

STATE OF HAWAII
DEPARTMENT OF LABOR AND
INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL
COMPENSATION FUND

FINANCIAL STATEMENTS AND FORECAST

June 30, 2006 and 2005



CONSULTANTS

CURTIS S. NAKASHIMA

COLLEEN Y. TSUCHIDA

DENNIS Y. SAKAMOTO

700 Bishop Street Suite 250 Honolulu Hawaii 96813-4103

Telephone 808.521-7844 Fax 808.521-6641 Email oc@onts-cpa.com

Mr. Nelson Befitel
Director, State of Hawaii
Department of Labor and Industrial Relations

We have audited the statements of assets, liability and fund balances arising from cash transactions of the State of Hawaii, Department of Labor and Industrial Relations, Workers' Compensation Special Compensation Fund as of June 30, 2006 and June 30, 2005 and the related statements of revenues collected and expenses paid and changes in fund balances-unreserved for the years then ended. These financial statements are the responsibility of the Workers' Compensation Special Compensation Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with U.S. generally accepted auditing standards. 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 Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

As described in Note 2, these financial statements were prepared on the cash receipts and disbursements basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets, liabilities and fund balances arising from cash transactions of the State of Hawaii, Department of Labor and Industrial Relations, Workers' Compensation Special Compensation Fund as of June 30, 2006 and June 30, 2005, and its revenues collected and expenses paid and changes in fund balances-unreserved for the years then ended, on the basis of accounting described in Note 2.

ONTS CPA, LLP

Honolulu, Hawaii
May 2, 2007

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL COMPENSATION FUND
Statements of Assets, Liability and Fund Balances - Cash Basis
June 30, 2006 and 2005

ASSETS

	<u>2006</u>	<u>2005</u>
Cash		
Held in State Treasury	\$20,396,130	\$21,640,931
Receivables		
Overpayment of benefits to claimants	363,618	346,577
Non-compliant employers	<u>4,608,824</u>	<u>4,685,310</u>
	4,972,442	5,031,887
Less: allowance for doubtful accounts	<u>(4,933,000)</u>	<u>(4,972,000)</u>
	<u>39,442</u>	<u>59,887</u>
	<u>\$20,435,572</u>	<u>\$21,700,818</u>

LIABILITY AND FUND BALANCES

Liability		
Security deposit from self-insured employer	\$ 1,005,000	\$ 1,000,000
	<u>1,005,000</u>	<u>1,000,000</u>
Fund Balances		
Reserved for receivables	39,442	59,887
Unreserved	<u>19,391,130</u>	<u>20,640,931</u>
	<u>19,430,572</u>	<u>20,700,818</u>
	<u>\$20,435,572</u>	<u>\$21,700,818</u>

The accompanying notes are an integral part of the financial statements.

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL COMPENSATION FUND
Statements of Revenues Collected and Expenses Paid
and Changes in Fund Balances-Unreserved - Cash Basis
Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Revenues Collected		
Levy on insurance carriers and self-insured employers	\$14,781,040	\$15,299,875
Interest income	709,358	596,534
No Dependency and non-work connected death cases	69,242	7,526
Penalties for non-compliance	56,784	56,243
Defaulting employers reimbursement	19,285	19,150
Other (including reimbursements of overpayment of benefits by claimants of \$10,435 and \$32,298, in 2006 and 2005, respectively)	<u>12,136</u>	<u>32,420</u>
	<u>15,647,845</u>	<u>16,011,748</u>
Expenses Paid		
Workers' compensation payments		
Benefit adjustment	7,648,387	8,083,345
Secondary injury provision	6,263,937	6,126,765
Defaulting employers	1,075,840	1,013,454
Concurrent employment	606,383	581,121
Total disability	331,604	337,961
Services of attendant and vocational rehabilitation	<u>121,770</u>	<u>119,792</u>
	16,047,921	16,262,438
Other expenses		
Inter/intra-department/agency reimbursed costs		
Attorney general's and other costs	575,198	612,598
Administrative support	142,857	109,991
Facilitator unit	131,305	154,786
Audit fee	<u>365</u>	<u>5,930</u>
	<u>16,897,646</u>	<u>17,145,743</u>

The accompanying notes are an integral part of the financial statements.

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL COMPENSATION FUND
Statements of Revenues Collected and Expenses Paid
and Changes in Fund Balances-Unreserved - Cash Basis
Years Ended June 30, 2006 and 2005
(continued)

	<u>2006</u>	<u>2005</u>
Deficiency of Revenues Collected Over Expenses Paid	(1,249,801)	(1,133,995)
Fund Balances, unreserved at beginning of year	<u>20,640,931</u>	<u>21,774,926</u>
Fund Balances, unreserved at end of year	<u>\$19,391,130</u>	<u>\$20,640,931</u>

The accompanying notes are an integral
part of the financial statements.

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL COMPENSATION FUND
Notes to Financial Statements - Cash Basis
Years Ended June 30, 2006 and 2005

1. Organization

The Workers' Compensation Special Compensation Fund (Fund) was created under Chapter 386, Section 151 of the Hawaii Revised Statutes (as amended) to allow each injured party an opportunity to receive disability benefits as provided by the State statutes. The Director of Finance of the State was custodian of the Fund and the Director of Labor and Industrial Relations was the administrator.

Under Sections 152-154 of Chapter 386 of the Hawaii Revised Statutes, the Fund was authorized to levy and collect assessments in amounts sufficient to meet the Fund's current and projected obligations. Section 153 provides for a levy assessed on insurers of employers, which was determined by the Director of Labor and Industrial Relations based on a percentage of gross premiums on workers' compensation policies. Section 154 authorized the Director of Labor and Industrial Relations to assess employers who maintain self-insured workers' compensation plans.

2. Summary of Significant Accounting Policies

a. Basis of Accounting

The Fund's policy was to prepare its financial statements on the cash receipts and disbursements basis of accounting. Under this basis, revenues were recognized when collected rather than when earned, and expenses were recognized when paid rather than when incurred. Consequently, penalty receivables, benefits payable to claimants, and accrued litigation fees payable at June 30, 2006 and 2005 were not included in the financial statements.

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL COMPENSATION FUND
Notes to Financial Statements - Cash Basis
Years Ended June 30, 2006 and 2005

b. Receivables

Receivables were recorded for financial statement presentation purposes and occurred when claimant benefit payments were made by the Fund on behalf of non-compliant employers, to deceased claimants and to claimants whose benefits were decreased through court or Department of Labor and Industrial Relations decisions. The allowance for uncollectible receivables was recognized as a reduction in receivables and accordingly, the net receivables were reported in Fund balance - reserved for receivables.

3. Interest Income

Effective August 1, 1999, the Fund participated in the State Treasury Investment Pool System of the State of Hawaii. The cash held in State Treasury was included in the investment pool system and was under the direction of the Director of Finance. The interest earned on pool investments was computed monthly by the Financial Administration Division of the Department of Budget and Finance using an interest rate (approximately 3.5% per annum) applied to the monthly cash balance. The credit risk on the cash held in State Treasury was determined at the State level and not by the Fund.

4. Commitments

The Fund was liable to pay workers' compensation benefits to claimants over the period of their disability. Estimated annual benefits payable to claimants were \$20,500,000 in the fiscal years ending June 30, 2007 and June 30, 2006. The liabilities were based on commitments as of June 30, 2006 and 2005, and did not include benefits, which may result from cases presently on appeal.



CONSULTANTS

CURTIS S. NAKASHIMA

COLLEEN Y. TSUCHIDA

DENNIS Y. SAKAMOTO

700 Bishop Street Suite 250 Honolulu Hawaii 96813-4103

Telephone 808.521-7844 Fax 808.521-6641 Email oc@onts-cpa.com

Mr. Nelson Befitel
Director, State of Hawaii
Department of Labor and Industrial Relations

We have compiled the accompanying forecasted schedule of cash balance and levy of assessments - cash basis of the State of Hawaii, Department of Labor and Industrial Relations, Workers' Compensation Special Compensation Fund for the period from August 1, 2006 through March 31, 2008 in accordance with attestation standards established by the American Institute of Certified Public Accountants.

The accompanying forecasted schedule presents, to the best of the Workers' Compensation Special Compensation Fund management's knowledge and belief, the cash balance and levy of assessments - cash basis of the State of Hawaii, Department of Labor and Industrial Relations, Workers' Compensation Special Compensation Fund for the forecasted period. It is not intended to be a forecast of financial position or results of operations. The accompanying forecasted information and this report were prepared for the State of Hawaii, Department of Labor and Industrial Relations, Workers' Compensation Special Compensation Fund for the purpose of providing a basis from which to assess levies on insurance carriers and self-insured employers.

A compilation is limited to presenting forecasted information that is the representation of the Workers' Compensation Special Compensation Fund's management and does not include evaluation of the support for the assumptions underlying such information. We have not examined the forecasted schedule and, accordingly, do not express an opinion or any other form of assurance on the accompanying schedule or assumptions. Furthermore, there will usually be differences between the forecasted and

actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

The accompanying forecasted schedule and this report are intended solely for the information and use of the State of Hawaii, Department of Labor and Industrial Relations, Workers' Compensation Special Compensation Fund and insurance carriers and self-insured employers and are not intended to be and should not be used by anyone other than the specified parties.

ONTS CPA, LLP

Honolulu, Hawaii
May 2, 2007

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL COMPENSATION FUND
Forecasted Schedule of Cash Balance and Levy of Assessments - Cash Basis (rounded to nearest thousand)
For the Twenty-Month Period from August 1, 2006 through March 31, 2008

	2006	2007								
	August	September	October	November	December	January	February	March	April	May
Forecasted cash balance - beginning of month	\$20,201	\$17,913	\$18,714	\$18,370	\$17,063	\$15,814	\$14,562	\$13,307	\$20,238	\$18,976
Revenues:										
Levy of insurance carriers and self-insured employers	134	3,399	1,079	44				8,190		
Interest income	68	76	76	73	46	43	40	36	33	51
Other	1	36	0	11						
Total Forecasted Cash Balance and Revenues Before Expenses	<u>20,404</u>	<u>21,424</u>	<u>19,869</u>	<u>18,498</u>	<u>17,109</u>	<u>15,857</u>	<u>14,602</u>	<u>21,533</u>	<u>20,271</u>	<u>19,027</u>
Expenses:										
Workers' Compensation Payments:										
Benefit adjustment	1,342	2,021	768	746	395	395	395	395	395	395
Secondary injury	892	498	548	511	537	537	537	537	537	537
Defaulting employers	57	79	72	25	115	115	115	115	115	115
Total disability	53	26	26	26	28	28	28	28	28	28
Other	56	66	61	49	66	66	66	66	66	66
Other Expenses:										
Inter/intra-department reimbursed costs/others	91	20	24	78	154	154	154	154	154	154
Total Forecasted Expenses	<u>2,491</u>	<u>2,710</u>	<u>1,499</u>	<u>1,435</u>	<u>1,295</u>	<u>1,295</u>	<u>1,295</u>	<u>1,295</u>	<u>1,295</u>	<u>1,295</u>
Forecasted cash balance - end of month	<u>\$17,913</u>	<u>\$18,714</u>	<u>\$18,370</u>	<u>\$17,063</u>	<u>\$15,814</u>	<u>\$14,562</u>	<u>\$13,307</u>	<u>\$20,238</u>	<u>\$18,976</u>	<u>\$17,732</u>
Levy of assessments:										
Self-insured employers										<u>\$ 8,190</u>
Insurance carriers										

See summary of significant assumptions and accounting policies and accountants' compilation report.

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL COMPENSATION FUND
Forecasted Schedule of Cash Balance and Levy of Assessments - Cash Basis (rounded to nearest thousand)
For the Twenty-Month Period from August 1, 2006 through March 31, 2008

	2008									
	June	July	August	September	October	November	December	January	February	March
Forecasted cash balance - beginning of month	\$17,732	\$16,469	\$15,097	\$13,722	\$15,689	\$14,307	\$12,930	\$11,550	\$10,166	\$8,779
Revenues:										
Levy of insurance carriers and self-insured employers	47	44	41	38	34	39	36	32	29	25
Interest income				3,345						
Other										
Total Forecasted Cash Balance and Revenues Before Expenses	<u>17,779</u>	<u>16,513</u>	<u>15,138</u>	<u>17,105</u>	<u>15,723</u>	<u>14,346</u>	<u>12,966</u>	<u>11,582</u>	<u>10,195</u>	<u>8,804</u>
Expenses:										
Workers' Compensation Payments:										
Benefit adjustment	395	637	637	637	637	637	637	637	637	637
Secondary injury	537	522	522	522	522	522	522	522	522	522
Defaulting employers	115	90	90	90	90	90	90	90	90	90
Total disability	28	28	28	28	28	28	28	28	28	28
Other	66	60	60	60	60	60	60	60	60	60
Other Expenses:										
Inter/intra-department reimbursed costs/others	169	79	79	79	79	79	79	79	79	94
Total Forecasted Expenses	<u>1,310</u>	<u>1,416</u>	<u>1,416</u>	<u>1,416</u>	<u>1,416</u>	<u>1,416</u>	<u>1,416</u>	<u>1,416</u>	<u>1,416</u>	<u>1,431</u>
Forecasted cash balance - end of month	<u>\$16,469</u>	<u>\$15,097</u>	<u>\$13,722</u>	<u>\$15,689</u>	<u>\$14,307</u>	<u>\$12,930</u>	<u>\$11,550</u>	<u>\$10,166</u>	<u>\$8,779</u>	<u>\$7,373</u>
Levy of assessments:										
Self-insured employers				<u>\$ 3,345</u>						
Insurance carriers										

(1) Does not include additional levy assessment due from insurance carriers in March 2008.

See summary of significant assumptions and accounting policies and accountants' compilation report.

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL COMPENSATION FUND
Summary of Significant Assumptions and Accounting
Policies - Cash Basis for the Period from
August 1, 2006 through March 31, 2008

1. Nature of Presentation

The accompanying forecasted schedule of cash balance and levy of assessments presents, to the best of the Workers' Compensation Special Compensation Fund management's knowledge and belief, the Fund's expected December 31 cash balance and levy of assessments for the forecasted period. Accordingly, the presentation reflects its judgment as of May 2, 2007, the date of this presentation, of the expected conditions and its expected course of action. The assumptions disclosed herein are those that the Workers' Compensation Special Compensation Fund management believes are significant to the presentation. There will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. The accompanying presentation and this report were prepared for the Fund's use in assessing levies on insurance carriers and self-insured employers and should not be used for any other purpose.

2. Basis of Accounting

The accompanying forecasted schedule has been prepared on the cash receipts and disbursements basis of accounting, which differs from generally accepted accounting principles.

3. Levy on Insurance Carriers and Self-Insured Employers

The forecasted assessment on insurance carriers was based on a 2.6% levy on an estimated \$315,000,000 of gross premiums to be written in 2006. The estimate of gross premium was based on management's knowledge and belief. The self-insured employers' assessment for September 2007, was based on 29% of the total levies to be assessed in 2007.

SEE ACCOUNTANTS' REPORT

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
WORKERS' COMPENSATION SPECIAL COMPENSATION FUND
Summary of Significant Assumptions and Accounting
Policies - Cash Basis for the Period from
August 1, 2006 through March 31, 2008

4. Interest Income

Effective August 1, 1999, the Fund participates in the State Treasury Investment Pool System of the State of Hawaii. The interest earned on pool investments is computed monthly by the Financial Administration Division of the Department of Budget and Finance using an interest rate (3% per annum for the forecasted schedule) applied to the monthly cash balance.

5. Workers' Compensation Payments

Expenses were estimated based on trend analysis of past financial data to provide for new cases and increases in disability payments. This payment, authorized by Hawaii Revised Statutes section 386-35, provides economic relief to permanently totally-disabled claimants.

In 1982, legislation was passed to provide for an increase in workers' compensation benefit adjustment payments every ten years. Effective January 1, 2002, the benefit adjustment payments increased from \$437 to \$564. For the forecasted schedule of cash balance and levy of assessments - cash basis, the increase in benefit adjustment payments is estimated to be a 10% increase for new claims and a projected reimbursement to insurance carriers of approximately \$4,500,000 in March 2007.

6. Inter/Intra-Department/Agency Reimbursed Costs

The attorney general's reimbursed costs are forecasted at approximately \$47,000 per month. Other facilitator unit and administrative support reimbursed costs are forecasted at approximately \$24,000 per month. The cost of accounting program software is forecasted at \$400,000 for December 2006 through June 2007.

SEE ACCOUNTANTS' REPORT