NEIL ABERCROMBIE
GOVERNOR

STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

May 4, 2012

TO: Directors of Finance, Budget, and Personnel; State and County Personnel Officers; Payroll Officers and Information Technology Staff

FROM: Wesley K. Machida, Administrator

SUBJECT: Personnel and Payroll Reporting Changes for Newly Hired Employees' Retirement System Members after June 30, 2012

The 2012 Legislative Session just ended, and we would like to inform you of legislation (Senate Bill 1269, CD 1 ("S.B. 1269")) that, if approved by the Governor, is likely to require significant changes to your payroll operations. S.B. 1269 changes the definition of "compensation" for the Employees' Retirement System (ERS) purposes for employees who become ERS members after June 30, 2012. The change in the definition of "compensation" will impact payroll reporting by employers, as well as the basis for employer and employee contributions to the ERS. If the necessary payroll systems, procedures, and processes are not in place to handle the requirements of S.B. 1269, there will be overpayments to the ERS of employee and employer contributions. When overpayments of contributions occur, significant additional time and effort will have to be expended by employers and the ERS to process refunds and to comply with applicable state and federal tax reporting requirements.

S.B. 1269 amends the definition of "compensation" for the purpose of calculating retirement benefits for all employees who become ERS members after June 30, 2012. For these "new" members, the definition of "compensation" is more limited than the definition of "compensation" for current ERS members. The difference in the definition of "compensation" for "new" and "old" ERS members will require that employers modify their payroll reporting for new employees. Essentially, only normal periodic payments, shortage differentials and Department of Education (DOE) twelve-month differentials should be reported to the ERS for new employees. All other types of pay will not be eligible for ERS benefits and should not be reported to the ERS. Therefore, employers will have to report two (2) different compensation amounts to the ERS:

(1) for current members/employees as of June 30, 2012, and

(2) for new members/employees as of July 1, 2012 and after.

Note: An employee who was employed prior to July 1, 2012, leaves, and then returns to service after June 30, 2012 could, depending upon various factors, be considered a "new" member for purposes of S.B. 1269.

Employees' Retirement System
of the State of Hawaii

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ERS contributions should only be deducted from "compensation" and should only be paid on "compensation."

S.B. 1269 defines “compensation” for **employees who become ERS members after June 30, 2012** as:

- normal periodic payments of money for service, the right to which accrues on an hourly, daily, monthly or annual basis;
- shortage differentials;
- elective salary reduction contributions under 125, 403(b) and 457(b) of the IRC of 1986, as amended (i.e., deductions for "deferred compensation" and "teachers' annuity"); and
- twelve-month differentials for employees of the department of education.

“Compensation” does not include:

> Any additional or extra payments to an employee or officer, including overtime, supplementary payments, bonuses, lump sum salary supplements, allowances or differentials, including differentials for stand-by duty, temporary unusual work hazards, compression differentials, or temporary differentials, except for the types of payments specifically listed above.

Current ERS members will not be affected by the change in the definition of "compensation"; payroll reporting and basis for contributions for current ERS members will remain unchanged.

As with Act 163, we anticipate that your computer systems will require modifications due to the change in the definition of compensation and the different requirements for current and new employees. We are also aware that the implementation of these changes may require some testing and review. Despite time constraints and limited resources, we hope that you will be able to modify your systems as soon as possible because the law becomes effective on June 30, 2012.

We will schedule a meeting with all employers to discuss the requirements of S.B. 1269, including the remedial measures that will have to be taken by employers when overpayments and erroneous reporting to the ERS occur. We will also cover the impact of House Bill 2487 that requires employers to pay additional contributions for those employees who retire on or after July 1, 2012 with significant compensation increases in their final years of employment.

Should you have any questions regarding the above, please contact Ms. Donna Curry, Program Specialist, at 586-1678, or by e-mail at curryd@hiers.org.

Thank you in advance for your assistance.