HAWAII EMPLOYER-UNION
HEALTH BENEFITS TRUST FUND
STATE OF HAWAII

Annual Financial Report

June 30, 2012 and 2011

MGO Certified Public Accountants.

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To the Board of Trustees of
the Hawaii Employer-Union Health Benefits Trust Fund
of the State of Hawaii and
Ms. Jan K. Yamane, Acting State Auditor
State of Hawaii, Office of the Auditor
Honolulu, Hawaii

Independent Auditor's Report

We have audited the accompanying statements of net assets (deficit) for the enterprise fund and fiduciary assets and liabilities for the agency fund of the Hawaii Employee-Union Health Benefits Trust Fund of the State of Hawaii (Trust Fund) as of June 30, 2012 and 2011, and the related statements of revenues, expenses and changes in net assets (deficit), and cash flows for the enterprise fund for the years then ended. These financial statements are the responsibility of the Trust Fund's management. Our responsibility is to express opinions on these financial statements based on our audits.

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

As discussed in Note 1, the financial statements of the Trust Fund are intended to present the financial position, and the changes in financial position and cash flows, of only that portion of the activities of the State of Hawaii that is attributable to the transactions of the Trust Fund. They do not purport to, and do not present fairly the financial position of the State of Hawaii as of June 30, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to previously present fairly, in all material respects, the respective financial position of the enterprise fund and agency fund of the Trust Fund as of June 30, 2012 and 2011, and the respective changes in financial position and cash flows, where applicable, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 4, 2013, on our consideration of the Trust Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters for the year ended June 30, 2012. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or noncompliance. 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.

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

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

Macias Gini & O'Connell LLP

Newport Beach, California
January 4, 2013

This section of the Hawaii Employer-Union Health Benefits Trust Fund of the State of Hawaii (Trust Fund) financial report presents the reader with an introduction and overview of the Trust Fund's financial performance for the years ended June 30, 2012 and 2011. This discussion has been prepared by management and should be read in connection with the financial statements and the notes thereto, which follow this section.

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

During 2007, the Trust Fund adopted Governmental Accounting Standards Board Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other than Pensions* (GASB 43). GASB 43 establishes accounting and financial reporting standards for plans that provide other postemployment benefits (OPEB) other than pensions. GASB 43 requires a statement of plan net assets and a statement of changes in plan net assets for defined benefit OPEB plans that are administered as trusts or equivalent arrangements. However, if an OPEB plan is not administered as a trust or equivalent arrangement it is required to be reported as an agency fund.

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

In August 2006, the Trust Fund issued a Request for Proposals seeking proposals to provide benefit plans effective July 1, 2007. The evaluation committee recommended and the Board of Trustees approved the award of contracts for twelve benefit plans for the period July 1, 2007 through June 30, 2009.

Beginning July 1, 2007 the Trust Fund began offering self-funded medical and prescription drug plans in addition to the fully insured HMO plan. Under self-funded arrangements, the Trust Fund contracts with plan administrators for provider networks, claims processing, cost containment and other services. Instead of premiums, the Trust Fund pays administrative fees to the contractor and reimburses the contractor only for claims paid.

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

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

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

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

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

Act 245, Session Laws of Hawaii (SLH) 2005 (partially codified as HRS Chapter 87D), temporarily authorized employee organizations to establish voluntary employees beneficiary association (VEBA) trusts to provide health benefits to state and county employees in their bargaining units outside of the Trust Fund. It established a three-year pilot program to allow for the analysis of the costs and benefits of a VEBA trust against those of the Trust Fund. Effective March 1, 2006, the HSTA implemented the three-year pilot program. As a result, all active HSTA employees were enrolled in the VEBA trust and subsequently cancelled from the Trust Fund's health benefit plans. Act 245's sunset dates were amended three times: July 1, 2009, July 1, 2010 and December 31, 2010.

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

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

OVERVIEW OF THE FINANCIAL STATEMENTS

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

Enterprise Fund - Active Employee Healthcare Benefits

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

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

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

Agency Fund - Retiree Healthcare Benefits

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

FINANCIAL HIGHLIGHTS

For the year ended June 30, 2012, the Trust Fund collected in the aggregate $629,045,741 and $225,835,858 in employer and employee contributions for the health benefit plans and Medicare Part B premium reimbursements, respectively, and paid carriers in the aggregate $479,613,688 and $339,551,199 and retirees $50,166,130 in premiums, self-insured claims and Medicare Part B premium reimbursements, respectively, for the year ended June 30, 2012. The monthly premiums for the Trust Fund's benefit plans include administrative fees that are intended to cover the Trust Fund's administrative expenses. The aggregated administrative fees collected from the employers totaled $5,854,676 for the year ended June 30, 2012. The Trust Fund reported $5,541,588 for carrier retrospective premiums payable as of June 30, 2012.

For the year ended June 30, 2011, the Trust Fund collected in the aggregate $592,493,336 and $165,914,796 in employer and employee contributions for the health benefit plans and Medicare Part B premium reimbursements, respectively, and paid carriers in the aggregate $184,408,814 and

$442,031,638 and retirees $47,217,116 in premiums, self-insured claims and Medicare Part B premium reimbursements, respectively, for the year ended June 30, 2011. The monthly premiums for the Trust Fund's benefit plans include administrative fees that are intended to cover the Trust Fund's administrative expenses. The aggregated administrative fees collected from the employers totaled $5,431,271 for the year ended June 30, 2011. The Trust Fund reported $4,187,438 for carrier retrospective premiums payable as of June 30, 2011.

The administrative expenses budgeted for the Trust Fund totaled approximately $5,109,314 for the year ended June 30, 2012. Actual administrative operating expenses for the enterprise fund totaled $4,739,269 for the year ended June 30, 2012. The expenses included $2,459,610 for personnel services; $1,632,464 for consultant services; $18,676 for equipment; $320,963 for lease rent; and $307,556 for other expenses such as open enrollment, office supplies, telephone, travel, repairs and maintenance, copier rental and postage for the year ended June 30, 2012.

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

The presentation of the operations of the self-insured plans for active employees reported in the enterprise fund shows the aggregate amount of premium revenues recognized as operating revenues and related benefit claims expense incurred as operating expenses. This presentation is in accordance with the financial reporting criteria of GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues* (GASB 10), where the risk of loss for these self-insured plans transfers from the employers to the Trust Fund, thus the activity should be reported in aggregate in the statement of revenues, expenses and changes in net assets (deficit).

FINANCIAL ANALYSIS

Enterprise Fund

A summary of the Trust Fund's net assets (deficit) for active employees is shown below as of June 30, 2012 and 2011:

	2012	2011	Change	% Change
Assets				
Current assets	$ 51,632,927	$ 54,294,191	$ (2,661,264)	-4.9%
Capital assets	6,182,012	7,217,258	(1,035,246)	-14.3%
Total assets	57,814,939	61,511,449	(3,696,510)	-6.0%
Liabilities				
Current liabilities	48,587,874	62,685,806	(14,097,932)	-22.5%
Long-term liabilities	1,241,014	901,744	339,270	37.6%
Total liabilities	49,828,888	63,587,550	(13,758,662)	-21.6%
Net assets (deficit)				
Invested in capital assets	6,182,012	7,217,258	(1,035,246)	-14.3%
Unrestricted	1,804,039	(9,293,359)	11,097,398	119.4%
Total net assets (deficit)	$ 7,986,051	$ (2,076,101)	$ 10,062,152	484.7%

The enterprise fund's total assets decreased by $3.697 million or 6.0% during the fiscal year ended June 30, 2012. The decrease is primarily attributable to a decrease in cash and cash equivalents of approximately $10.205 million due to higher than projected claim benefit payments in the self-funded accounts and premium payments.

The enterprise fund's total liabilities decreased by $13.759 million or 21.6% during the fiscal year ended June 30, 2012. The decrease was attributable to an increase to the premiums payable account in the amount of approximately $19.132 million and a decrease in the benefit claims payable in the amount of approximately $33.907 million. This was due to the changing of the HMSA and HMA medical plans from self-funded to fully-insured effective January 1, 2012.

There was $10.062 million or 484.7% reduction of the total net deficit for the fiscal year ended June 30, 2012. This is primarily attributable to a $73.193 million net decrease in self-insured claims expense, $2.574 million increase in premium reserves of fully insured risk sharing plans, and $5.975 million increase in subsidy from the Agency fund, off-set by a decrease in self-insured premium revenues of $90.889 million.

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

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

The enterprise fund's total assets increased by $16.022 million or 35.2% during the fiscal year ended June 30, 2011. The increase is primarily attributable to the following: 1) an increase of approximately $8.047 million to the premiums receivable from State of Hawaii and Counties due to an increase to active employee rates effective March 1, 2011, and effective January 1, 2011, the enrollment of approximately 12,500 HSTA VEBA actives and 2,500 HSTA VEBA retirees into the trust fund; and 2) an increase in cash and cash equivalents of approximately $10.2 million due lower than projected claim benefit payments in the self-funded accounts.

The enterprise fund's total liabilities decreased by $13.173 million or 26.1% during the fiscal year ended June 30, 2011. The increase was attributable to the following: 1) an increase to the retrospective premium payable of approximately $2 million, which represents 5% of premiums held back by the Trust Fund as an estimated contingency in the event the Trust Fund incurs expenses greater than premiums paid, 2) an increase to the premiums payable account in the amount of $7.202 million due to the HSTA VEBA members enrollment into the Trust Fund, 3) an increase in the benefit claims payable in the amount of $3.059 million.

There was $2.849 million or 57.8% reduction of the total net deficit for the fiscal year ended June 30, 2011. This is primarily attributable to a $3.923 million net decrease in self-insured claims expense and change in incurred but not reported claims expense, off-set by a decrease in self-insured premium revenue of $9.971 million.

A summary of changes in net assets (deficit) for the years ended June 30, 2012 and 2011, for active employees follows:

	2012	2011	Change	% Change
Revenues				
Operating revenues	$ 161,062,458	$ 248,953,635	$ (87,891,177)	-35.3%
Nonoperating revenues	6,245,227	1,147,445	5,097,782	444.3%
Total revenues	167,307,685	250,101,080	(82,793,395)	-33.1%
Expenses				
Operating expenses	157,245,533	247,251,833	(90,006,300)	-36.4%
Total expenses	157,245,533	247,251,833	(90,006,300)	-36.4%
Increase in net assets	10,062,152	2,849,247	7,212,905	-253.2%
Net deficit at beginning of year	(2,076,101)	(4,925,348)	2,849,247	-57.8%
Total net assets (deficit) at end of year	$ 7,986,051	$ (2,076,101)	$ 10,062,152	484.7%

The enterprise fund's total revenues decreased by $82.793 million or 33.1% for the fiscal year ended June 30, 2012. The enterprise fund's operating revenues decreased due to the decrease in premium revenue for self insurance plans. In January 2012, self funding HMSA and HMA medical plan carriers were converted into fully insured contracts. The nonoperating revenues increased due to $5.975 million increase of subsidy from the agency fund. The interest income and other nonoperating revenue decreased by $0.876 million due to a write-down of investments held in the State pool in 2012 of $81,400 and a write-up of investments in 2011 of $743,900.

The enterprise fund's operating expenses decreased by $90.006 million or 36.4% for the fiscal year ended June 30, 2012. There was $73.193 million decrease in claims expenses. Effective January 1, 2012, since the HMSA and HMA medical plans changed from self-insured to fully-insured, both of the operating revenues and the operating expenses decreased. Also, the decrease in accrued incurred but not reported claims for self-insured plans was part of the reason for the operating expenses decrease.

The enterprise fund's total net deficit changed by $10.062 million or 484.7% for the fiscal year ended June 30, 2012. This is primarily attributable to a $5.975 million increase in subsidy from Agency Fund, $2.575 million increase in premium reserves revenues, and $1.9 million net operating income from the self-insured plans.

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

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

The enterprise fund's total revenues decreased by $12.965 million or 4.9% for the fiscal year ended June 30, 2011. The enterprise fund's operating revenues decreased due to the decrease in premium revenue for self insurance plans. In February 2010, the Trust Fund offered a new HMSA 80/20 PPO plan. This plan had lower premiums than the 90/10 PPO plan and was the prevalent plan. The nonoperating revenues decreased due to $3.201 million decrease of subsidy from the agency fund and interest income.

The enterprise fund's operating expenses decreased by $3.070 million or 1.2% for the fiscal year ended June 30, 2011. There was $7.890 million decrease in claims expenses and $3.967 million increase in incurred but not reported claims.

The enterprise fund's total net deficit changed by $2.849 million or 57.8% for the fiscal year ended June 30, 2011. This is primarily attributable to a $3.923 million net decrease in self-insured claims expense and change in incurred but not reported claims expense due to the addition of the HMSA 80/20 PPO plan effective February 1, 2010, off-set by a decrease in self-insured premium revenues of $9.971 million.

Agency Fund

A summary of the Trust Fund's plan assets and liabilities for retirees is shown below as of June 30, 2012 and 2011:

	2012	2011	Change	% Change
Assets:				
Cash and cash equivalents	$ 93,022,037	$ 90,800,499	$ 2,221,538	2.4%
Cash and investments held by fiscal agent	236,947,610	169,272,987	67,674,623	40.0%
Receivables	36,388,825	37,806,413	(1,417,588)	-3.7%
Deposits	11,990,076	10,248,076	1,742,000	17.0%
Total assets	$ 378,348,548	$ 308,127,975	$ 70,220,573	22.8%
Liabilities:				
Premiums payables	$ 17,717,627	$ 7,921,812	$ 9,795,815	123.7%
Benefit claims payable	4,651,669	15,275,791	(10,624,122)	-69.5%
Amounts held on behalf of employers for benefits	352,789,782	282,990,527	69,799,255	24.7%
Other	3,189,470	1,939,845	1,249,625	64.4%
Total liabilities	$ 378,348,548	$ 308,127,975	$ 70,220,573	22.8%

The agency fund's cash and cash equivalents increase of $2.221 million was mainly attributable to the net experience gain of self-funded plans for retirees. The net gain increase was approximately $13.2 million. There also was a $54,000 write-down of investments held in the State investment pool. At the end of fiscal year ended June 30, 2012, the OPEB pre-funding deposits by various employers were being held by a fiscal agent. The cash and investments held by fiscal agent increase of approximately $67.674 million was attributable to the collection of pre-funding deposits for OPEB by various employers. The agency fund's receivables account decrease of $1.418 million was attributable to the decrease in employer contributions for retirees effective January 1, 2012. Retiree premiums decreased for some health benefit plans such as medical and prescription drug.

The agency fund's premiums payable increase of $9.795 million and the agency fund's benefit claims payable decrease of approximately $10.624 million was attributable to the change of HMSA and HMA medical plans from self funded to fully insured effective January 1, 2012. The amounts held on behalf of employees for benefits increase of approximately $69.799 million was attributable to the following: 1) an increase in OPEB pre-funding deposits by various employers and 2) an increase in net gain from the self funded plans due to the premium revenue being more than the benefit claims expense.

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

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

The agency fund's cash and cash equivalents increase of $40.911 million was mainly attributable to the net experience gain of self-funded plans for retirees. The net gain increase was approximately $29.0 million. There also was a $0.517 million write-up of investments held in the State investment pool. At the end of fiscal year ended June 30, 2011, the OPEB pre-funding deposits by various employers were being held by a fiscal agent. The $34.091 million net increase (the agency fund's cash and investments held by fiscal agent increase of $169.272 million partially offset by the agency fund's cash and cash equivalents – pre-funding deposits decrease of $135.182 million) was attributable to the collection of pre-funding deposits for OPEB by various employers. The agency fund's receivables account increase of $6.708 million was attributable to the increase in retiree rates effective January 1, 2011.

The agency fund's premiums payable increase of $2.205 million was due to the increase in retiree rates. The agency fund's benefit claims payable increase of approximately $2.408 million was attributable to an increase in premiums and the addition of the participants in the HSTA VEBA Trust for fiscal year ended June 30, 2011. The amounts held on behalf of employees for benefits increase of approximately $76.174 million was attributable to the following: 1) an increase in OPEB pre-funding deposits by various employers, 2) write-up of investments held in State investment pool, 3) increase in net gain from the self-funded plans due to the increase in premium revenue being more than the increase in benefit claims expenses.

CAPITAL ASSETS

The aggregated net asset value of capital assets was $6,182,012 at June 30, 2012. The aggregated depreciation expense totaled $1,050,261 for the year ended June 30, 2012. The Trust Fund acquired $15,015 in office furniture and equipment during fiscal year 2012. There were no disposals of capital assets during fiscal year 2012.

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

ECONOMIC FACTORS AFFECTING NEXT FISCAL YEAR

Factors Affecting Fiscal Year 2013

Under GASB 43, the Trust Fund does not meet the criteria of a trust fund, therefore, deposits made by employers to the Trust Fund do not meet the criteria of contributions to other postemployment benefits (OPEB) that may be considered an asset to offset the liability. The Trust Fund submitted legislation to the 2012 Legislature (HB2491) to administer a separate trust fund for the purpose of receiving employer contributions that will prefund OPEB costs for retirees and their beneficiaries. HB2491 HD1 SD1 was signed into law on July 9, 2012, therefore, effective fiscal year 2013, the Trust Fund will meet the criteria of a trust fund. Deposits made by employers will be considered contributions to OPEB.

The contract with Silverscript for the Medicare prescription drug plan was implemented on July 1, 2012.

REQUEST FOR INFORMATION

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

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

Respectfully Submitted,

Barbara Coriell
Administrator

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HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
STATE OF HAWAII

ENTERPRISE FUND
Statements of Net Assets (Deficit)
June 30, 2012 and 2011

	2012	2011
Assets		
Current assets		
Cash and cash equivalents (Note 3)	$ -	$ 10,205,190
Receivables		
Premiums receivable from State of Hawaii and counties	30,239,480	31,071,398
Other receivables held by insurance companies (Note 5)	2,548,974	260,576
Rebates receivable (Note 5)	1,723,960	908,865
Accrued interest receivable	31,809	96,552
Other receivables	378,797	-
Prepaid expenses	243,227	242,930
Deposits (Note 6)	16,466,680	11,508,680
Total current assets	51,632,927	54,294,191
Capital assets, net of accumulated depreciation of $7,577,660 in 2012 and $6,527,399 in 2011 (Note 4)	6,182,012	7,217,258
Total assets	57,814,939	61,511,449
Liabilities		
Current Liabilities		
Vouchers and contracts payable	431,607	320,041
Accrued wages and employee benefits payable	163,593	181,006
Due to State of Hawaii	87,994	21,360
Due to employees	1,381,268	1,219,222
Retrospective premiums payable (Note 5)	2,612,905	2,254,527
Premiums payable (Note 5)	36,360,785	17,228,808
Benefit claims payable (Note 6)	7,485,932	41,392,678
Compensated absences, current portion	63,790	68,164
Total current liabilities	48,587,874	62,685,806
Noncurrent Liabilities		
Compensated absences (Note 2)	186,741	166,546
Other postemployment benefits (Note 8B)	1,054,273	735,198
Total liabilities	49,828,888	63,587,550
Net Assets (Deficit)		
Net assets		
Invested in capital assets	6,182,012	7,217,258
Unrestricted	1,804,039	(9,293,359)
Total net assets (deficit)	$ 7,986,051	$ (2,076,101)

See accompanying notes to financial statements.

HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
STATE OF HAWAII

ENTERPRISE FUND

Statements of Revenues, Expenses, and Changes in Net Assets (Deficit)
Years ended June 30, 2012 and 2011

	2012	2011
Operating revenues		
Premium revenue-self insurance	$ 152,434,417	$ 243,323,819
Administrative fee (Note 2)	3,536,970	3,217,590
Administrative fee-Agency Fund (Note 2)	2,317,706	2,213,681
Increase in premium reserves - fully insured risk sharing plans	2,773,365	198,545
Total operating revenues	161,062,458	248,953,635
Operating expenses		
Claims expense-self insurance (Note 6)	167,198,917	240,391,553
Change in incurred but not reported (IBNR) claims	(16,710,100)	657,100
Loss on carrier payment methodology (Note 2)	967,186	28,314
Depreciation (Note 4)	1,050,261	1,547,140
Administrative operating expenses	4,739,269	4,627,726
Total operating expenses	157,245,533	247,251,833
Operating income	3,816,925	1,701,802
Nonoperating revenues		
Interest income and other, net of write-down of investments held in State pool of $81,446 in 2012 and write-up of $743,937 in 2011. (Note 3)	270,495	1,147,445
Subsidy from Agency Fund (Note 7)	5,974,732	-
Total nonoperating revenues	6,245,227	1,147,445
Increase in net assets	10,062,152	2,849,247
Total net deficit at beginning of year	(2,076,101)	(4,925,348)
Total net assets (deficit) at end of year	$ 7,986,051	$ (2,076,101)

See accompanying notes to financial statements.

HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
STATE OF HAWAII

ENTERPRISE FUND
Statements of Cash Flows
Years ended June 30, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Cash paid to vendors	$ (2,168,390)	$ (2,443,425)
Cash paid to employees	(2,142,127)	(1,709,238)
Cash received from State of Hawaii, counties and individuals for premiums and benefit payments	500,858,008	401,775,762
Cash paid for premiums and benefit payments	(510,786,319)	(391,195,860)
Rebates received related to prescription drug plan	27,081	2,733,735
Reserves paid to insurance carriers	(2,288,398)	(228,880)
Net cash provided by (used in) operating activities	(16,500,145)	8,932,094
Cash flows from capital and related financing activities:		
Purchases of furniture, equipment and software development	(15,015)	(105,969)
Net cash used in capital and related financing activities	(15,015)	(105,969)
Cash flows from non-capital and related financing activities:		
Subsidy from Agency Fund	5,974,732	-
Net cash provided by non-capital and related financing activities	5,974,732	-
Cash flows from investing activities:		
Interest received	335,238	1,379,065
Net cash provided by investing activities	335,238	1,379,065
Net change in cash and cash equivalents	(10,205,190)	10,205,190
Cash and cash equivalents at beginning of year	10,205,190	-
Cash and cash equivalents at end of year	$ -	$ 10,205,190
Reconciliation of operating income to net cash provided by (used in) operating activities:		
Operating income	$ 3,816,925	$ 1,701,802
Adjustments to reconcile operating income to net cash (used) by operating activities:		
Depreciation	1,050,261	1,547,140
(Increase) decrease in premiums receivable from State of Hawaii and counties	831,918	(8,046,537)
Increase in other receivables held by insurance companies	(2,288,398)	(228,880)
(Increase) decrease in rebates receivable	(815,095)	847,102
Increase in other receivables	(378,797)	-
Increase in prepaid expenses	(297)	(61,414)
Increase in deposits	(4,958,000)	-
Increase in vouchers and contracts payable	111,566	211,696
Increase (decrease) in accrued wages and employee benefits payable	(17,413)	71,220
Increase (decrease) in amounts due to State of Hawaii	66,634	(174,715)
Increase in amounts due to employees	162,046	549,998
Increase in retrospective premiums payable	358,378	2,000,385
Increase in premiums payable	19,131,977	7,202,118
Increase (decrease) in benefits claims payable	(33,906,746)	3,058,618
Increase in compensated absences	15,821	62,053
Increase in other postemployment benefits	319,075	191,508
Total adjustments	(20,317,070)	7,230,292
Net cash provided by (used in) operating activities	$ (16,500,145)	$ 8,932,094

See accompanying notes to financial statements.

HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
STATE OF HAWAII

AGENCY FUND
Statements of Fiduciary Assets and Liabilities
June 30, 2012 and 2011

	2012	2011
Assets		
Cash and cash equivalents (Note 3)	$ 93,022,037	$ 90,800,499
Cash and investments held by fiscal agent (Note 3)	236,947,610	169,272,987
Receivables		
Medicare reimbursements from individuals, net of allowance of $491,146 in 2012 and $403,332 in 2011	257,279	389,207
Premium receivable from State of Hawaii and counties	31,473,876	32,274,892
Other receivables held by insurance companies (Note 5)	30,230	42,721
Rebates receivable (Note 5)	4,606,234	5,063,909
Accrued interest receivable	21,206	35,684
Total receivables	36,388,825	37,806,413
Deposits (Note 6)	11,990,076	10,248,076
Total assets	$ 378,348,548	$ 308,127,975
Liabilities		
Due to State of Hawaii	$ 188,857	$ 62
Due to retirees	17,966	10,242
Investment fees payable	53,964	-
Retrospective premium payable (Note 5)	2,928,683	1,932,911
Premiums payable (Note 5)	17,717,627	7,921,812
Benefit claims payable (Note 6)	4,651,669	15,275,791
Amounts held on behalf of employers for benefits	352,789,782	282,987,157
Total liabilities	$ 378,348,548	$ 308,127,975

See accompanying notes to financial statements.

(1) FINANCIAL REPORTING ENTITY

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

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

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

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

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

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

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

The Trust Fund provided insurance coverage to the following individuals as of June 30, 2012 and 2011:

	2012	2011
Active employees	67,051	66,350
Retirees	42,340	41,704
Dependents	77,901	77,384
Total	187,292	185,438

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Proprietary Fund (Enterprise Fund) - The accounting for the active employee healthcare benefits is reported as an enterprise fund. An enterprise fund is used to account for the acquisition, operation and maintenance of government facilities and services that are entirely or predominantly supported by user charges. The enterprise fund operations are reported using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the timing of cash flows.

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

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

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

The Trust Fund follows GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other than Pensions* (GASB 43). GASB 43 establishes accounting and financial reporting standards for plans that provide other postemployment benefits (OPEB) other than pensions. GASB 43 requires organizations to report a statement of fiduciary assets and liabilities – agency fund for multiple-employer OPEB plans that are not administered as trusts or equivalent arrangements. For fiscal years 2012 and 2011, the Trust Fund does not meet the criteria of a trust or equivalent arrangement for the purposed of GASB 43, thus assets and liabilities for the postemployment health benefits are reported as an agency fund.

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

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

In fiscal years 2012 and 2011, the accounting for the active employee healthcare benefits are reported under the statements of net assets (deficit) – enterprise fund, statements of revenue, expenses and changes in net assets (deficit) – enterprise fund and statements of cash flows – enterprise fund. The accounting for the postemployment healthcare benefits are reported in the statements of fiduciary assets and liabilities – agency fund. For financial reporting purposes, certain assets, liabilities, revenues and inflows and expenses and outflows have been allocated for the separate accounting of active employees and postemployment healthcare benefits.

Capital Assets

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

Cash and Cash Equivalents

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

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

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 compensated absence liabilities for accumulated vacation is as follows for the years ended June 30, 2012 and 2011:

	Enterprise Fund	
	2012	2011
Balance at beginning of year	$ 234,710	$ 172,657
Additions	121,831	107,390
Reductions	(106,010)	(45,337)
Balance at end of year	250,531	234,710
Less current portion	(63,790)	(68,164)
Noncurrent portion	$ 186,741	$ 166,546

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, 2012 and 2011, relating to the Trust Fund approximated $600,069 and $528,447.

Receivables

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

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

Benefits Claims Expense and Cost

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

Management has made certain assumptions based on currently available information and industry statistics in determining the benefits claims expense. Accordingly, the ultimate costs may vary significantly from the estimated amounts reported in the financial statements. Management believes that, given the inherent variability in benefits claims expense, such aggregate liabilities are within a reasonable range of adequacy. Such estimates are based on estimated claims cost reported prior to fiscal year-end, and estimates (based on actuarial projections of historical loss development) of claims cost incurred but not reported. Reserves are continually reviewed and adjusted as experience develops or new information becomes known; such adjustments are charged to net assets as incurred for active employees. Rebates receivable are recorded in the period that the claim is paid and is netted against the cost of the claim.

Management recorded its best estimate for the obligation of unpaid claims of $7,485,932 and $41,392,678 for active employees and $4,651,669 and $15,275,791 for retirees as of June 30, 2012 and 2011, respectively, based on the Trust Fund's consulting actuary's estimate for the liability for unpaid claims. These amounts include administrative fees payable to the contracted plan administrator for services provided and benefit claims incurred as of June 30, 2012 and 2011.

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 years ended June 30, 2012 and 2011, respectively, the Trust Fund recognized losses of approximately $967,186 and $28,314 and $759,932 and $25,110, related to active employees and retirees, respectively.

HRS Section 87A states that the Trust Fund employer contributions are irrevocable. In addition, HRS Section 87A does not require the Trust Fund to return insurance carrier refunds, rate credits and other earnings, as authorized by the Board, to identifiable employees who participated in ascertainable years that created the refund or credit. Accordingly, the Trust Fund recognizes the gains as increases in gain/loss on carrier payment methodology and related receivable as other receivables held by insurance companies.

Administrative Fees

The Trust Fund assesses and collects administrative fees from employers to support the activities of the Trust Fund. The administrative fees are assessed each pay period and vary depending upon the type of bargaining agreements. Effective July 1, 2011, administrative fees from certain bargaining units were collected from both employers and employees. For the years ended June 30, 2012 and 2011, respectively, the administrative fees charged to participating agencies and employees to administer the plans was $3,536,970 and $3,217,590 and $2,317,706 and $2,213,681 for active employees and retirees, respectively. These amounts are recognized as revenues in the enterprise fund, as all administrative expenses are recognized in the enterprise fund.

Estimates

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

Reclassifications

Certain reclassifications have been made to the 2011 financial statements in order to conform to the current year presentation.

(3) CASH AND INVESTMENTS

As of June 30, 2012 and 2011, the Trust Fund's cash and investments were distributed and reported in the financial statements as follows:

	2012		
	Enterprise Fund	Agency Fund	Total
Cash and cash equivalents:			
Cash	$ 40,507	$ 43,574,253	$ 43,614,760
Equity in the State Pool	(40,507)	93,021,692	92,981,185
Mutual funds	-	193,373,702	193,373,702
Total	$ -	$ 329,969,647	$ 329,969,647

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

Trust Fund Investment Pool

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

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

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

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

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

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

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

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

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

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

In December 2011, the Board approved moving from a 50% risk oriented / 50% stable policy target to a 65% risk oriented / 35% stable policy target that was fully implemented during the first quarter of 2012. The shift to a more risk-oriented (equity) mix improves the portfolio's expected risk-adjusted return to approximately 7% while continuing to provide a reasonable level of principal protection during periods of market stress.

The selected asset allocation for the Trust Fund's two asset pools is as follows:

Asset Classification	Target	Minimum	Maximum
Short-term Liquidity/Operating Asset Pool			
Cash and equivalents and short-duration fixed income	100%	0%	100%
Long-term Investment Portfolio			
Cash and cash equivalents	0%	0%	5%
U.S. Fixed Income	15%	10%	15%
Inflation Linked Securities	19%	14%	24%
U.S. Real Estate Securities	21%	16%	26%
U.S. Equities	28%	23%	33%
International Equities	17%	12%	22%

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

Interest Rate Risk – Interest rate risk is the risk that changes in the market rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. The Trust Fund does not have a policy to manage interest rate risk. As of June 30, 2012 and 2011, the Trust Fund had monies invested short-term in the State Pool, mutual funds, and money market funds all with original maturities of less than three months.

Credit Risk – Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. As a means to manage credit risk, the Trust Fund's policy requires individual securities to be rated investment-grade (Baa3/BBB- or higher) by at least two of the three rating agencies (Moody's, S&P and/or Fitch) and for mutual funds to have an average rating above investment grade. As of June 30, 2012 and 2011, the Trust Fund was invested in two fixed-income oriented mutual funds, the Vanguard Total Bond Market Index Fund, which only invests in investment grade securities, and the BlackRock Inflation Protection Fund. Mutual funds are not rated by nationally recognized statistical rating organizations. At June 30, 2012 and 2011, the Vanguard Total Bond Market Index Fund and the BlackRock Inflation Protection Fund are not rated by nationally recognized statistical rating organization.

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

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Trust Fund will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The Trust Fund's Investment Policy or the HRS' do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits. At June 30, 2012 and 2011, the Trust Fund had cash deposits of $43,614,610 and $18,386,214, respectively, that are in excess of the Federal Deposit Insurance Corporation limits. However, deposits are held short-term (less than one month) until monies can be invested with the fiscal agent.

Concentration of Credit Risk – The Trust Fund provides guidelines regarding portfolio diversification by placing limits on the amount the Trust Fund may invest in any one issuer, types of investment instruments, and position limits per issue of an investment instrument. At June 30, 2012 and 2011, the Trust Fund's investment concentration was as follows:

Investment Type/Issuer	Investment Type - Percentage of Portfolio	One Issuer of Investment Instrument - Percentage of Portfolio
2012:		
Mutual Funds	58%	
Vanguard		47%
BlackRock		11%
2011:		
Mutual Funds	56%	
Vanguard		48%
BlackRock		8%

State Treasury Cash and Investment Pool

The State Director of Finance is responsible for the safekeeping of all monies paid into the State Treasury (cash pool). The Director of Finance may invest any monies of the State, which in the Director's judgment are in excess of the amounts necessary for meeting the immediate requirements of the State. Cash is pooled with funds from other State agencies and departments and is invested in accordance with the State Investment Policy. Cash accounts that participate in the State Pool accrue interest based on the weighted average cash balances of each account. The weighted average maturity of the cash pool at June 30, 2012 and 2011, respectively, was 370 and 201 days.

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

Credit Risk – Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The State's Investment Policy limits investments in state and U.S. Treasury securities, time certificates of deposit, U.S. government or agency obligations, repurchase agreements, commercial paper, bankers' acceptance, and money market funds and student loan resources securities maintaining a rating of AAA. As of June 30, 2012 and 2011, the State Pool has not been rated by a nationally recognized statistical rating organization.

The State Pool as of June 30, 2012 and 2011, included auction rate securities collateralized by student loans. During 2008, a number of these auctions failed and companies without the ability to hold such securities until maturity have taken significant losses. During the year ended June 30, 2012, the State experienced an unfavorable change in the fair value of its investments in the auction rate securities due to declining market conditions and recorded a decrease in fair value of $135,743 of which $81,446 and $54,297 was allocated to the enterprise fund and agency fund, respectively. During the year ended June 30, 2011, the State experienced a favorable change in the fair value of its investments in the auction rate securities due to improved market conditions, and recorded an increase in fair value of $1,260,910 of which $743,937 and $516,973 was allocated to the enterprise fund and agency fund, respectively. The Trust Fund's allocated share of the changes resulted in a total cumulative decrease of $366,588 and $230,845 as of June 30, 2012 and 2011, respectively. These adjustments were recorded as an increase of cash and cash equivalents and interest income and other in the enterprise fund and cash and cash equivalents and amounts held on behalf of employers for benefits in the agency fund.

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

(4) CAPITAL ASSETS

The enterprise fund capital asset activity for the years ended June 30, 2012 and 2011, was as follows:

	Balance at July 1, 2011	Increases	Decreases	Balances at June 30, 2012
Capital assets being depreciated				
Office furniture and equipment	$ 4,268,938	$ 15,015	$ -	$ 4,283,953
Computer equipment and software	9,475,719	-	-	9,475,719
Less accumulated depreciation	(6,527,399)	(1,050,261)	-	(7,577,660)
Capital assets, net	$ 7,217,258	$ (1,035,246)	$ -	$ 6,182,012

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

The Trust Fund has developed an expense allocation to recover a portion of depreciation expense from the agency fund for use of the capital assets in administering the agency fund. Approximately 40% and 41% of the depreciation expense for fiscal years 2012 and 2011, respectively, was recovered from the agency fund as part of the administrative fee charged to the agency fund.

(5) HEALTH AND LIFE INSURANCE BENEFIT CONTRACTS

The Trust Fund’s primary purpose is to provide employee-beneficiaries, retiree-beneficiaries and dependent-beneficiaries with a health benefits plan and group life insurance. To effectuate that purpose, the Trust Fund requested proposals in August 2006 and awarded multi-year health and life insurance benefit contracts commencing July 1, 2007 and continuing through June 30, 2009 and subsequently exercised its options to extend contracts through December 31, 2011. Upon expiration, the Trust Fund requested proposals in April 2011 and awarded multi-year health and life insurance benefit contracts commencing January 1, 2012, and continuing through June 30, 2013, for active employees and commencing January 1, 2012, and continuing through December 31, 2012, for retirees. All contracts were effective January 1, 2012, except for the prescription drug contract for active employees and retirees. The prescription drug contract for active employees was effective May 1, 2012, and continuing through June 30, 2013. The prescription drug contract for non-Medicare retirees was effective May 1, 2012, and continuing through December 31, 2012. The prescription drug contract for Medicare retirees was effective July 1, 2012, and continuing through December 31, 2012. All contracts have two (2) one-year options to extend.

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

- Self funding: Rates are experience rated and are set by the Trust Fund Board acting on the advice of the consultant/actuary. Due to the size of the pool there is no stop loss insurance associated with these plans. The Trust Fund pays administrative fees to the TPAs and pays actual claim costs as claims are paid. If claims are less than the amount projected and included in the premium collection from employers and employee-beneficiaries, surplus funds remain in the Trust Fund. In addition, prescription drug rebates are received 6 to 9 months after they are realized.

- Fully insured: Premiums are received from employers and paid to the carriers. There is no additional risk to the Trust Fund or funds to be paid to the Trust Fund. Rates are set by the carrier.

- Fully insured with Retrospective Risk Sharing and Risk Sharing: Rates are set by carrier using the plans' experience. Full premium is collected from employers and 95% are paid to the carriers. At the end of the year, if claims and retention exceed the reduced premium paid, the Trust Fund will pay the carriers the amount of the excess up to the withheld five percent (5%). The annual accounting for active employees and retirees is maintained separately. As such, the premium surplus of one group cannot be used to offset the underwriting loss of another group, except for a contractual supplemental agreement effective July 1, 2011 with Hawaii Dental Service (HDS), which combined active employees and retirees rate stabilization reserves to offset any deficits. 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.

<u>Health Maintenance Organization – Closed Panel HMO</u>

The Trust Fund entered into a contract with Kaiser Foundation Health Plan, Inc. (Kaiser) to provide active employees and retirees with HMO benefits for the period July 1, 2007 through December 31, 2011. The HMO is not a participating contract. Accordingly, there is no premium surplus or underwriting loss.

The Trust Fund entered into a contract with Kaiser to provide HSTA VB active employees and retirees with HMO benefits for the period January 1, 2011 through December 31, 2011. The HMO is under the same financial arrangement. Accordingly, there is no premium surplus or underwriting loss.

The Trust Fund entered into a new contract with Kaiser effective January 1, 2012 through June 30, 2013 for active employees of the Trust Fund and HSTA VB; and effective January 1, 2012 through December 31, 2012 for retirees of the Trust Fund and HSTA VB. The HMO is not a participating contract. Accordingly, there is no premium surplus or underwriting loss

<u>Medical and Prescription Drug Benefits</u>

The Trust Fund entered into a contract with the Hawaii Medical Service Association (HMSA) and Health Management Associates (HMA) to provide claims administration services for active employees and retirees for medical plans for the period July 1, 2007 through December 31, 2011. The plans include a 90/10 PPO with HMA and a 90/10 PPO (July 1, 2009 through January 31, 2010), 80/20 PPO (effective February 1, 2010), HMO, High Deductible Health Plan (HDHP) and Supplemental Plan with HMSA. The amounts paid for claims and administrative services to HMSA and HMA are reconciled with the payments made by HMSA and HMA and any remaining surplus or deficit will be remitted to or owed by the Trust Fund. As of June 30, 2012 and 2011, respectively, amounts held by HMSA were $565,129 and $260,576 for active employees and $13,627 and $42,721 for retirees.

The Trust Fund entered into a contract with HMSA to provide HSTA VB active employees and retirees with medical and prescription drug benefits for the period January 1, 2011 through December 31, 2011. The plans included a 90/10 and 80/20 PPO and Supplemental for actives and a 90/10 PPO for retirees. The prescription drug benefits with HMSA were extended through April 30, 2012 for active employees and non-Medicare retirees and through June 30, 2012 for Medicare retirees. The plans are fully insured and therefore, there is no premium surplus or underwriting loss.

The Trust Fund entered into a new contract with HMSA to provide medical benefits effective January 1, 2012 to active employees and retirees of the Trust Fund. The plans included a 90/10 PPO plan, 80/20 PPO Plan, HMO, HDHP, and Supplemental Medical plans for actives and a 90/10 PPO plan for retirees. These plans are fully insured with risk sharing and therefore, any premium surplus will be refunded to the Trust Fund and any underwriting losses will not be paid by the Trust Fund.

The Trust Fund entered into a new contract with HMSA to provide medical benefits for HSTA VB active employees and retirees effective January 1, 2012. The plans included a 90/10 PPO plan, 80/20 PPO plan, and Supplemental Medical plans for actives and a 90/10 PPO plan for retirees. These plans are fully insured with risk sharing and therefore, any premium surplus will be refunded to the Trust Fund and any underwriting losses will not be paid by the Trust Fund.

The Trust Fund entered into a contract with informedRx for the period July 1, 2007, through April 30, 2012 for active employees and non-Medicare retirees and through June 30, 2012 for Medicare retirees. The Trust Fund's contract with informedRx entitles the Trust Fund to rebates from pharmaceutical manufacturers related to claims paid by the Trust Fund and processed by informedRx. As of June 30, 2012 and 2011, respectively, rebates receivable from informedRx were $881,784 and $884,153 for active employees and $4,270,472 and $5,063,909 for retirees.

The Trust Fund entered into a new contract with CVS Caremark to provide prescription drug benefits effective May 1, 2012 for active employees and non-Medicare retirees of the Trust Fund and HSTA VB. The Trust Fund's contract with CVS Caremark entitles the Trust Fund to rebates from pharmaceutical manufacturers related to claims paid by the Trust Fund and processed by CVS Caremark. As of June 30, 2012, rebates receivable from CVS Caremark were $842,176 for actives and $335,762 for retirees.

Effective July 1, 2012, the Trust Fund entered into a contract with Silverscript to provide prescription drug benefits for Medicare retirees for the Trust Fund and HSTA VB.

<u>Vision Care Benefits</u>

The Trust Fund entered into a contract with Vision Service Plan (VSP) for the period July 1, 2007 through December 31, 2011. The contracts include a five percent (5%) retrospective premium agreement for both active employees and retirees. Under these agreements, the Trust Fund will pay VSP ninety-five percent (95%) of the premiums due each month.

The Trust Fund entered into a contract with VSP to provide HSTA VB active employees and retirees with vision benefits for the period January 1, 2011 through December 31, 2011. The contract included a five percent (5%) retrospective premium agreement for both active employees and retirees. Under these agreements, the Trust Fund will pay VSP ninety-five percent (95%) of the premiums due each month.

At the end of the plan year, if claims and retention exceed 95% of the premiums due for the plan year, the Trust Fund will pay VSP the amount of the excess up to the withheld 5%. Since VSP is still allowed to receive the retrospective premium if they experience losses for the plan year based on the final accounting, a payable to VSP was recorded. At June 30, 2012 and 2011, respectively, the Trust Fund's retrospective premium payable was $142,498 and $529,115 and $588,773 and $313,479 for active employees and retirees, respectively.

The Trust Fund entered into a new contract with VSP effective January 1, 2012 for active employees and retirees of the EUTF and HSTA VB. This plan is fully insured with risk sharing and therefore, any premium surplus will be refunded to the Trust Fund and any underwriting losses will not be paid by the Trust Fund.

Dental Benefits

The Trust Fund entered into a contract with HDS for the period July 1, 2007, through December 31, 2011. The contracts include a five percent (5%) retrospective premium agreement for both active employees and retirees. Under these agreements, the Trust Fund will pay HDS ninety-five percent (95%) of the premiums due each month.

The Trust Fund entered into a contract with HDS to provide HSTA VB active employees and retirees primary dental benefits and for active employees' supplemental dental benefits for the period January 1, 2011 through December 31, 2011. There was no retrospective premium agreement for the HSTA VB contract.

At the end of the plan year, if claims and retention exceed 95% of the premiums due for the plan year, the Trust Fund will pay HDS the amount of the excess up to the withheld five percent (5%). Since HDS is still allowed to receive the retrospective premium if they experience losses for the plan year based on the final accounting, a payable to HDS was recorded. At June 30, 2012 and 2011, respectively, the Trust Fund's retrospective premium payable was $2,470,407 and $1,725,412 and $2,339,910 and $1,619,432 for active employees and retirees, respectively.

The Trust Fund entered into a new contract with HDS effective January 1, 2012 for active employees and retirees of the Trust Fund and HSTA VB. This plan is fully insured with risk sharing and therefore, any premium surplus will be refunded to the Trust Fund and any underwriting losses will not be paid by the Trust Fund.

Life Insurance Benefits

The Trust Fund entered into a contract with Standard Insurance Company (Standard) to provide term life insurance benefits to all eligible active employees and retirees for the period July 1, 2007 through December 31, 2011. The amounts paid for claims and administrative services are reconciled with the payments made to Standard and any remaining surplus will be refunded to the Trust Fund and any underwriting The amounts paid for claims and administrative services are reconciled with the payments made to Standard and any remaining surplus will be refunded to the Trust Fund and any underwriting losses will not be paid by the Trust Fund.

The Trust Fund entered into a contract with Standard to provide HSTA VB active employees' and retirees' life insurance benefits for the period January 1, 2011 through December 31, 2011.

The Trust Fund entered into a new contract with Royal State National Insurance Company, Ltd. (RSN) to provide term life insurance benefits to all eligible active employees and retirees of the Trust Fund and HSTA VB effective January 1, 2012. The amounts paid for claims and administrative services are reconciled with the payments made to Royal State National and any remaining surplus will be refunded to the Trust Fund and any underwriting losses will not be paid by the Trust Fund.

Dual-Coverage Medical and Prescription Drug Benefits

The Trust Fund entered into a contract with Royal State National Insurance Company, Ltd. (RSN) to provide active employees with dual-coverage medical and prescription drug benefits for the period July 1, 2007 through December 31, 2011. The amounts paid for claims and administrative services are reconciled with the payments made to RSN and any remaining surplus will be refunded to the Trust Fund and any underwriting losses will not be paid by the Trust Fund. As of June 30, 2012 and 2011, respectively, amounts held by RSN were $335,032 and $0 for active employees.

The Trust Fund entered into a new contract with RSN to provide active employees with dual-coverage medical and prescription drug benefits effective January 1, 2012. The amounts paid for claims and administrative services are reconciled with the payments made to RSN and any remaining surplus will be refunded to the Trust Fund and any underwriting losses will not be paid by the Trust Fund.

Chiropractic Plan

The Trust Fund entered into a contract with RSN to provide active employees with chiropractic benefits for the period July 1, 2007 through December 31, 2011. The Chiropractic plan is not a participating contract. Accordingly, there is no premium surplus or underwriting loss.

The Trust Fund entered into a contract with RSN to provide HSTA VB active employees with chiropractic benefits for the period January 1, 2011 through December 31, 2011.

The Trust Fund entered into a new contract with RSN to provide active employees for the Trust Fund and HSTA VB and retirees of HSTA VB with chiropractic benefits effective January 1, 2012.

<u>All Contracts</u>

The following is a summary of the of premium reserves held by insurance companies, rebates receivable, retrospective premiums payable, and premiums payable balances by insurance company at June 30, 2012 and 2011:

	2012	
	Active Employees	Retirees
Other receivables held by insurance companies		
RSN	$ 335,032	$ -
HMA	958,530	16,603
HDS	690,283	-
HMSA	565,129	13,627
	$ 2,548,974	$ 30,230
Rebates receivable		
Receivable from CVS	$ 842,176	$ 335,762
Receivable from InformedRx	881,784	4,270,472
	$ 1,723,960	$ 4,606,234
Retrospective premiums payable		
HDS - dental contract	2,470,407	2,339,910
VSP - vision contract	142,498	588,773
	$ 2,612,905	$ 2,928,683
Premiums payable		
HDS	$ 2,549,060	$ 1,523,197
HDS - HSTA VB	544,852	106,692
Kaiser Hawaii	6,976,158	4,053,950
Kaiser Hawaii - HSTA VB	1,226,186	175,058
RSN Dual/Chiro	118,048	-
RSN Chiro - HSTA VB	18,318	5,129
RSN Life	227,708	143,145
RSN Life - HSTA VB	46,160	10,490
VSP	588,269	118,692
VSP - HSTA	86,811	19,647
Standard	442	238
COBRA payable · HDS	376	-
COBRA payable · Royal	641	-
COBRA payable · Kaiser	2,780	-
COBRA payable · VSP	30	-
HMSA	19,555,266	10,343,097
HMSA - HSTA VB	4,419,680	1,218,292
	$ 36,360,785	$ 17,717,627

	2011	
	Active Employees	**Retirees**
Other receivables held by insurance companies		
HMSA	$ 260,576	$ 42,721
Rebates receivable		
Receivable from informedRx	$ 884,153	$ 5,063,909
Receivable from HMSA	24,712	-
	$ 908,865	$ 5,063,909
Retrospective premiums payable		
HDS - dental contract	1,725,412	1,619,432
VSP - vision contract	529,115	313,479
	$ 2,254,527	$ 1,932,911
Premiums payable		
HDS	$ 2,568,385	$ 1,790,048
HDS - HSTA	672,049	117,576
Kaiser Hawaii	6,274,043	3,681,120
Kaiser Hawaii - HSTA	1,324,511	169,425
RSN Dual/Chiro	123,375	-
RSN Chiro - HSTA	27,450	-
VSP	573,629	356,170
VSP - HSTA	91,875	18,176
Standard	220,176	141,523
Standard - HSTA	50,149	10,535
COBRA payable · HDS	376	-
COBRA payable · Royal	707	-
COBRA payable · Kaiser	2,780	-
COBRA payable · VSP	2,021	-
HMSA - HSTA	5,297,282	1,637,239
	$ 17,228,808	$ 7,921,812

(6) BENEFIT CLAIMS EXPENSE

Beginning July 1, 2007, the Trust Fund offered self-funded medical and prescription drug plans, administered by Hawaii Medical Service Association (HMSA), Health Management Associates (HMA), and National Medical Health Card Systems (NMHCS) (now informedRx) under contracts for the period July 1, 2007 through December 31, 2011, except for informedRx, which was switched to CVS Caremark effective May 1, 2012 for active employees and non-Medicare retirees. Under the self-funded arrangements, the contract administrators provide the Trust Fund provider networks, claims processing, cost containment and other services. Instead of premiums, the Trust Fund pays administrative fees to the contractor for the services rendered and reimburses the contractor for claims paid. Activity in the liability for unpaid benefit claims expense related to the self-funded medical and prescription drug plans is as follows for the years ended June 30, 2012, 2011, and 2010:

	Active employees	Retirees	Total
Balance at July 1, 2009	$ 45,993,413	$ 14,318,267	$ 60,311,680
Current year claims and changes in estimates	236,864,948	161,907,925	398,772,873
Contractor processing administrative fees related to current year	11,960,034	13,756,828	25,716,862
Paid during current year	(256,484,335)	(177,115,259)	(433,599,594)
Balance at June 30, 2010	$ 38,334,060	$ 12,867,761	$ 51,201,821
Balance at July 1, 2010	$ 38,334,060	$ 12,867,761	$ 51,201,821
Current year claims and changes in estimates	231,188,748	189,723,257	420,912,005
Contractor processing administrative fees related to current year	11,746,538	14,839,743	26,586,281
Paid during current year	(239,876,668)	(202,154,970)	(442,031,638)
Balance at June 30, 2011	$ 41,392,678	$ 15,275,791	$ 56,668,469
Balance at July 1, 2011	$ 41,392,678	$ 15,275,791	$ 56,668,469
Current year claims and changes in estimates	146,856,156	159,906,939	306,763,095
Contractor processing administrative fees related to current year	6,115,425	9,962,577	16,078,002
Paid during current year	(186,878,327)	(180,493,638)	(367,371,965)
Balance at June 30, 2012	$ 7,485,932	$ 4,651,669	$ 12,137,601

Below is a summary of benefit claims payable by carrier at June 30, 2012 and 2011:

	2012			
	Active Employees		**Retirees**	
Benefit claims payable:				
Benefit claims - CVS	$	2,120,668	$	764,502
Benefit claims - HMA		41,023		7,039
Benefit claims - HMSA		-		-
Benefit claims - InformedRx		(167)		3,603,006
IBNR for Self Funded Plans		5,247,200		-
Admin Fee - CVS		75,246		18,024
Admin Fee - HMA		31		-
Admin Fee - HMSA		1,931		(13,452)
Admin Fee - informedRx		-		272,550
	$	7,485,932	$	4,651,669

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

According to the terms of contracts with HMSA, HMA, CVS, and informedRx, the Trust Fund was required to make a deposit to cover estimated claims costs for the self-funded medical and prescription drug plans. The deposits held by the carriers for the self-funded medical and prescription drug plans as of June 30, 2012 and 2011, are as follows:

	2012					
	Active Employees		**Retirees**		**Total**	
HMSA – Medical and drug contract	$	6,300,000	$	3,700,000	$	10,000,000
informedRx (formerly NHMCS) - Drug contract		3,008,000		6,392,000		9,400,000
CVS - Drug contract		4,958,000		1,742,000		6,700,000
HMA - Medical contract		2,200,680		156,076		2,356,756
	$	16,466,680	$	11,990,076	$	28,456,756

	2011		
	Active Employees	**Retirees**	**Total**
HMSA – Medical and drug contract	$ 6,300,000	$ 3,700,000	$ 10,000,000
informedRx (formerly NHMCS) -			
Drug contract	3,008,000	6,392,000	9,400,000
HMA - Medical contract	2,200,680	156,076	2,356,756
	$ 11,508,680	$ 10,248,076	$ 21,756,756

(7) SUMMARY OF CONTRIBUTIONS AND PRE-FUNDED DEPOSITS

The employer and employee contributions recognized and deposits received for the years ended June 30, 2012 and 2011, were as follows:

	2012		
Required contributions	**Active Employees**	**Retirees**	**Total**
Employer			
State of Hawaii	$ 140,959,768	$ 246,490,677	$ 387,450,445
State of Hawaii - HSTA	43,829,765	25,267,455	69,097,220
City & County of Honolulu	38,793,257	63,007,261	101,800,518
County of Hawaii	12,167,889	13,721,664	25,889,553
County of Maui	12,696,458	11,289,369	23,985,827
County of Kauai,			
including Department of Water	5,407,835	6,566,477	11,974,312
Board of Water Supply – Honolulu	2,138,054	5,126,550	7,264,604
County of Hawaii - Department of Water	814,775	768,487	1,583,262
	256,807,801	372,237,940	629,045,741
Employee	224,338,131	1,497,727	225,835,858
	481,145,932	373,735,667	854,881,599
Pre-funded deposits			
Employer			
City & County of Honolulu	-	40,000,000	40,000,000
County of Kauai,			
including Department of Water	-	10,785,959	10,785,959
Board of Water Supply – Honolulu	-	6,600,000	6,600,000
County of Hawaii - Department of Water	-	1,632,000	1,632,000
	-	59,017,959	59,017,959
Subtotal – required and pre-funding deposits	481,145,932	432,753,626	913,899,558
Less: amounts received for administrative fees	(3,536,970)	(2,317,706)	(5,854,676)
Total contributions and deposits			
received for benefit payments	$ 477,608,962	$ 430,435,920	$ 908,044,882

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

The required contributions include both contributions for self-insured and fully-insured plans. The self-insured contributions are reported as operating revenues in the statement of revenues, expenses and changes in net assets (deficit) for the enterprise fund. The contributions related to the fully-insured plans are included as a component of the premium payable on the statements of net assets for the enterprise fund and the statements of fiduciary assets and liabilities for the agency fund. Contributions related to the fully-insured plans for the year ended June 30, 2012 for the enterprise fund and agency fund, respectively, were $325,174,545 and $153,831,741 and for the year ended June 30, 2011 for the enterprise fund and agency fund, respectively, were $152,027,760 and $79,319,379.

As a result of plan operations in the current year, the Trust Fund utilized previously built-up reserves to cover the cost of healthcare benefits resulting in a transfer from the agency fund to the enterprise fund of $5,974,732 for the year ended June 30, 2012.

(8) RETIREMENT BENEFITS

A. Employees' Retirement System

Plan Description

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

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

On July 1, 2006, a new hybrid contributory plan became effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan are eligible for retirement at age 62 with 5 years of credited service or age 55 and 30 years of credited service. Members will receive a benefit multiplier of 2% for each year of credited service in the hybrid plan. The benefit options are similar to the current contributory plan. Approximately 60,345 current members, all members of the noncontributory plan and certain members of the contributory plan, are eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006 are required to join the hybrid plan.

Funding Policy

The contribution rate for State employees administering the Trust Fund is approximately 4.09% and 6.05% of pay for 2012 and 2011, respectively. The actuarial cost or funding method used to calculate the total employer contribution required is the entry age normal actuarial cost method. Under this method, the employer contribution rates are a fixed percentage of compensation, including normal cost plus amounts required to pay for the unfunded actuarial accrued liability.

The employer contribution rate for June 30, 2012 and 2011, was 15%.

The Trust Fund's share of the aggregated pension expense was approximately $223,848, $197,900, and $169,800 for the years ended June 30, 2012, 2011 and 2010, respectively, and the annual expense is included in the financial statements.

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

B. Postemployment Health Care and Life Insurance Benefits

Plan Description

In addition to providing pension benefits, the State, pursuant to HRS Chapter 87A, provides certain health care and life insurance benefits to all qualified retirees under an agent multiple-employer defined benefit plan. The plan's participating employers include the State and Counties of Honolulu, Hawaii, Maui and Kauai (Counties).

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

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

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

As of July 1, 2011, the date of the most recent actuarial valuation the plan membership was as follows:

	Retirees (including Surviving Spouse) Receiving Benefits	Deferred Vested Members not yet Receiving Benefits	Active Employees	Total
Employer:				
State of Hawaii	31,281	4,873	49,616	85,770
City & County of Honolulu	6,597	689	8,522	15,808
County of Hawaii	1,366	139	2,315	3,820
County of Maui	1,147	183	2,460	3,790
County of Kauai, including Department of Water	672	86	1,110	1,868
Board of Water Supply – Honolulu	570	47	502	1,119
County of Hawaii - Department of Water Supply	85	-	165	250
	41,718	6,017	64,690	112,425

Funding Policy

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

The participants required contribution to the Trust Fund is based on the pay-as-you-go basis and the actuarial determined annual required contribution (ARC) amount for the years ended June 30, 2012 and 2011, based on the July 2011 and July 2009, actuarial valuations, respectively, were as follows:

	2012		
	Required Contribution for June 30, 2012 (pay-as-you-go basis)	ARC for June 30, 2012	ARC as a Percentage (%) of Covered Payroll [1]
Employer:			
State of Hawaii	$ 271,758,132	$ 952,579,000	36.7%
City & County of Honolulu	63,007,261	155,778,000	28.4%
County of Hawaii	13,721,664	36,193,000	27.8%
County of Maui	11,289,369	32,878,000	24.8%
County of Kauai, including Department of Water Supply	6,566,477	17,060,000	25.7%
Board of Water Supply - Honolulu	5,126,550	10,750,000	36.0%
County of Hawaii - Department of Water Supply	768,487	2,400,000	30.0%
	$ 372,237,940	$ 1,207,638,000	

[1] Percentages are an estimate based information included in the actuarial valuation dated July 1, 2011. Actual amounts for fiscal year 2012 were not available.

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

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

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

Beginning in fiscal year 2008, the Trust Fund receives and holds deposits from participating employers to pre-fund retiree benefits on behalf of the employees in a separate account in the agency fund and allocates any interest earned related to those the pre-funding deposits based on accumulated amounts to date. These deposits do not meet the criteria of a contribution to the other postemployment benefits plan as the plan does not meet the criteria of a trust fund under GASB 43. The cumulative deposits and interest held by the Trust Fund in the agency fund for pre-funding are as follows for the years ended June 30, 2012 and 2011:

	2012	**2011**
Board of Water Supply – Honolulu	$ 21,710,155	$ 14,555,346
County of Hawaii	63,927,963	61,901,669
County of Maui	25,961,920	25,135,264
County of Kauai, including Department of Water	32,963,719	21,144,981
Hawaii County Department of Water Supply	6,257,153	4,478,575
City & County of Honolulu	81,493,345	40,172,152
	$ 232,314,255	$ 167,387,987

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

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

The employees that administer the Trust Fund are employees of the State. The Trust Fund's annual other postemployment (OPEB) cost (expense) is allocated by the State based on the Trust Fund's proportionate share of contributions for postemployment health benefits and was calculated at 0.0510% and 0.0393% of the State's annual required contribution (ARC) for the years ended June 30, 2012 and 2011, respectively. The ARC is an amount actuarially determined in accordance with GASB 45, which was implemented effective July 1, 2007.

The following table shows the components of the annual OPEB cost, the amount contributed to the plan, and changes in the Trust Fund's net OPEB obligation for the years ended June 30, 2012 and 2011.

	2012	2011
Annual required contribution	$ 432,795	$ 272,357
Interest on net OPEB obligation	44,770	16,901
Adjustment to annual required contribution	(40,700)	(15,365)
Annual OPEB cost	436,865	273,893
Contributions made	(117,790)	(82,385)
Increase in net OPEB obligation	319,075	191,508
Net OPEB obligation at beginning of year	735,198	543,690
Net OPEB obligation at end of year	$ 1,054,273	$ 735,198

The percentage of annual OPEB cost contributed was 27.0%, 30.1% and 27.8% for the years ended June 30, 2012, 2011 and 2010, respectively.

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

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

Additional information for the latest actuarial valuation follows:

Valuation date	7/1/2011
Actuarial cost method	Entry age normal
Amortization method	Level percentage of payroll, open
Amortization period	30 years
Actuarial assumptions:	
Investment rate of return	4%
Healthcare cost trend rate (1):	
Medical and prescription drug, pre 65	8% initial; 5% ultimate
Medical and prescription drug HSTA, pre 65	8.5% initial, 5% ultimate
Medical and prescription drug, post 65	8.5% initial, 5% ultimate
Medical and prescription drug HSTA, post 65	8.5% initial, 5% ultimate
Medicare Advantage, pre 65	8.5% initial, 5% ultimate
Medicare Advantage, post 65	15% initial, 5% ultimate
Dental	4% initial; 4% ultimate
Vision	3% initial; 3% ultimate
Medicare Part B	13.4% initial; 5% ultimate
Projected salary increases	3.5%

(1) Includes an inflation assumption of 3%.

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

(9) COMMITMENTS AND CONTINGENCIES

Deferred Compensation

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

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

Litigation

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

On June 30, 2006, a class action lawsuit was brought in the First Circuit Court, State of Hawaii, by certain State and county retirees against the Trust Fund, the Trust Fund's board of trustees, and the State ("collectively "State defendants"), as well as various county governments that participate in the Trust Fund's health benefit plans. The plaintiffs' amended complaint alleges various claims based on an argument that the Trust Fund is constitutionally, statutorily, and contractually required to provide health benefit plans that provide retirees and their dependents with benefits that are substantially equal to those provided to active employees and their dependents. In addition, the plaintiffs claim that the Trust Fund's failure to provide substantially equal health benefit plans to retirees and their dependents was negligent. The plaintiffs seek declaratory and injunctive relief, damages, and attorneys' fees and costs. The damages sought appear to be amounts that the plaintiffs (and their class) have paid for health benefits, which they would not have paid had their plans been equivalent to the Trust Fund's active employee plans. The defendants filed motions to dismiss the plaintiffs' complaint. The judge decided that the Trust Fund had primary jurisdiction over issues involved in the plaintiffs' claims and stayed this action pending referral of those issues to the Trust Fund.

In May and June 2007, the plaintiffs filed a petition with the Trust Fund's board of trustees seeking a declaratory ruling regarding certain issues raised by their lawsuit. The Trust Fund's board of trustees held a hearing on the plaintiffs' petition under the Trust Fund rules and Chapter 91 of the HRS. After the hearing, the Trust Fund's board of trustees issued its Findings of Fact, Conclusions of Law, and Order. The plaintiffs filed an appeal for judicial review of the Findings of Fact, Conclusions of Law, and Order under HRS §91-14. Plaintiffs appealed the Trust Fund's rulings to the First Circuit Court, State of Hawaii. After briefing and oral argument, the First Circuit Court overturned the Trust Fund's Board's rulings. The State and the Trust Fund's Board appealed the First Circuit Court's decision. On March 26, 2010, the Hawaii Supreme Court affirmed in part and reversed in part the First Circuit Court's decision. The Hawaii Supreme Court held that the First Circuit Court: (1) did not err in concluding that a retired state and county government employee's health benefits are protected by Article XVI, Section 2 of the Hawaii Constitution as "accrued benefits," and (2) erred by concluding that HRS Chapter 87A requires that postemployment health benefits reasonably approximate those of active workers. On March 2, 2011, Judge Patrick Border of the First Circuit Court, State of Hawaii, heard and granted Plaintiffs' motion for class action certification. The class certified was all individuals who began working for the Territory of Hawaii, State of Hawaii, or any political subdivision thereof, prior to July 1, 2003, and who qualify as a retired employee-beneficiary and/or whose dependent qualifies as a dependent-beneficiary as those terms are defined in sections 87A-1 and 87A-21 of the Hawaii Revised Statutes.

The parties are currently engaged in discovery. No trial date has yet been set. State Defendants intend to continue to vigorously defend against Plaintiffs' claims in this lawsuit. The outcome of this lawsuit cannot be determined and no amount has been recorded in the financial statements as of or for the years ended June 30, 2012 and 2011.

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

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

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

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

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

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

On October 14, 2011, the State filed a Notice of Appeal of the Amended Final Judgment; on November 4, 2011, Plaintiffs filed a cross-appeal of the amended final judgment, the final judgment, an order denying their motion for attorneys' fees and costs, and certain other orders entered by Judge Sakamoto. The appeal has been fully briefed and the parties are awaiting further action on the appeal by the ICA. The State intends to continue to vigorously defend against Plaintiffs' claim in this lawsuit. The outcome of this lawsuit cannot be determined and no amount has been recorded in the financial statements as of or for the years ended June 30, 2012 and 2011.

InformedRx v. EUTF, State of Hawaii, Civil No. 11-1-3162-12 (RAN) and 11-1-3163-12 (RAN)

On April 8, 2011, the Trust Fund issued a Request for Proposals (RFP) for Pharmacy Benefit Management (PBM) services for both the Employer-Group Waiver Program (EGWP) contract covering Medicare-eligible retirees, and non-EGWP contract covering active employees and non-Medicare-eligible (or "early") retirees (Active contract).

Following evaluation of proposals, the Trust Fund selected CVS Caremark for both the EGWP and Active new contracts. On August 8, 2011, informedRx filed an extensive Protest. On August 24, 2011, the Trust Fund sustained the Protest in part, and denied the remainder of the Protest.

On August 31, 2011, informedRx filed a Request for Hearing with the Department of Commerce and Consumer Affairs (DCCA). On December 16, 2011, the Special Hearings Officer issued a Decision upholding the award of contract to CVS Caremark for the Active contract. For the EGWP contract, the Special Hearings Officer remanded to the Trust Fund for further scoring on four out of the twenty-six alleged points of error. On December 23, 2011, informedRx appealed the Special Hearings Officer's Decision regarding the EGWP contract and Active contract in its entirety to the circuit court, in Civil No. 11-1-3162-12 (RAN). Also on December 23, 2011, the Trust Fund appealed two of the Special Hearings Officer's four points on remand for the EGWP contract. The two appeals before the circuit court were consolidated for convenience.

In the meantime, on remand from the DCCA, the Trust Fund re-evaluated the four specific points in the RFP ad directed by the DCCA Special Hearings Officer for the EGWP contract. The final scoring remained the same, with CVS Caremark ranked as the highest proposer. On January 27, 2012, informedRx filed a protest (EGWP protest) challenging the proposed award of the EGWP contract and then on February 7, 2012, the protest was denied by the Trust Fund and informedRx filed a Request for Hearing with DCCA. On March 9, 2012, the DCCA Senior Hearings Officer issued a Decision affirming the EUTF's denial of the EGWP protest, and dismissing the Request for Hearing. The Decision was not appealed by informedRx to the circuit court.

After briefing was completed in the appeals before the circuit court, Judge Rhonda Nishimura heard oral arguments from the parties on June 8, 2012. On August 27, 2012, Judge Nishimura issued a minute order denying both appeals on all points, with the prevailing parties to prepare the orders for her signature. On September 21 and 24, 2012, the circuit court issued written orders denying the appeals, and on November 1, 2012, a draft Judgment prepared by CVS was forwarded to the court for signature.

On November 8, 2012, the circuit court entered final judgment in the consolidated proceeding, upholding the decision of the Special Hearings Officer in its entirety.

Pursuant to HRS § 91-15, review of the final judgment of the circuit court is governed by HRS chapter 602, which governs the Hawaii courts of appeal. In turn, Rule 4 of the Hawaii Rules of Appellate Procedure provides in relevant part that "[w]hen a civil appeal is permitted by law, the notice of appeal shall be filed within 30 days after entry of the judgment or appealable order."

(10) RISK MANAGEMENT

The Trust Fund is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; and workers' compensation. In accordance with HRS 87A-25, the Trust Fund has obtained fiduciary liability insurance with an annual aggregate for losses of $10 million and a fidelity bond to cover employee dishonesty with an annual aggregate for losses of $1 million. In addition, the Trust Fund also obtained a public officials and employment practices insurance policy to cover any wrongful acts or employment practices violation in which the Trust Fund retains the first $25,000 per occurrence and the annual aggregate for losses is $3 million.

The Trust Fund is covered under the State's self-insurance program for workers' compensation. During fiscal years 2012 and 2011, the Trust Fund paid $18,108 and $11,076, respectively, in workers' compensation premiums to the State's General Fund.

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

(11) LEASE COMMITMENT

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

The lease commenced on January 1, 2005 and expired on November 30, 2009. In December 2009, the lease was amended with an expiration date of October 31, 2014. In January 2011, the lease was amended to surrender and acquire office space. The total rentable space was reduced from 10,324 square feet to 9,555 square feet. In addition to minimum rent, the lease provides for the payment of common area maintenance charges. At June 30, 2012, the aggregated minimum rental commitment under the noncancelable operating lease is as follows:

Year ending June 30,	
2013	310,000
2014	310,000
2015	104,000
	$ 724,000

The rent expense for the years ended June 30, 2012 and 2011, was $320,963 and $306,199, respectively.

(12) SUBSEQUENT EVENTS

Prescription Drug Contract for Medicare Retirees

The prescription drug contract for Medicare retirees was executed on July 1, 2012 with Silverscript.

Qualifying OPEB Trust Fund

Under GASB 43, the Trust Fund does not meet the criteria of a trust fund, therefore, deposits made by employers to the Trust Fund do not meet the criteria of contributions to other postemployment benefits (OPEB) that may be considered an asset to offset the liability. The Trust Fund submitted legislation to the 2012 Legislature (HB2491) to administer a separate trust fund for the purpose of receiving employer contributions that will prefund OPEB costs for retirees and their beneficiaries. HB2491 HD1 SD1 was signed into law on July 9, 2012.

HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
STATE OF HAWAII
Required Supplementary Information (Unaudited)
Five-Year Loss Development Information
June 30, 2012 and 2011

SELF-INSURED HEALTHCARE PLANS

The Trust Fund began providing and administering fully-insured health and other benefit plans beginning July 1, 2003. The Trust Fund also began providing self-insured plans effective July 1, 2007 through December 31, 2011 for medical plans and through April 30, 2012 for prescription drug plans for active employees and non-Medicare retirees and through June 30, 2012 for Medicare retirees. Therefore, the loss development tables on the following page show data for five successive policy years starting from the fiscal year ended June 30, 2008, for active employee and retiree self-insured plans.

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

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

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

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

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

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

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

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

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

HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
STATE OF HAWAII
Required Supplementary Information (Unaudited)
Five-Year Loss Development Information
June 30, 2012

Self-Insured Active Employee Healthcare Benefit Plans

	2008	2009	2010	2011	2012
1. Required contribution and investment revenue:					
Earned	$ 195,936,354	$ 221,762,304	$ 256,755,699	$ 246,004,463	$ 153,831,438
Ceded	-	-	-	-	-
Net earned	$ 195,936,354	$ 221,762,304	$ 256,755,699	$ 246,004,463	$ 153,831,438
2. Unallocated expenses	$ 2,382,253	$ 2,324,705	$ 3,464,359	$ 3,828,417	$ 2,142,126
3. Estimated claims and expenses, end of policy year:					
Incurred	$ 233,857,827	$ 267,973,485	$ 244,971,987	$ 241,048,648	$ 150,488,917
Ceded	-	-	-	-	-
Net incurred	$ 233,857,827	$ 267,973,485	$ 244,971,987	$ 241,048,648	$ 150,488,917
4. Net paid (cumulative) as of:					
End of policy year	$ 196,730,425	$ 262,097,745	$ 251,299,883	$ 237,215,369	$ 185,234,570
One year later	231,169,876	283,354,922	239,959,499	234,225,771	
Two years later	231,157,984	283,378,367	239,959,499		
Three years later	231,157,984	283,378,367			
Four years later	231,157,984				
Five years later					
Six years later					
Seven years later					
Eight years later					
Nine years later					
5. Reestimated ceded claims and expenses	$ -	$ -	$ -	$ -	$ -
6. Reestimated net incurred claims and expenses:					
End of policy year	$ 233,857,827	$ 267,973,485	$ 244,971,987	$ 241,048,648	$ 150,488,917
One year later	231,169,876	283,354,922	239,959,499	234,225,771	
Two years later	231,157,984	283,378,367	239,959,499		
Three years later	231,157,984	283,378,367			
Four years later	231,157,984				
Five years later					
Six years later					
Seven years later					
Eight years later					
Nine years later					
7. Increase (decrease) in estimated net incurred claims and expenses from end of policy year	$ (2,699,843)	$ 15,404,882	$ (5,012,488)	$ (6,822,877)	$ -

HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
STATE OF HAWAII
Required Supplementary Information (Unaudited)
Five-Year Loss Development Information
June 30, 2012

Self-Insured Other Postemployment Health Benefit Plans

	2008	2009	2010	2011	2012
1. Required contribution and investment revenue:					
Earned	$ 16,722,162	$ 166,760,728	$ 211,253,620	$ 235,439,876	$ 167,755,487
Ceded	-	-	-	-	-
Net earned	$ 16,722,162	$ 166,760,728	$ 211,253,620	$ 235,439,876	$ 167,755,487
2. Unallocated expenses	$ -	$ -	$ -	$ -	$ -
3. Estimated claims and expenses, end of policy year:					
Incurred	$ 167,508,722	$ 183,539,058	$ 169,514,348	$ 199,476,186	$ 141,054,193
Ceded	-	-	-	-	-
Net incurred	$ 167,508,722	$ 183,539,058	$ 169,514,348	$ 199,476,186	$ 141,054,193
4. Net paid (cumulative) as of:					
End of policy year	$ 143,959,614	$ 181,276,558	$ 168,365,724	$ 197,019,136	$ 170,423,736
One year later	164,519,936	188,620,467	169,424,601	194,063,811	
Two years later	164,731,483	188,597,900	169,424,601		
Three years later	164,731,483	188,597,900			
Four years later	164,731,483				
Five years later					
Six years later					
Seven years later					
Eight years later					
Nine years later					
5. Reestimated ceded claims and expenses	$ -	$ -	$ -	$ -	$ -
6. Reestimated net incurred claims and expenses:					
End of policy year	$ 167,508,722	$ 183,539,058	$ 169,514,348	$ 199,476,186	$ 141,054,193
One year later	164,519,936	188,620,467	169,424,601	194,063,811	
Two years later	164,731,483	188,597,900	169,424,601		
Three years later	164,731,483	188,597,900			
Four years later	164,731,483				
Five years later					
Six years later					
Seven years later					
Eight years later					
Nine years later					
7. Increase (decrease) in estimated net incurred claims and expenses from end of policy year	$ (2,777,239)	$ 5,058,842	$ (89,747)	$ (5,412,375)	$ -

HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
STATE OF HAWAII

ENTERPRISE FUND
Schedule of Administrative Operating Expenses
Years ended June 30, 2012 and 2011

	2012	2011
Operating expense:		
Personnel services	$ 2,459,610	$ 2,034,019
Contracted services	1,632,464	1,958,482
Equipment	18,676	37,344
Occupancy	320,963	306,199
Printing and binding	63,752	22,987
Insurance	81,863	80,679
Repairs and maintenance	6,309	23,813
Postage	82,563	57,105
Telephone	32,555	42,115
Transportation	15,817	14,012
Rental of equipment	1,412	21,727
Supplies	18,538	17,013
Training	3,770	11,270
Other	977	961
Total administrative expenses	$ 4,739,269	$ 4,627,726

HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
STATE OF HAWAII

AGENCY FUND
Schedule of Changes in Fiduciary Assets and Liabilities
Year ended June 30, 2012

	July 1, 2011	Additions	Deductions	June 30, 2012
Assets				
Cash and cash equivalents	$ 90,800,499	$ 548,807,643	$ (546,586,105)	$ 93,022,037
Cash and investments held by fiscal agent	169,272,987	91,654,387	(23,979,764)	236,947,610
Receivables				
Medicare reimbursements from individuals, net of allowance of $491,146 in 2012 and $403,332 in 2011	389,207	50,572,509	(50,704,437)	257,279
Premium receivable from State of Hawaii and counties	32,274,892	369,674,332	(370,475,348)	31,473,876
Other receivables held by insurance companies	42,721	1,071,216	(1,083,707)	30,230
Rebates receivable	5,063,909	9,857,547	(10,315,222)	4,606,234
Accrued interest receivable	35,684	252,187	(266,665)	21,206
Total receivables	37,806,413	431,427,791	(432,845,379)	36,388,825
Deposits	10,248,076	1,742,000	-	11,990,076
Total assets	$ 308,127,975	$ 1,073,631,821	$(1,003,411,248)	$ 378,348,548
Liabilities				
Due to State of Hawaii	$ 62	$ 188,795	$ -	$ 188,857
Due to retirees	10,242	1,596,962	(1,585,868)	21,336
Investment fees payable	-	53,964	-	53,964
Retrospective premium payable	1,932,911	2,066,785	(1,071,013)	2,928,683
Premiums payable	7,921,812	309,617,274	(299,821,459)	17,717,627
Benefit claims payable	15,275,791	158,258,128	(168,882,250)	4,651,669
Amounts held on behalf of employers for benefits	282,987,157	250,618,761	(180,819,506)	352,786,412
Total liabilities	$ 308,127,975	$ 722,400,669	$ (652,180,096)	$ 378,348,548

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MGO Certified Public Accountants.

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San Diego

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To the Board of Trustees of
the Hawaii Employer-Union Health Benefits Trust Fund
of the State of Hawaii and
Ms. Jan K. Yamane, Acting State Auditor
State of Hawaii, Office of the Auditor
Honolulu, Hawaii

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

We have audited the financial statements of Hawaii Employee-Union Health Benefits Trust Fund of the State of Hawaii (Trust Fund), as of and for the year ended June 30, 2012, and have issued our report thereon dated January 4, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Trust Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Trust Fund in a separate letter dated January 4, 2013.

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

Macias Gini & O'Connell LLP

Newport Beach, California
January 4, 2013

HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
STATE OF HAWAII
Schedule of Prior Year Finding and Response
June 30, 2012

2010-02 Risk Assessment and Financial Reporting

Recommendation

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

Status

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