BENEFITS	
Beginning of year	24,939,933
End of year	$ 26,199,080

The accompanying notes are an integral part of this statement.

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE A – FINANCIAL REPORTING ENTITY

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

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

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

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

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

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

NOTE A – FINANCIAL REPORTING ENTITY (continued)

As of June 30, 2007, the Trust Fund provided insurance coverage to approximately the following individuals:

Active employees	53,100
Retirees	36,900
Spouses	36,100
Domestic partners	900
Dependents under the age of 19	29,500
Dependents between the ages of 19 – 23 who are full-time students	7,700
Disabled dependents	400
Total	164,600

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Measurement Focus and Basis of Accounting

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

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.

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

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

In 2007, the accounting for the active employee healthcare benefits are reported under the statement of net assets – enterprise fund, statement of revenue, expenses and changes in net assets – enterprise fund and statement of cash flows – enterprise fund. The accounting for the retiree healthcare benefits are

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

1. Measurement Focus and Basis of Accounting (continued)

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

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

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

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

2. Capital Assets

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

3. Cash

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

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3. Cash (continued)

and departments and deposited into approved financial institutions or participates in the State Treasury Investment Pool System. Cash accounts that participate in the investment pool accrue interest based on the weighted average cash balances of each account.

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

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

Cash includes the following as of June 30, 2007:

	Active	Retiree	Total
Category 1 investments	$30,250,000	$24,750,000	$55,000,000
Other	26,133,933	14,346,983	40,480,916
	$56,383,933	$39,096,983	$95,480,916

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 as of June 30, 2007 is as follows:

Balance at beginning of year	$148,992
Additions	85,920
Reductions	(94,072)
Balance at end of year	140,840
Less current portion	58,701
	$ 82,139

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4. Compensated Absences (continued)

All employees earn sick leave credits at the rate of one and three-quarters working days for each month of service. Sick leave credits may be accumulated without limit. Sick leave can be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for unpaid sick leave credits is reported in the accompanying financial statements. However, a Trust Fund employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the Employees' Retirement System of the State of Hawaii. Accumulated sick leave as of June 30, 2007 relating to the Trust Fund approximated $465,600.

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.

NOTE C – CAPITAL ASSETS

The aggregated capital asset activity for the year ended June 30, 2007 was as follows:

	Balance at July 1, 2006	Increases	Decreases	Balance at June 30, 2007
Capital assets being depreciated				
Office furniture and equipment	$ 4,146,444	$ 50,541	$ –	$ 4,196,985
Less accumulated depreciation	(3,576,226)	(340,907)	–	(3,917,133)
Capital assets, net	$ 570,218	$(290,366)	$ –	$ 279,852

NOTE D – HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS

The Trust Fund's primary purpose is to provide employee-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.

All of the carriers use experience ratings in determining the premium rates except for Kaiser Foundation Health Plan and Mutual Benefits Association of Hawaii. The carriers 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.

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 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. At June 30, 2007, the payable to HMSA for the plan year is as follows:

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

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

Medical and Prescription Drug Benefits (continued)

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

	Active employees	Retirees	Total
Final underwriting gain for plan year ended June 30, 2004	$ 7,052,188	$ 4,233,158	$ 11,285,346
Amounts refunded to the Trust Fund for plan year ended June 30, 2004	(7,052,188)	(4,233,158)	(11,285,346)
Final underwriting gain for plan year ended June 30, 2005	11,875,407	15,835,063	27,710,470
Interest	271,889	348,281	620,170
Estimated underwriting gain for plan year ended June 30, 2006, subject to final accounting	509,687	2,731,523	3,241,210
Amounts held by insurance carrier at June 30, 2006	12,656,983	18,914,867	31,571,850
Additional underwriting gain (loss) based on final accounting for plan year ended June 30, 2006	804,335	(942,970)	(138,635)
Interest	146,317	480,775	627,092
Estimated underwriting loss, prior to retrospective premiums for plan year ended June 30, 2007	(18,882,197)	(12,288,474)	(31,170,671)
2007 retrospective premiums held by the Trust Fund at June 30, 2007 due to the insurance carrier, subject to final accounting	15,652,433	8,451,520	24,103,953
Estimated underwriting loss for the plan year ended June 30, 2007, subject to final accounting	(3,229,764)	(3,836,954)	(7,066,718)
Amounts held by insurance carrier at June 30, 2007	$10,377,871	$14,615,718	$ 24,993,589

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

Medical and Prescription Drug Benefits (continued)

	Active employees	Retirees	Total
Final underwriting gain for plan year ended June 30, 2004	$ 7,052,188	$ 4,233,158	$11,285,346
Final underwriting gain for plan year ended June 30, 2005	11,875,407	15,835,063	27,710,470
Final underwriting gain for plan year ended June 30, 2006	1,314,022	1,788,553	3,102,575
Estimated underwriting loss for plan year ended June 30, 2007, subject to final accounting	(3,229,764)	(3,836,954)	(7,066,718)
Cumulative estimated underwriting gain at June 30, 2007	$17,011,853	$18,019,820	$35,031,673

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

	Active employees	Retirees	Total
Final underwriting gain for plan year ended June 30, 2004	$ 9,822,838	$ 13,271,969	$ 23,094,807
Amounts refunded to the Trust Fund for plan year ended June 30, 2004	(9,822,838)	(13,271,969)	(23,094,807)
Final underwriting gain for plan year ended June 30, 2005	10,334,757	13,103,593	23,438,350
Interest	206,115	290,462	496,577
Estimated underwriting gain for plan year ended June 30, 2006, subject to final accounting	2,254,593	3,630,532	5,885,125
Amounts held by insurance carrier at June 30, 2006	12,795,465	17,024,587	29,820,052
Additional underwriting gain based on final accounting for plan year ended June 30, 2006	189,855	279,456	469,311
Interest	647,231	639,010	1,286,241
Estimated underwriting loss, prior to retrospective premiums for the plan year ended June 30, 2007	(7,397,966)	(4,522,863)	(11,920,829)
2007 retrospective premiums held by the Trust Fund at June 30, 2007 due to the insurance carrier, subject to final accounting	3,804,868	6,513,321	10,318,189
Estimated underwriting (loss) gain, subject to final accounting	(3,593,098)	1,990,458	(1,602,640)
Amounts held by insurance carrier at June 30, 2007	$10,039,453	$ 19,933,511	$ 29,972,964

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

Medical and Prescription Drug Benefits (continued)

	Active employees	Retirees	Total
Final underwriting gain for plan year ended June 30, 2004	$ 9,822,838	$13,271,969	$23,094,807
Final underwriting gain for plan year ended June 30, 2005	10,334,757	13,103,593	23,438,350
Final underwriting gain for plan year ended June 30, 2006	2,444,448	3,909,988	6,354,436
Estimated underwriting (loss) gain for plan year ended June 30, 2007, subject to final accounting	(3,593,098)	1,990,458	(1,602,640)
Cumulative estimated underwriting gain at June 30, 2007	$19,008,945	$32,276,008	$51,284,953

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

	Active employees	Retirees	Total
Final underwriting gain for plan year ended June 30, 2004	$ 16,875,026	$ 17,505,127	$ 34,380,153
Amounts refunded to the Trust Fund for plan year ended June 30, 2004	(16,875,026)	(17,505,127)	(34,380,153)
Final underwriting gain for plan year ended June 30, 2005	22,210,164	28,938,656	51,148,820
Interest	478,004	638,743	1,116,747
Estimated underwriting gain for plan year ended June 30, 2006, subject to final accounting	2,764,280	6,362,055	9,126,335
Amounts held by insurance carrier at June 30, 2006	25,452,448	35,939,454	61,391,902
Additional underwriting gain (loss) based on final accounting for plan year ended June 30, 2006	994,190	(663,514)	330,676
Interest	793,548	1,119,785	1,913,333
Estimated underwriting loss, prior to retrospective premiums for plan year ended June 30, 2007	(26,280,163)	(16,811,337)	(43,091,500)
2007 retrospective premiums held by the Trust Fund at June 30, 2007 due to the insurance carrier, subject to final accounting	19,457,301	14,964,841	34,422,142
Estimated underwriting loss for the plan year ended June 30, 2007, subject to final accounting	(6,822,862)	(1,846,496)	(8,669,358)
Amounts held by insurance carrier at June 30, 2007	$20,417,324	$ 34,549,229	$ 54,966,553

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

Medical and Prescription Drug Benefits (continued)

	Active employees	Retirees	Total
Final underwriting gain for plan year ended June 30, 2004	$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
Estimated underwriting loss for plan year ended June 30, 2007, subject to final accounting	(6,822,862)	(1,846,496)	(8,669,358)
Cumulative estimated underwriting gain at June 30, 2007	$36,020,798	$50,295,828	$86,316,626

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 contract includes a five percent (5%) retrospective premium agreement for both active employees and retirees. Under this agreement, 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. At June 30, 2007, the payable to VSP for the plan year is as follows:

	Active employees	Retirees	Total
Plan year ended June 30, 2007	$229,788	$149,421	$379,209

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

Vision Care Benefits (continued)

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

	Active employees	Retirees	Total
Plan year ended June 30, 2004			
Final underwriting gain (loss)	$ 545,197	$ (43,778)	$ 501,419
Plan year ended June 30, 2005			
Final underwriting gain	$ 632,130	$ 7,049	$ 639,179
Plan year ended June 30, 2006			
Estimated underwriting gain, prior to retrospective premiums	$ 45,776	$ 194,428	$ 240,204
Additional underwriting loss based on final accounting	(14,836)	(5,086)	(19,922)
Final underwriting gain, prior to retrospective premiums	30,940	189,342	220,282
2006 retrospective premiums	264,098	151,048	415,146
Final underwriting gain	$ 295,038	$ 340,390	$ 635,428
Plan year ended June 30, 2007			
Estimated underwriting gain, prior to retrospective premiums	$ 269,434	$ 144,975	$ 414,409
2007 retrospective premiums held by the Trust Fund at June 30, 2007 due to the insurance carrier, subject to final accounting	229,788	149,421	379,209
Estimated underwriting gain, subject to final accounting	$ 499,222	$ 294,396	$ 793,618
Cumulative estimated underwriting gain as of June 30, 2007, including retrospective premiums	$ 1,971,587	$ 598,057	$ 2,569,644

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

Vision Care Benefits (continued)

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 as of June 30, 2007:

	Active employees	Retirees	Total
Plan year ended June 30, 2007	$264,098	$151,048	$415,146

Life Insurance Benefits

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

	Active employees	Retirees	Total
Final underwriting gain for plan year ended June 30, 2004	$ 760,037	$ 92,741	$ 852,778
Amounts refunded to the Trust Fund for plan year ended June 30, 2004	(760,037)	(92,741)	(852,778)
Final underwriting gain for plan year ended June 30, 2005	989,272	181,354	1,170,626
Interest	38,890	20,334	59,224
Final underwriting gain for plan year ended June 30, 2006	817,581	236,971	1,054,552
Amounts held by insurance carrier at June 30, 2006	1,845,743	438,659	2,284,402
Interest	48,212	29,549	77,761
Amounts refunded to the Trust Fund in 2007 for plan year ended June 30, 2005	(147,593)	(76,033)	(223,626)
Estimated underwriting gain (loss) for plan year ended June 30, 2007, subject to final accounting	447,873	(83,887)	363,986
Amounts held by insurance carrier at June 30, 2007	$2,194,235	$ 308,288	$2,502,523

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

Life Insurance Benefits (continued)

	Active employees	Retirees	Total
Fund underwriting gain for plan year ended June 30, 2004	$ 760,037	$ 92,741	$ 852,778
Final underwriting gain for plan year ended June 30, 2005	989,272	181,354	1,170,626
Final underwriting gain for plan year ended June 30, 2006	817,581	236,971	1,054,552
Estimated underwriting gain (loss) at June 30, 2007 for plan year ended June 30, 2007, subject to final accounting	447,873	(83,887)	363,986
Cumulative estimated underwriting gain at June 30, 2007	$3,014,763	$ 427,179	$3,441,942

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 contract includes a ten percent (10%) retrospective premium agreement for both active employees and retirees. Under this agreement, 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. At June 30, 2007, the payable to HDS for the plan year is as follows:

	Active employees	Retirees	Total
Plan year ended June 30, 2007	$ 3,088,247	$ 1,767,638	$ 4,855,885

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

	Active employees	Retirees	Total
Plan year ended June 30, 2004			
Final underwriting loss	$(2,069,104)	$(1,141,373)	$(3,210,477)
Plan year ended June 30, 2005			
Final underwriting loss	$(1,179,107)	$ (674,674)	$(1,853,781)

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

Dental Benefits (continued)

	Active employees	Retirees	Total
Plan year ended June 30, 2006			
Estimated underwriting loss, prior to retrospective premiums	$(3,979,287)	$(1,873,453)	$(5,852,740)
Additional underwriting gain based on final accounting	204,776	29,290	234,066
2006 retrospective premiums paid in 2007	3,359,097	1,659,312	5,018,409
Final underwriting loss	$ (415,414)	$ (184,851)	$ (600,265)
Plan year ended June 30, 2007			
Estimated underwriting (loss) gain, prior to retrospective premiums	$(1,596,605)	$ 406,453	$(1,190,152)
2007 retrospective premiums held by the Trust Fund at June 30, 2007	3,088,247	1,767,638	4,855,885
Estimated underwriting gain, subject to final accounting	$ 1,491,642	$ 2,174,091	$ 3,665,733
Cumulative estimated underwriting (loss) gain as of June 30, 2007	$(2,171,983)	$ 173,193	$(1,998,790)

Chiropractic Benefits

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

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

Dual-Coverage Medical and Prescription 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. As of 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 at June 30, 2006	$ 99,631
Interest	3,621
Amounts held by insurance carrier at June 30, 2007	$103,252

Final underwriting gain at June 30, 2004	$ 45,862
Final underwriting gain at June 30, 2005	166,202
Final underwriting gain at June 30, 2006	103,252
Estimated underwriting loss at June 30, 2007 for plan year ended June 30, 2007, subject to final accounting	(824)
Cumulative estimated underwriting gain as of June 30, 2007	$314,492

All Contracts

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

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

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

All Contracts (continued)

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

	Active employees	Retirees	Total
For plan year ended June 30, 2006:			
VSP – Vision contract	$ 30,940	$189,342	$220,282
RSN – Dual coverage contract	103,252	–	103,252
	$134,192	$189,342	$323,534

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

	Active employees	Retirees	Total
Plan year ended June 30, 2007:			
VSP – Vision contract	$ 229,788	$ 149,421	$ 379,209
HDS – Dental contract	3,088,247	1,767,638	4,855,885
HMSA – Medical and prescription drug contract	19,457,301	14,964,841	34,422,142
	$22,775,336	$16,881,900	$39,657,236

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

	Active employees	Retirees	Total
For plan year ended June 30, 2006:			
VSP – Vision contract	$ 295,038	$ 340,390	$ 635,428
RSN – Dual coverage contract	103,252	–	103,252
Other	34,760	302	35,062
	$ 433,050	$ 340,692	$ 773,742

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

All Contracts (continued)

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

NOTE E – RETIREMENT BENEFITS

1. Employees' Retirement System

Plan Description

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

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

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

NOTE E – RETIREMENT BENEFITS (continued)

1. Employees' Retirement System (continued)

Funding Policy

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

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

2. Post-Retirement Health Care and Life Insurance Benefits

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.

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

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

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

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

NOTE E – RETIREMENT BENEFITS (continued)

3. Cost of Retirement Benefits

The Trust Fund's share of the aggregated pension and post-retirement benefits expense was approximately $136,000 and $72,000, respectively, for the year ended June 30, 2007 and are included in the Trust Fund's financial statements.

NOTE F – COMMITMENTS AND CONTINGENCIES

1. Deferred Compensation

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

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

2. Litigation

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

On June 30, 2006, a class action lawsuit was brought in the First Circuit Court, State of Hawaii, by certain State and county retirees against the Trust Fund, the Trust Fund's board of trustees, and the State ("collectively "State defendants"), as well as various county governments that participate in the Trust Fund's health benefit plans. The plaintiffs' amended complaint alleges various claims based on an argument that the Trust Fund is constitutionally, statutorily, and contractually required to provide health

NOTE F – COMMITMENTS AND CONTINGENCIES (continued)

2. Litigation (continued)

benefit plans that provide retirees and their dependents with benefits that are substantially equal to those provided to active employees and their dependents. In addition, the plaintiffs claim that the Trust Fund's failure to provide substantially equal health benefit plans to retirees and their dependents was negligent. The plaintiffs seek declaratory and injunctive relief, damages, and attorneys' fees and costs. The damages sought appear to be amounts that the plaintiffs (and their class) have paid for health benefits which they would not have paid had their plans been equivalent to the Trust Fund's active employee plans. The defendants filed motions to dismiss the plaintiffs' complaint. The judge decided that the Trust Fund had primary jurisdiction over issues involved in the plaintiffs' claims and stayed this action pending referral of those issues to the Trust Fund. In May and June 2007, the plaintiffs filed a petition with the Trust Fund's board of trustees seeking a declaratory ruling. The Trust Fund's board of trustees held a hearing on the plaintiffs' petition under the Trust Fund rules and Chapter 91 of the Hawaii Revised Statutes ("HRS"). After the hearing, the Trust Fund's board of trustees issued Findings of Fact, Conclusions of Law, and Order. The plaintiffs filed an appeal for judicial review of the Findings of Fact, Conclusions of Law, and Order under HRS § 91-14. A briefing schedule has been set for this appeal which is to be heard by the First Circuit Court on February 13, 2008. The plaintiffs also filed a motion to amend their complaint in the original lawsuit. The proposed amendments basically allege procedural and substantive errors in the Trust Fund's declaratory order proceeding. The defendants have filed opposition to the plaintiffs' motion arguing that the sole means of judicial review of the Trust Fund's declaratory order proceeding is an appeal under HRS § 91-14, that granting the motion would be duplicative of and create possible conflicts with the plaintiffs' separate appeal of the Trust Fund's declaratory order, and that all proceedings in the lawsuit should continue to be stayed pending the outcome of the plaintiffs' appeal of the Trust Fund's declaratory order. The State defendants intend to vigorously defend this action.

3. Reserve for Encumbrances

The aggregated reserve for outstanding encumbrances as of June 30, 2007 amounted to approximately $319,000.

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.

NOTE G – RISK MANAGEMENT (continued)

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

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

NOTE H – RELATED PARTY TRANSACTIONS

The State's contribution for medical, dental, life insurance, vision care, and prescription drug benefits is transferred to the Trust Fund from the State Department of Budget and Finance each month and is accounted for as a deduction of the receivable due from the State.

NOTE I – 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 year ended June 30, 2007, the aggregated administrative fees amounted to approximately $3,600,000.

NOTE J – 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, 2007, the Trust Fund recognized aggregated losses of approximately $1,174,000.

NOTE K – LEASE COMMITMENT

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

NOTE K – LEASE COMMITMENT (continued)

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

At June 30, 2007, the aggregated minimum rental commitment under the noncancelable operating lease is as follows:

	Amount
Year ending June 30,	
2008	$217,000
2009	217,000
2010	90,000
	$524,000

The aggregated rent expense for the year ended June 30, 2007 was $224,715.

NOTE L – FUNDED STATUS AND FUNDING PROGRESS – OPEB PLAN

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

Actuarial valuation date	Actuarial value of assets (a)	Actuarial accrued liability (AAL) (b)	Unfunded AAL (UAAL) (b) – (a)	Funded ratio (a) / (b)	Covered payroll (c)	UAAL as of percentage of covered payroll (b) – (a) / (c)
7/1/2006	$0	$6,269,500,000	$6,269,500,000	0%	$2,695,000,000	233%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements is meant to present multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits. As 2007 is the first year of implementation for GASB 43 and only one actuarial valuation has been completed, there is no trend information available.

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

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

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

valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. Additional information as of the latest actuarial valuation follows:

Valuation date	7/1/06
Actuarial cost method	Entry age normal
Amortization method	Level percentage of pay, open
Amortization period	30 years
Actuarial assumptions:	
Investment rate of return*	8%
Healthcare cost trend rate*:	
Medical and prescription drug	11% initial; 5% ultimate
Dental	7% initial; 4% ultimate
Vision	3%
Medicare Part B	5.6% initial; 5% ultimate
Projected salary increases	3.5%

*Includes an inflation assumption of 3%.

Membership of the plan consisted of the following at July 1, 2006, the date of the latest actuarial valuation:

Retirees and beneficiaries receiving benefits	36,803
Terminated plan members entitled to but not yet receiving benefits	2,463
Active plan members	50,666
Total	89,932
Number of participating employers	7

NOTE M – DEPOSITS

Beginning July 1, 2007, the Trust Fund will offer 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). According to the terms of contracts with HMSA and NMHCS, the Trust Fund was initially required to make a deposit to cover estimated claims costs for the self-funded medical and prescription drug plans. The deposits held by the carriers for the self-funded medical and prescription drug plans as of June 30, 2007 are as follows:

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

Hawaii Employer-Union Health Benefit Trust Fund
State of Hawaii

REQUIRED SUPPLEMENTARY INFORMATION
(unaudited)

June 30, 2007

Schedule of Funding Progress

Actuarial valuation date	Actuarial value of assets (a)	Actuarial accrued liability (AAL) (b)	Unfunded AAL (UAAL) (b) – (a)	Funded ratio (a) / (b)	Covered payroll (c)	UAAL as of percentage of covered payroll (b) – (a) / (c)
7/1/2006	$0	$6,269,500,000	$6,269,500,000	0%	$2,695,000,000	233%

Schedule of Employer Contributions

Year ended June 30,	Annual required contribution	Percentage contribution
2007	$514,000,000	47%

PART II

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

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

Board of Trustees
Hawaii Employer-Union Health Benefits Trust Fund
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, 2007, and have issued our report thereon dated December 14, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Trust Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D of the Hawaii Revised

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State of Hawaii

Statutes) and procurement rules, directives and circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audits, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to the Board of Trustees and management of the Trust Fund in a separate letter dated December 14, 2007.

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

Grant Thornton LLP

Honolulu, Hawaii
December 14, 2007