



DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of Inspector General
Office of Audit Services

Region IX
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Report Number: A-09-04-00039

June 4, 2004

Georgina Kawamura
Director of Finance
Department of Budget and Finance
State of Hawaii
P.O. Box 150
Honolulu, Hawaii 96810

Dear Ms. Kawamura:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of Employees' Retirement System of the State of Hawaii Pension Costs" for the period July 1, 2001 to June 30, 2003. Should you have any questions or comments concerning the matters commented on in this report, please direct them to the HHS official named below.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), OIG reports issued to HHS grantees and contractors are made available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which HHS chooses to exercise. (See 45 CFR Part 5.)

To facilitate identification, please refer to report number A-09-04-00039 in all correspondence.

Sincerely,

A handwritten signature in black ink, appearing to read "Lori A. Ahlstrand", written in a cursive style.

Lori A. Ahlstrand
Regional Inspector General
for Audit Services

Enclosures – as stated

Direct Reply to HHS Action Official:

Mr. David S. Low, Director
Division of Cost Allocation
Program Support Center
Department of Health and Human Services
50 United Nations Plaza
Room 347
San Francisco, California 94102

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF
EMPLOYEES' RETIREMENT
SYSTEM
OF THE STATE OF HAWAII
PENSION COSTS**



**JUNE 2004
A-09-04-00039**

Office of Inspector General

<http://oig.hhs.gov>

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

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The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support in OIG's internal operations. The OCIG imposes program exclusions and civil monetary penalties on health care providers and litigates those actions within the department. The OCIG also represents OIG in the global settlement of cases arising under the Civil False Claims Act, develops and monitors corporate integrity agreements, develops model compliance plans, renders advisory opinions on OIG sanctions to the health care community, and issues fraud alerts and other industry guidance.

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OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.



EXECUTIVE SUMMARY

BACKGROUND

The Federal Government makes contributions to States' public employee retirement systems through Statewide Central Service Cost Allocation Plans, which the States submit annually for approval by the U.S. Department of Health and Human Services (HHS), Division of Cost Allocation.

The Hawaii Legislature established the Employees' Retirement System of the State of Hawaii (ERS) in 1925 to provide a defined benefit plan consisting of retirement, disability, and survivor benefit programs for State and county government employees. A Board of Trustees administers ERS and the State of Hawaii Department of Budget and Finance provides for its administrative supervision.

OBJECTIVE

The overall objective of this audit was to determine whether the State of Hawaii (State) appropriately charged the Federal Government for pension expenses for State employees working on Federal programs for the 2-year period July 1, 2001 through June 30, 2003. Specifically, we reviewed the State's pension plan and contributions to determine whether (1) the retirement contribution rates were set in accordance with Federal regulations and (2) funds designated as contributions to the ERS were used to pay pensions and related administrative costs.

RESULTS OF AUDIT

The State appropriately charged the Federal Government for pension expenses for the 2-year period July 1, 2001 through June 30, 2003 in accordance with the Office of Management and Budget (OMB) Circular A-87. The State's retirement contribution rates were based on an actuarial projection method that complied with Federal regulations. In addition, ERS properly used funds designated as retirement contributions to pay pensions and related administrative costs.

STATE'S COMMENTS

In a letter dated May 24, 2004, the State provided technical comments to our draft report which we have incorporated into the final report, where appropriate.

INTRODUCTION

BACKGROUND

Federal Participation in Public Employee Retirement Systems

The Federal Government makes contributions to States' public employee retirement systems through Statewide Central Service Cost Allocation Plans, which the States submit annually for approval by the HHS, Division of Cost Allocation.

State of Hawaii ERS

The Hawaii Legislature established ERS in 1925 to provide a defined benefit plan consisting of retirement, disability, and survivor benefit programs for State and county government employees. A Board of Trustees administers ERS and the State of Hawaii Department of Budget and Finance provides for its administrative supervision.

Employer Pension Contribution Rate Applicable to Federal Grants and Contracts

As part of its annual Statewide Central Service Cost Allocation Plan, the State of Hawaii Department of Budget and Finance, through its consultant, MAXIMUS Inc., negotiates a composite fringe rate with the HHS Division of Cost Allocation that is applicable to State agencies. This rate is made up of numerous fringe benefit items, including a rate for employer pension contributions. The rate is applied to Federal grants and contracts administered by State agencies. The negotiated pension contribution rates were 0.03 percent¹ and 8.88 percent for the fiscal years ended June 30, 2002 and June 30, 2003, respectively.

The HHS Division of Cost Allocation does not negotiate pension contribution rates at the county level since the county agencies receive a relatively small amount of Federal participation.

Impact of Act 100 on Employer Contribution Amounts

To help balance the State and counties' budgets, in 1999 the State legislature enacted Act 100, which amended § 88-107 of the Hawaii Revised Statutes. Act 100 required that actuarial investment earnings exceeding the 10-percent investment yield rate for fiscal years 1997 and 1998 be used to reduce the State and counties' employer contribution requirements for fiscal years 2000 through 2002. The reductions totaled \$346.9 million, including \$156.9 million for fiscal year 2000, \$156.3 million for fiscal year 2001, and \$33.7 million for fiscal year 2002. The Federal Government benefited from a reduced negotiated contribution rate in fiscal year 2002 due to Act 100. Act 100 also stipulated that the use of the excess actuarial investment earnings for fiscal years 1997 and 1998 is a one-time provision, and no law shall be enacted again to require ERS to apply actuarial investment earnings to offset the contribution amount.

¹ This rate for fiscal year 2002 was due in large part to a carry-forward adjustment to account for the over-collection of pension contribution amounts in fiscal year 2000. The carry-forward adjustment from fiscal year 2000 was due primarily to the use of ERS' excess investment earnings from fiscal year 1997 which lowered employer contributions.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

The overall objective of this audit was to determine whether the State appropriately charged the Federal Government for pension expenses for State employees working on Federal programs for the 2-year period July 1, 2001 through June 30, 2003. Specifically, we reviewed the State's pension plan and contributions to determine whether (1) the retirement contribution rates were set in accordance with Federal regulations and (2) funds designated as contributions to the ERS were used to pay pensions and related administrative costs.

Scope

Our audit covered the operation of ERS for the 2-year period July 1, 2001 through June 30, 2003. We did not review the State's overall internal control structure, since such a review was not necessary to accomplish the objectives of our audit.

Methodology

To accomplish our audit objectives, we:

- reviewed applicable Federal regulations and standards relating to pension expenditures, including OMB Circular A-87 and Governmental Accounting Standards Board Statements 25 and 27;
- reviewed the Hawaii Revised Statutes, chapter 88, Pension and Retirement Systems guidelines;
- obtained the ERS Comprehensive Annual Financial Reports for fiscal years 2002 and 2003 to review financial statements, investment policies, actuarial assumptions, and other material related to retirement contributions;
- met with officials from the State of Hawaii Department of Budget and Finance to discuss the process by which pension accumulation contributions are collected and forwarded to ERS;
- met with ERS officials to discuss the investment policies and the uses of the pension funds; and
- held discussions with representatives from the HHS Division of Cost Allocation and the State's consultant, MAXIMUS, Inc., relating to the negotiated employer pension contribution rates.

We conducted our review in accordance with generally accepted government auditing standards. We conducted fieldwork from January through April 2004, which included visits to the offices of the Department of Budget and Finance and ERS in Honolulu, HI.

RESULTS OF AUDIT

The State appropriately charged the Federal Government for pension expenses for the 2-year period July 1, 2001 through June 30, 2003 in accordance with the OMB Circular A-87. The State's retirement contribution rates were based on actuarial projections method that complied with Federal regulations. In addition, ERS properly used funds designated as retirement contributions to pay pensions and related administrative costs.

STATE'S COMMENTS

In a letter dated May 24, 2004, the State provided technical comments to our draft report which we have incorporated into the final report, where appropriate.

ACKNOWLEDGMENTS

This report was prepared under the direction of Lori A. Ahlstrand, Regional Inspector General for Audit Services. Other principal Office of Audit Services staff who contributed include:

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For information or copies of this report, please contact the Office of Inspector General's Public Affairs office at (202) 619-1343.