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STATE INSURANCE FUND CORPORATION

(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and
Required Supplementary Information
as of and for the year ended June 30, 2012,
and Independent Auditors' Report

STATE INSURANCE FUND CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)
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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
State Insurance Fund Corporation:

We have audited the accompanying statement of net assets of State Insurance Fund Corporation (the "Corporation") (a component unit of the Commonwealth of Puerto Rico) as of June 30, 2012, and the related statements of revenues, expenses and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above, present fairly, in all material respects, the financial position of State Insurance Fund Corporation as of June 30, 2012, and the changes in its net assets, and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

To the Board of Directors
State Insurance Fund Corporation
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Accounting principles generally accepted in the United States of America require that the management's discussion and analysis information on pages 3 through 10 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 an opinion on the basic financial statements taken as a whole. The required supplementary information comprising the Ten-Year Claims Development Information and the Schedules of Funding Progress and Employer Contributions for Pension Costs and Postemployment Benefits Other than Pensions on pages 61 thru 64, are not a required part of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries to management regarding the methods of measurement and presentation of the required supplementary information. We did not audit such information and express no opinion on it.

BDO Puerto Rico, P.S.C.

San Juan, Puerto Rico

December 30, 2012

Certified Public Accountants
(of Puerto Rico)
License No. 53 expires December 1, 2015
Stamp 2664839 of the P.R. Society of
Certified Public Accountants has been
affixed to the file copy of this report

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STATE INSURANCE FUND CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) AS OF AND FOR THE YEAR ENDED JUNE 30, 2012

INTRODUCTION

State Insurance Fund Corporation (the "Corporation") is a component unit of the Commonwealth of Puerto Rico (the "Commonwealth") created by Law No. 45 of April 18, 1935, as amended, known as the Workmen Compensation Insurance Act (the "Act"). Under the provisions of the Act, the Corporation is the exclusive provider of insurance coverage for work related accidents, deaths, and illnesses suffered by workers in Puerto Rico. On October 29, 1992, the Act was amended by Law No. 83 to convert the agency into a governmental corporation and to establish the functions and responsibilities of the Board of Directors, the Administrator and the Industrial Medical Advisory Board.

The Act provides that the Corporation's administrative expenses shall not exceed 22% of the total insurance premiums collected during the previous fiscal year. Administrative expenses exclude depreciation and amortization expense, provision for (recoveries of) uncollectible accounts, interest expense and investment managers' fees. The Corporation complied with this requirement of the Act for the year ended June 30, 2012.

This section presents a narrative overview and analysis of the financial performance of the Corporation as of and for the year ended June 30, 2012. The information presented here should be read in conjuction with the basic financial statements, including the notes thereto.

FINANCIAL HIGHLIGHTS

- Increase in operating revenues of $36.4 million in 2012 when compared to 2011.
- Operating loss decreased to $55.7 million in 2012 from $66.8 million in 2011.
- The actuarially determined expense of compensation benefits, medical benefits and benefit adjustment expenses went from a credit of $4.5 million in 2011 to a provision of $23.8 million in 2011.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

This discussion and analysis is required supplementary information to the basic financial statements and is intended to serve as an introduction to the basic financial statements of the Corporation. The Corporation is a self–supporting entity and follows the enterprise fund reporting; accordingly, the financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. Enterprise fund statements offer short and long term financial information about the activities and operations of the Corporation.

The basic financial statements include the following: (1) Statement of Net Assets, (2) Statement of Revenues, Expenses, and Changes in Net Assets, (3) Statement of Cash Flows, and (4) Notes to the Basic Financial Statements. The Corporation also includes additional information to supplement the basic financial statements.

The statement of net assets provides information on the Corporation's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Corporation is improving or deteriorating.

The statement of revenues, expenses and changes in net assets presents information on how the Corporation's net assets changed during the reporting period. Changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows.

The statement of cash flows shows changes in cash and cash equivalents, resulting from operating, non–capital and capital financing and investing activities, which include cash receipts and cash disbursements information.

The notes to the basic financial statements provide additional information that is essential for a full understanding of the data provided in the basic financial statements.

The required supplementary information consists of three schedules concerning the following: (1) the ten–year claims development information required by the Governmental Accounting Standards Board ("GASB") Statement No. 10, ***Accounting and Financial Reporting for Risk Financing and Related Insurance Issues***, as amended, (2) the supplementary information of the Corporation's Pension Costs as required by GASB Statement No. 27, ***Accounting for Pensions by State and Local Governmental Employers*** and, (3) the supplementary information of the Corporation's Postemployment Benefits other than Pensions Program as required by the GASB Statement No. 45, ***Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions***.

FINANCIAL ANALYSIS

The following is the condensed financial position of the Corporation as of June 30, 2012 and 2011:

Condensed Statement of Net Assets

	June 30,		Change	
	2012	2011	Amount	Percent
Assets:				
Cash and cash equivalents	$ 159,248,401	$ 408,084,597	$ (248,836,196)	-60.98%
Accounts Receivable	81,216,370	187,587,822	(106,371,452)	-56.70%
Investments	1,536,840,586	1,185,747,192	351,093,394	29.61%
Other assets	109,566,863	105,181,982	4,384,881	4.17%
Total assets	1,886,872,220	1,886,601,593	270,627	0.01%
Liabilities:				
Liability for incurred but unpaid benefits and benefit adjustment expenses	820,012,188	784,017,663	35,994,525	4.59%
Other liabilities	493,494,727	482,191,134	11,303,593	2.34%
Note payable	242,000,000	242,000,000	-	0.00%
Total liabilities	1,555,506,915	1,508,208,797	47,298,118	3.14%
Net assets:				
Invested in capital assets	37,965,293	25,676,516	12,288,777	47.86%
Restricted	72,600,000	72,600,000	-	-
Unrestricted	220,800,012	280,116,280	(59,316,268)	-21.18%
Total net assets	331,365,305	378,392,796	(47,027,491)	-12.43%
Total liabilities and net assets	$ 1,886,872,220	$ 1,886,601,593	$ 270,627	0.01%

- **The Corporation's total assets remained substantially the same in 2012**

Total assets of the Corporation amounted to $1,887 in 2012 and in 2011. Biggest increase within the assets was the investments which are up $351 million from 2011. Such increase is directly related to the decrease in cash and cash equivalents and accounts receivable. The decrease in cash and cash equivalents is mainly due to management's efforts to maximize the investment yield by trying to keep only the cash necessary to meet liquidity requirements. The decrease in accounts receivable is mainly due to the fact that in 2011 there were $101.0 million in securities sold but not yet delivered while there are only $5.8 million in 2012.

- **The Corporation's total liabilities increased by $47.3 million in 2011 (or 3%)**

Increase in total liabilities to $1,556 million in 2012 from $1,508 million in 2011 is mainly due to an increase in the liability for incurred but unpaid compensation and medical benefits, including benefit adjustment expenses. This liability includes a reserve for both reported and unreported insured events (compensation and medical benefits), which includes an estimation of future payments and related adjustment expenses. This liability is developed by an independent actuary from historical benefit expenses and/or payments gathered by the Corporation. The liability for compensation and medical benefits is based on historical claims experience data, assumptions, and projections of future events, including the frequency, severity and persistency of the claims, as well as the inflationary trends. The accrual for reimbursement of premiums represents an estimate actuarially determined as a result of the settlement of premiums under the policies. The assumptions used in estimating and establishing these liabilities are reviewed annually based on current circumstances and trends.

The liability for incurred but unpaid compensation and medical benefits, including benefit adjustment expenses, increased by $36.0 million or 5% from $784.0 million at June 30, 2011, to $820.0 million at June 30, 2012. For the year ended June 30, 2012, incurred compensation and medical benefits amounted to $528.1 million; meanwhile, compensation and medical benefits payments amounted to $498 million for the year ended June 30, 2012.

- **The Corporation's net assets decreased by $47.0 million in 2012 (or 12%)**

As of June 30, 2012, the Corporation had $220.8 million in net assets categorized as unrestricted assets, $72.6 million in restricted assets and $38.0 million invested in capital assets-net of related debt, for a total net assets of $331.4 million. In fiscal year 2012, net assets decreased by $47.0 million or 12%, from $378.4 million as of June 30, 2011, due to non-operating revenue of $60.0 million, net of an operating loss of $55.7 million and of transfers to other governmental agencies of $51.3 million.

The following summarizes the condensed changes in net assets of the Corporation for the years ended June 30, 2012 and 2011:

Condensed Statement of Revenues, Expenses and Changes in Net Assets (in thousands):

	2012	2011	Change	
Operating revenues	$ 636,541	$ 600,160	$ 36,381	6.06%
Operating expenses:				
Compensation and medical benefits	551,859	525,007	26,852	5.11%
General and administrative	140,366	141,944	(1,578)	-1.11%
Total operating expenses	692,225	666,951	25,274	3.79%
Operating loss	(55,684)	(66,791)	11,107	-16.63%
Non-operating revenues (expenses) - net	59,999	129,458	(69,459)	-53.65%
Transfers to other governmental agencies - net	(51,342)	(51,178)	(164)	0.32%
Changes in net assets	(47,027)	11,489	(58,516)	-509.33%
Net assets - beginning of the year	378,392	366,903	11,489	3.13%
Net assets - end of the year	$ 331,365	$ 378,392	$ (47,027)	-12.43%

The Corporation recognizes as income the subscribed premiums, which represent the preliminary premiums assessed at the beginning of the fiscal year plus additional premiums imposed or expected to be imposed as a result of the final settlement of premiums under the insurance policy or reduced by any unearned or reimbursable portion or provision for uncollectible accounts, as determined. Premiums are based on individual employers' reported payroll ledgers using predetermined insurance rates based on the employers' risk classifications. The regular policies are issued for a one–year period consistent with the Corporation's fiscal year, which runs from July 1 to June 30. Incidental policies are issued to cover special risks over a pre-determined period of time. Unearned premiums represent the remaining portion at the end of the fiscal year, which is attributed to the unexpired term of the incidental policies issued during the fiscal year.

Policy costs consist mainly of salaries and certain underwriting expenses. Benefits are recorded on an accrual basis, which includes benefit paid and a liability to cover estimated incurred but unpaid benefits and benefit adjustments expenses based on the ultimate settling cost, as determined by the independent actuary.

- **Operating revenues increased by $36.4 million in 2012 (or 6%)**

Operating revenues increased by $36.4 million or 6% during the year ended June 30, 2012. The increase in operating revenues was primarily due to the decrease of $33.1 million in insurance premiums earned offset by a decrease of $43.3 million in the provision for uncollectible insurance premiums and a decrease of $27.0 million in the reimbursement of insurance premiums.

- **Compensation and medical benefits increased by $26.9 million in 2012 (or 5%)**

Compensation and medical benefits increased by $26.9 million or 5% during the year ended June 30, 2012. Compensation benefits for the year ended June 30, 2012 amounted to $172.1 million, a decrease of $3.4 million or 2%, when compared to $175.5 million for the prior year. Medical benefits for the year ended June 30, 2012 amounted to $355.9 million, an increase of $1.9 million or 0.5%, when compared to $354.0 million for the prior year. Such lower expenses are mainly related to the efforts of management to decrease the controllable costs like salaries and contracted services.

The main driver for the increase in compensation and medical benefits was an increase from a credit for compensation benefits, medical benefits and benefits adjustments expenses amounting to $4.5 million in 2011 to a provision for compensation benefits, medical benefits and benefits adjustments expenses amounting to $23.8 million in 2012 for a net change of $28.3 million. This net change from 2011 to 2012 was mainly caused by a decrease in the discounting factor used to calculate the present value of the estimated outstanding losses as determined by the independent actuary. Such discounting factor is based on the investment yield of the Corporation (3.66% in 2012 and 4.2% in 2011).

- **General and administrative expenses (excluding depreciation and amortization) decreased by $3.1 million in 2012 (or 2%)**

General and administrative expenses (excluding depreciation and amortization) decreased by $3.1 million or 2% during the year ended June 30, 2012 mainly as a result of decreases in salaries due to the continued efforts of management of controlling this cost.

- **Non–operating revenues-net decreased by $69.5 million in 2012 (or 54%)**

Net non–operating revenues represent principally interest and dividend income, net change in fair value of investments, including derivative instruments, and interest expense. Government accounting policies requires that investments be carried at fair value; thus realized gains and losses from the sale of securities and unrealized changes in the fair value of outstanding securities are recorded through operations.

Net increase in fair value of investments, including derivative instruments, amounted to $29.0 million in 2012, a decrease of $71.3 million or 71% when compared to an increase in fair value of investments of $100.3 million in 2011. On the other hand, interest and dividend income, net of costs (investment managers' fees) amounted to $42.9 million in 2012, an increase of $2.2 million or 5%, when compared to $40.7 million in 2011.

Interest expense amounted to $11.7 million in 2012, an increase of $.4 million or 3.5%, when compared to $11.3 million in 2011.

- **Transfers to other governmental agencies-net increased by $.1 million in 2012 (or .3%)**

The Corporation is required by legislation to transfer to other governmental agencies funds for programs related to injured employees and their families. During the year ended June 30, 2012, the Corporation transferred funds to the Industrial Commission of Puerto Rico, the Department of Labor and Human Resources, the Department of the Family, Puerto Rico Housing Finance Authority and the Labor Affairs Office amounting to $51.3 million compared to $51.2 million in 2011.

CAPITAL ASSETS AND LONG-TERM DEBTS

- **Capital assets-net increased by $7.7 million in 2012 (or 8%)**

Capital assets are comprised of buildings used to render services to workers, medical and offices' equipment, motor vehicles and assets under capital lease. During the year ended June 30, 2012 capital assets, net of depreciation and amortization, increased by $7.7 million or 8% mainly due to the acquisition of a building for the amount of $10.1 million offset by depreciation and amortization expense of $6.2 million. Refer to Note 6 to the basic financial statements for further information regarding the Corporation's net capital assets.

- **Note payable did not change in 2012**

On May 11, 2011, the Corporation entered into a loan agreement ("the Loan") with a private financial institution for the amount of $242,000,000. The Loan matures on May 1, 2028 and carries a variable interest rate of 30 day LIBOR plus a 2.25% spread. First principal payment is due on fiscal year 2014. This loan requires the Corporation to comply with certain restrictive covenants, which, in the event of non–compliance, provide the financial institution the right to declare the outstanding debt as due and payable in cancellation of the loan agreement. One of the covenants requires the Corporation to pledge 130% of the outstanding principal on the loan in securities in its investment portfolio. Proceeds of the loan were used to repay a note payable and interest payable to the Government Development Bank for Puerto Rico ($220,000,000 principal and $3,273,000 in interest), purchase of two buildings ($8,490,000 for building purchased before June 30, 2011 and $10,100,000 for building purchased during fiscal year 2012 as noted above) and other purposes ($137,000).

CONTACTING THE CORPORATION'S FINANCIAL MANAGEMENT

This report is designed to provide all interested parties with a general overview of the Corporation's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to State Insurance Fund Corporation, PO Box 365028, San Juan, Puerto Rico, 00936-5028.

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STATE INSURANCE FUND CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF NET ASSETS
JUNE 30, 2012

ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$	159,248,401
Accounts receivable — net		81,216,370
Inventories		3,225,459
Prepaid expenses		128,532
Investments		453,624,420
Total current assets		697,443,182
NON-CURRENT ASSETS:		
Investments		768,616,166
Restricted assets:		
Investments		314,600,000
Capital assets — net of accumulated depreciation/amortization:		
Land		13,010,166
Depreciable assets, including software		93,202,706
Total non-current assets		1,189,429,038
TOTAL ASSETS	$	1,886,872,220
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Liability for incurred but unpaid benefits and benefit adjustment expenses	$	188,980,854
Accounts payable		86,658,150
Accrued liabilities		34,355,574
Unearned premiums		24,628,227
Accrual for reimbursement of premiums		55,057,078
Securities lending obligations		112,059,805
Current portion of:		
Other notes payable		4,489,202
Obligation under capital lease		624,365
Total current liabilities	$	506,853,255

(Continued)

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

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STATE INSURANCE FUND CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF NET ASSETS
JUNE 30, 2012

NON-CURRENT LIABILITIES:		
Liability for incurred but unpaid benefits and benefit adjustment expenses	$	631,031,334
Accrued liabilities		48,942,824
Accrual for reimbursement of premiums		63,545,490
Other notes payable		33,162,233
Obligation under capital lease		29,971,779
Liabilities payable from restricted assets:		
Note payable - due in more than one year		242,000,000
Total non-current liabilities		1,048,653,660
Total liabilities		1,555,506,915
COMMITMENTS AND CONTINGENCIES (Notes 19 and 20)		
NET ASSETS:		
Invested in capital assets — net of related debt		37,965,293
Restricted		72,600,000
Unrestricted		220,800,012
Total net assets		331,365,305
TOTAL LIABILITIES AND NET ASSETS	$	1,886,872,220

(Concluded)

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

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STATE INSURANCE FUND CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2012

OPERATING REVENUES:		
Insurance premiums earned	$	680,470,246
Miscellaneous income — net		1,025,744
Less:		
Reimbursement of insurance premiums		(35,433,556)
Provision for uncollectible insurance premiums		(9,521,565)
Total operating revenues		636,540,869
OPERATING EXPENSES:		
Compensation benefits		172,112,909
Medical benefits and legal fees		355,939,875
Provision for compensation benefits, medical benefits, and benefit adjustment expenses		23,806,597
Administrative expenses		134,184,019
Depreciation and amortization		6,181,742
Total operating expenses		692,225,142
OPERATING LOSS		(55,684,273)
NON–OPERATING REVENUES (EXPENSES):		
Interest and dividend income — net		42,859,616
Net decrease in fair value of investments, gross gains and losses		29,006,816
Cost of securities lending transactions		(124,700)
Interest on notes payable and obligation under capital lease		(11,742,577)
Total non–operating revenues— net		59,999,155
REVENUE BEFORE TRANSFERS TO OTHER GOVERNMENTAL AGENCIES		4,314,882
TRANSFERS TO OTHER GOVERNMENTAL AGENCIES		(51,342,373)
CHANGES IN NET ASSETS		(47,027,491)
NET ASSETS — Beginning of year		378,392,796
NET ASSETS — End of year	$	331,365,305

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

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STATE INSURANCE FUND CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2012

CASH FLOWS FROM OPERATING ACTIVITIES:	
Excess of collections over reimbursements of insurance premiums	$ 639,362,936
Payments of compensation benefits	(163,504,713)
Payments of medical benefits and legal fees	(354,827,860)
Payments of administrative expenses	(138,501,989)
Net cash used in operating activities	(17,471,626)
CASH FLOWS FROM NON–CAPITAL FINANCING ACTIVITIES:	
Transfers to governmental agencies	(51,342,373)
Increase in securities lending obligations	27,775,931
Payments of securities lending transaction costs	(124,700)
Net cash used in non–capital financing activities	(23,691,142)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:	
Acquisition of capital assets	13,914,750
Payments of notes payable — net of imputed interest	(3,991,861)
Payments of obligation under capital lease	(563,909)
Payments of interest on notes payable and obligation under capital lease	(11,742,577)
Net cash used in capital and related financing activities	(2,383,597)
CASH FLOWS FROM INVESTING ACTIVITIES:	
Proceeds from sales and redemptions of debt and equity securities	3,000,331,610
Purchases of debt and equity securities	(3,250,812,052)
Collections of interest and dividend income	43,301,512
Cash received on derivative transactions	(258,480)
Collections in excess of originations of employees loans	2,147,579
Net cash used in investing activities	(205,289,831)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(248,836,196)
CASH AND CASH EQUIVALENTS — Beginning of year	408,084,597
CASH AND CASH EQUIVALENTS — End of year	$ 159,248,401

(Continued)

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

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STATE INSURANCE FUND CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2012

RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES:	
Operating loss	$ (55,684,273)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation and amortization	6,181,742
Provision for uncollectible accounts	9,521,565
Changes in assets and liabilities:	
Decrease in operating assets:	
Accounts receivable	1,654,768
Inventories	3,175,699
Prepaid expenses	172,429
Increase (decrease) in operating liabilities:	
Liability for incurred but unpaid benefits and benefit adjustment expenses	35,994,525
Accounts payable	(10,265,079)
Accrued liabilities	2,354,864
Unearned premiums	(1,080,434)
Accrual for reimbursement of premiums	(9,497,432)
Net cash used in operating activities	$ (17,471,626)
SUMMARY OF NON–CASH TRANSACTIONS:	
Securities purchased but not yet received	$ 19,588,794
Securities sold but not yet delivered	$ 5,760,980
Net decrease in the fair value of investments (unrealized gains)	$ (20,444,162)
Accretion of discount on investments	$ 816,195
Retirement of capital assets:	
Cost	$ 1,747,489
Accumulated depreciation	$ 1,747,489

(Concluded)

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

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization-State Insurance Fund Corporation (the "Corporation") is a discretely presented component unit of the Commonwealth of Puerto Rico (the "Commonwealth") created by Law No. 45 of April 18, 1935, as amended, known as the Workmen Compensation Insurance Act (the "Act"). The objectives of the law are to:

- protect workers against the effects of employment related accidents and illness;
- establish employers' responsibility to insure its employees;
- establish the type of insurance coverage; and
- regulate the insurance coverage to make it mandatory for employers.

This insurance covers workers against injuries, disability or death because of work or employment related accidents, or because of illness suffered as a consequence of their employment. On October 29, 1992, the Act was amended by Law No. 83 to convert the agency into a governmental corporation and to establish the functions and responsibilities of the Corporation's Board of Directors and Administrator, and the Industrial Medical Advisory Board.

Summary of Significant Accounting Policies-The accounting and reporting policies of the Corporation conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities. The Corporation follows Governmental Accounting Standards Board ("GASB") Statement No. 55, "*The Hierarchy of Generally Accepted Principles for State and Local Governments*", in the preparation of its financial statements.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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.

Following is a description of the most significant accounting policies:

Basis of Accounting-The Corporation accounts for insurance premiums, claim costs, acquisition costs, loss contingencies and others related costs in accordance with provisions of the GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, as amended, which requires that the financial statements of the Corporation be presented on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America.

Basis of Presentation-The Corporation's financial statements are presented as an enterprise fund and conform to the provisions of GASB Statement No. 34, *Basic Financial Statements- and Management's Discussion and Analysis- for State and Local Governments*. GASB Statement No. 34, as amended, establishes standards for external financial reporting for all state and local governmental entities, which includes a statement of net assets, a statement of revenues, expenses, and changes in net assets and a statement of cash flows.
The statement of net assets and the statement of revenues, expenses, and changes in net assets report information on all activities of the Corporation. The statement of net assets presents the Corporation's assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- Invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- Restricted net assets result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation. As of June 30, 2012, the Corporation's restricted net assets amounted to $72,600,000. Refer to Note 11 for restrictions related to note payable.
- Unrestricted net assets consist of net assets that do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, in order to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on use that are imposed by management, but such constraints may be removed or modified.

The statement of revenues, expenses, and changes in net assets presents information on how the Corporation's net assets changed during the reporting period. The Corporation distinguishes operating revenues and expenses from non–operating items. Operating revenues and expenses are those that result from the Corporation providing the services that correspond to their principal ongoing operations, which include those that result from providing insurance coverage and compensation benefits to the injured and disabled workers, including death benefits. Revenues and expenses not meeting these definitions are reported as non–operating revenues and expenses.

The statement of cash flows shows changes in cash and cash equivalents, resulting from operating, non-capital and capital financing and investing activities, which include cash receipts and cash disbursements information.

As permitted by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and other Governmental Entities that Use Proprietary Fund Accounting*, the Corporation has elected to apply all Financial Accounting Standards Board authoritative guidance issued after November 30, 1989 that does not conflict with those issued by GASB.

Revenue Recognition and Unearned Premiums-The Corporation recognizes as income the subscribed premiums, which include the preliminary premiums assessed at the beginning of the fiscal year plus additional premiums imposed as a result of the final settlement of premiums under the insurance policy during the year and an estimate for additional premiums not yet imposed. Premiums are based on individual employers' reported payroll ledgers using predetermined insurance rates based on employers' risk classifications. The regular policies are issued for a one–year period consistent with the Corporation's fiscal year, which runs from July 1 to June 30. Incidental policies are issued to cover special risks over a pre-determined period of time. Unearned premiums represent the remaining portion at the end of the fiscal year, which is attributed to the unexpired term of the incidental policies issued during the fiscal year.

Insurance premiums due to the Corporation are recorded as insurance premiums receivable, net of the allowance for uncollectible accounts. Premiums receivable consist of both billed and unbilled amounts. Unbilled amounts include premiums for policies, which have not been assessed plus an estimate for additional premiums that are expected to be imposed as a result of the final settlement of premiums under the insurance policy.

The estimates made for the additional and the reimbursable premiums are based on previous experience. The difference between the estimated and the actual amount of the premiums and the reimbursable premiums is recorded in the year when it is determined. The estimate of additional premiums is determined by management and covers the result of the final settlement of premium under the policies and through the audit of the employers' payroll ledgers. The accrual of premiums to be reimbursed represents an estimate actuarially determined based on the historical and projected results of the settlement of premiums under the policies. These amounts are estimates, and while the Corporation believes such amounts are reasonable, there can be no assurance that the amounts ultimately received or disbursed will equal the recorded amounts.

The accrual for reimbursement of premiums was discounted to reflect the present value of future reimbursable premium payments using a discounting factor of 5.11% at June 30, 2012. Management believes that discounting such liability results in a better matching of costs and revenues since reimbursable premiums have a long payment cycle.

Current and non–current portions of the liability for reimbursement of premiums are based on projected actuarially determined payments.

Policy Acquisition Costs-Acquisition costs consists of salaries and certain underwriting expenses, which are primarily related to the issuance of new policies. These costs are expensed as incurred since regular policies are issued for a one–year period, which is consistent with the Corporation's fiscal year, July 1st to June 30th. Acquisition costs related to incidental policies with terms beyond one year are deemed to be insignificant and are charged to expense as incurred.

Reinsurance-The Corporation does not use reinsurance agreements to reduce its exposure to large losses.

Incurred but Unpaid Benefits and Benefit Adjustment Expenses-Benefit expenses are recorded as incurred. The Corporation establishes liabilities for estimated incurred but unpaid benefits and benefit adjustment expenses based on the ultimate estimated cost of settling the benefits.

Incurred but unpaid benefits and benefit adjustment expenses include: (a) individual case estimates for reported cases (b) aggregate accrual estimates for reported and unreported cases based on past experience modified for current trends, and (c) an estimate of expenses for investigating and settling cases. The liabilities for cases reported which have not been adjudged and cases incurred but not yet reported are estimated by an independent actuary. The estimated liability also includes cases under reconsideration or on appeal before the Industrial Commission of Puerto Rico, a governmental agency, for additional medical treatment or benefits.

The liabilities for incurred but unpaid benefits and benefit adjustment expenses were discounted to reflect the present value of future benefit payments using a discounting factor of 3.66% at June 30, 2012. Management believes that discounting such liability results in a better matching of costs and revenues since compensation benefits have a long payment cycle.

Management believes that the liability for incurred but unpaid benefits and benefit adjustment expenses, actuarially determined at June 30, 2012, is a reasonable estimate of the ultimate net cost of settling benefits and benefit expenses incurred. Because actual benefit costs depend upon such factors as duration of worker disability, medical cost trends, occupational disease, inflation, and other social and economic factors, the process used in computing the ultimate cost of settling benefits and expenses for administering benefits is necessarily based on estimates. The amount ultimately paid may be above or below such estimates. Adjustments resulting from changes in estimates of these liabilities are charged or credited to operations in the period in which they occur.

Current and non–current portions of the liability for estimated incurred but unpaid benefits and benefit adjustment expenses are based on projected actuarially determined payments.

Securities Purchased under Agreements to Resell-From time to time, the Corporation enters into purchases of securities under agreements to resell ("resell agreements"). The amounts advanced under these agreements generally represent short–term loans and are reflected as an asset. The securities underlying these agreements are usually held by the broker or his/her agent, with whom the agreement is transacted.

Investments-Investments in equity securities with readily determinable fair values and all investments in debt securities are carried at fair value. Money market investments with a remaining maturity at time of purchase of one year or less are carried at cost. Investment positions in 2a–7 like external investment pools are carried at the pools' share price. Fair value is determined based on quoted market prices and quotations received from independent broker/dealers or pricing service organizations. The Corporation has private equity investments, whose fair values have been estimated in the absence of readily determinable fair values. This estimate is based on information provided by the underlying fund managers.

Securities transactions are accounted for on the trade date. Realized gains and losses from the sale of securities and unrealized changes in the fair value of outstanding securities are included in net increase (decrease) in fair value of investments. Realized gains and losses are computed as the difference between the proceeds of the sale and the original cost of the investment sold. Gains and losses on the sale of securities are determined based on the specific identification method.

Securities Lending Transactions-The Corporation accounts for and reports its security lending transactions in accordance with the provisions of GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions,* as amended. This statement establishes standards of accounting and financial reporting for securities lending transactions in which governmental entities (lenders) transfer their securities to broker–dealers and other entities (borrowers) for collateral and simultaneously agree to return the collateral for the same securities in the future.

Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets. Securities received as collateral are reported as assets if the Corporation has the ability to pledge or sell them without a borrower default. Liabilities resulting from these securities lending transactions also are reported in the statement of net assets. Securities lending transactions collateralized by letters of credit or by securities that the Corporation does not have the ability to pledge or sell unless the borrower defaults are not reported as assets and liabilities in the statement of net assets.

Allowance for Doubtful Accounts-The allowance for uncollectible insurance premiums and other receivables is an amount that management believes will be adequate to absorb possible losses on existing receivables that may become uncollectible based on evaluations of the collectability of the receivables and prior credit loss experience. Because of uncertainties inherent in the estimation process, the related allowance may change in the future.

Inventories- Inventories are stated at cost (first–in, first–out method).

Capital Assets-Capital assets are stated at cost. Depreciation and amortization expense is computed using the straight–line method over the estimated useful lives of the assets, or in the case of assets under capital lease, over the term of the lease, whichever is shorter. The Corporation records as capital expenditures, assets with an individual cost of more than $100. The useful lives of these assets are as follow:

Description	Useful Life
Building and improvements	3–50 years
Medical and office equipment	3–10 years
Information systems	3 years
Motor vehicles	5 years
Assets under capital leases	Lease–term

Expenditures for repairs and maintenance, which do not extend the useful lives of the assets, are charged to operations in the year incurred. At the time capital assets are sold or otherwise disposed, the cost and related accumulated depreciation are removed from the books and the resulting gain or loss, if any, is credited or charged to operations.

Compensated Absences-Compensated absences, such as unpaid vacation and sick leave pay, are accrued when incurred using the pay or salary rates in effect at the statement of net assets' date. The employees of the Corporation are granted 30 days of vacation and 18 days of sick leave annually. An additional amount is accrued for certain salary related benefits associated with the payment of compensated absences. In the event of employee resignation, an employee is reimbursed for accumulated vacation and sick leave days.

Pensions-The Corporation accounts for pension costs under the provisions of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers*. This statement establishes standards for the measurement, recognition and display of pension expense and related liabilities in financial statements of state and local governmental employers.

Postemployment Benefits Other Than Pensions-The Corporation accounts for postemployment benefits other than pensions ("OPEB") under the provisions of the GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This statement requires a systematic, accrual–basis measurement and recognition of OPEB cost (expense) over a period that approximates employees' years of service and provides information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan. GASB No. 45 allows employers to amortize the portion of the cost attributed to past service over a period not to exceed thirty (30) years.

Income Taxes-The Corporation, as a governmental corporation of the Commonwealth, is exempt from the payment of income taxes.

Statement of Cash Flows-The accompanying statement of cash flows is presented in accordance with the provisions of GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities that Use Proprietary Fund Accounting*. The provisions of GASB No. 34 require that the direct method be used to present the funds inflows and outflows of the Corporation. For purposes of the statement of cash flows, the Corporation considers all highly liquid debt instruments with maturities of three months or less when purchased to be cash equivalents.

Future Adoption of Accounting Pronouncements-The GASB has issued the following Statements:

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which is effective for periods beginning after December 15, 2011.
- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus an amendment of GASB Statements No. 14 and No. 34*, which is effective for periods beginning after June 15, 2012.
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is effective for periods beginning after December 15, 2011.
- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which is effective for periods beginning after December 15, 2011.

- GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions-an amendment of GASB Statement No. 53*, which is effective for periods beginning after June 15, 2011.

- GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which is effective for periods beginning after December 15, 2011.

- GASB Statement No. 66, *Technical Corrections-2012-an amendment of GASB Statements No. 10 and No. 62*, which is effective for periods beginning after December 15, 2012.

Management is evaluating the impact that these statements will have on the Corporation's basic financial statements.

2. CASH AND CASH EQUIVALENTS

The Corporation's cash and cash equivalents as of June 30, 2012 are comprised of the following:

Description		Amount
Cash on hand	$	893,468
Due from commercial banks		19,297,724
Total cash and due from banks		20,191,192
Interest bearing deposit accounts ("IBA's") with GDB:		
Due on demand		9,119,959
Cash equivalents- investments (see Note 3)		129,937,250
Total	$	159,248,401

Custodial credit risk related to deposits is the risk that in the event of a financial institution failure, the Corporation's deposits might not be recovered. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance ($250,000 at June 30, 2012). At June 30, 2012, all securities pledged by depository institutions as collateral are held by a trustee of the Treasury Department of the Commonwealth. As of June 30, 2012, the Corporation had approximately $18.1 million in depository balance with financial institutions, which were insured and/or collateralized.

Interest bearing deposits with GDB are uninsured and uncollateralized. These deposits are exposed to custodial credit risk.

Foreign currency risk is the risk that changes in exchange rates will adversely affect the value of a deposit. Cash in foreign currency amounted to $120,403 at June 30, 2012. Cash in foreign currency present minimal foreign currency risk at June 30, 2012.

See Note 3 for additional information related to credit risk, foreign currency risk and custodial credit risk on cash equivalent investments.

3. INVESTMENTS

The Board of Directors ("BOD") of the Corporation has enacted the Statement of Investment Policy, Guidelines and Objectives (the "SIPGO") with the objective of providing general and specific guidance for the maximization of resources available for the payment of benefits to injured workers as the pervasive goal of the workers' compensation coverage of its insurance program. SIPGO sets as the primary objective for the available funds, to maximize the yield of invested assets, while having the adequate liquidity to pay obligations as they become due. The strategic objective is accomplished through a proper mix of adequate time horizon, risk tolerance and return expectation, and is achieved through strategic assets allocation. SIPGO provides guidance for the strategic assets allocation including the internally managed short term funds, securities selection and related restrictions; sets the responsibilities of the BOD, the Corporation's management, investment consultants, portfolio managers, and custodians. The SIPGO establishes standards for review and communication of compliance with the prevailing policies and procedures. The SIPGO also provides that the Finance Committee of the BOD (the "Finance Committee") is responsible for implementing and monitoring the investment program of the Corporation. The Finance Committee meets on a quarterly basis

The SIPGO allows management to purchase or enter into the following investment instruments:

- United States Government and agencies obligations
- Obligations of the Commonwealth, its agencies, municipalities, public corporations and instrumentalities
- Government National Mortgage Association (GNMA)
- Mortgage pass–through guaranteed by United States Government agencies other than GNMA, such as Federal Home Loan Mortgage Corporation (FHLMC) and Federal National Mortgage Association (FNMA), among others
- Mortgage and asset–backed securities
- Common and preferred stocks
- Corporate bonds and notes (convertible or non–convertible)
- Money market funds and bank–sponsored short–term investment fund
- Resell agreements
- Commercial paper
- Options, futures and interest–rate swap agreements for hedging and risk control purposes, as well as for the creation of synthetic products, which qualify under any of the foregoing investment categories
- Open–end mutual funds with acceptable underlying assets and rated AAA by Standard & Poor's or AAA by Moody's
- Puerto Rico Government Investment Trust Fund (PRGITF)
- Securities lending transactions

The SIPGO establishes limitations and other guidelines on amounts to be invested in the aforementioned investment categories and by issuer/counterparty and on exposure by country. In addition, such policy provides guidelines on the institutions with which investment transactions can be entered into. The BOD of the Corporation will determine, from time to time, other transactions that the Corporation may enter into. Certain investment transactions that are generally considered to carry a greater than normal risk require the prior approval of Government Development Bank for Puerto Rico ("GDB"), a component unit of the Commonwealth, before being executed.

The following table summarizes the type and maturity of investments held by the Corporation at June 30, 2012. Expected maturities will differ from contractual maturities, because counter parties may have the right to call or prepay obligations with or without call or prepayment penalties. No investment in any one issuer other than the U.S. government and its agencies and the Commonwealth and its agencies and instrumentalities, represented 5% or more of total investment portfolio at June 30, 2012.

STATE INSURANCE FUND CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2012

Investment Type	Within One Year	After One to Five Years	After Five to Ten Years	After Ten Years	Total
U.S. Treasuries	$ 2,787,024	$ 86,587,046	$ 52,460,716	$ 108,842,089	$ 250,676,874
U.S. sponsored agencies bonds and notes:					
Federal Home Loan Bank (FHLB)		8,849,559	3,964,320		12,813,879
Federal Home Loan Mortgage Corporation (FHLMC)		5,423,261	5,916,010	297,508	11,636,779
Federal National Mortgage Association (FNMA)		2,312,590		1,554,447	3,867,037
Federal Farm Credit Bank (FFCB)		1,664,724	1,612,420	1,328,618	4,605,762
Other	962,350				962,350
Mortgage-backed securities:					
Government National Mortgage Association (GNMA)				18,053,016	18,053,016
FNMA		3,955,387	1,855,788	123,896,983	129,708,158
FHLMC			2,662,160	20,872,053	23,534,213
Collateralized mortgage obligations (CMO's) issued and/or guaranteed by:					
GNMA				4,059,382	4,059,382
FNMA			14,425		14,425
FHLMC			2,141,952		2,141,952
Commercial mortgages				29,399,683	29,399,683
Other				1,799,219	1,799,219
Asset-backed securities		13,576,519	4,457,354	13,920,787	31,954,660
Corporate bonds and notes	43,833,435	271,839,900	122,827,464	24,770,772	463,271,571
Foreign government bonds and notes		2,605,750	8,496,409		11,102,159
U.S. municipal notes		42,132,779	81,410,087	7,654,990	131,197,856
Money market funds	51,844,316				51,844,316
External investments pool-fixed-income securities	1,038,659				1,038,659
Investments held under securities lending transactions:					
Interest bearing deposits	13,001,423				13,001,423
Resell agreements	78,399,126				78,399,126
Commercial paper	20,659,256				20,659,256
Total debt securities and fixed-income external investment pools	$ 212,525,588	$ 438,947,515	$ 287,819,104	$ 356,449,547	1,295,741,754
Equity securities					311,926,906
External investment pools — equity securities:					
Russell 1000 Growth Index Fund					2,379,266
Guayacan Private Equity Fund L.P. II					7,695,828
Guayacan Fund of Funds III, L.P.					19,964,820
US Government Properties Income & Growth Fund, L.P					23,888,691
McCoy Investments II, L.P.					5,180,570
Total					$ 1,666,777,836

As of June 30, 2012, investments were classified as current and non–current in the accompanying statement of net assets as follows:

Description	Amount
Current assets:	
Cash equivalents	$ 129,937,250
Investments in debt and equity securities	453,624,420
Total current assets	583,561,670
Non–current assets	1,083,216,166
Total	$ 1,666,777,836

The Corporation's investments presented as cash equivalents as of June 30, 2012 are comprised of the following:

Description	Amount
Interest bearing deposits held under securities lending transactions:	
Certificates of deposit with other banks, due within three months	$ 4,001,423
Investments in debt securities held under securities lending transactions:	
Commercial paper, due within three months	10,692,385
Resell agreements, due overnight	63,399,126
	74,091,511
Investments in:	
Money market funds	51,844,316
	51,844,316
Total	$ 129,937,250

Investments in fixed–income external investment pools include $1,038,659 invested with the Puerto Rico Government Investment Trust Fund (the "PRGITF"), a government–sponsored pool, which is administered by the GDB. The PRGITF may purchase only high quality securities denominated in U.S. dollars that the investment advisors believe present minimal credit risk. The PRGITF had an average maturity of less than 60 days; accordingly, they were presented as investments with maturity of less than one year. The Corporation was exposed to custodial credit risk. This pool is subject to regulatory oversight by the Commissioner of Financial Institutions of Puerto Rico. The fair value of the pool is the same as the fair value of the pool shares.

The fair value of investments in limited partnerships as of June 30, 2012, amounted to approximately $56.7 million. The allocations of net gain and net loss to limited partners are based on certain percentages, as established in the limited partnership agreements. The investments in limited partnerships were as follows:

- During the fiscal year 2012, an additional investment of $714,286 was made in the Guayacán Private Equity Fund L.P. II, a Delaware limited partnership created by Grupo Guayacán, Inc., as General Partner, bringing the amount invested at June 30, 2012 to $7,611,802. The Corporation has a total commitment of $10.0 million. This fund seeks to provide investors with a superior investment return and extensive diversification by investing in nineteen (19) private equity investment partnerships in the United States and Europe. This fund also invests a portion of its assets in a Puerto Rico based private equity investment entity.

- During the fiscal year 2012, an additional investment of approximately $8,312,000 was made in the Guayacán Fund of Funds III, L.P., a limited partnership organized in April 2007, pursuant to the laws of the State of Delaware, bringing the amount invested at June 30, 2012 to $20,039,215. The Corporation has a total commitment of $40.0 million. This partnership intends to seek out, invest in, and add value to companies, which will be based or operating in Puerto Rico or in companies whose products or services are targeted at the U.S. Hispanic market, with specific interest in those companies where Advent-Morro's Equity Partners, Inc. Puerto Rico contact, know–how and track record can be leveraged to enhance investment selection and post–investment value-add. Guayacán Private Fund of Funds III, L.P. will strive to have a balanced mix of portfolio investments primarily focusing on later stage opportunities such as: expansion financing, leveraged buyouts, management buyouts, and recapitalizations. This partnership may invest in de–novo companies that are being set up to enter established industries via market consolidation opportunities and/or internal growth.

- During the fiscal year 2012, the Corporation invested approximately $22.2 million in U.S. Government Properties Income & Growth Fund, L.P., a limited partnership organized in August 2011, pursuant to the laws of the State of Delaware. The Corporation has a total commitment of $25.0 million. This partnership is a real investment fund that targets investments in assets leased to the U.S. General Services Administration and other federal leases located in the United States to provide current income and potential asset appreciation.

- During the fiscal year 2012, the Corporation invested approximately $5.2 million in McCoy Investments, L.P., a limited partnership organized in August 2011, pursuant to the laws of the State of Delaware. The Corporation has a total commitment of $15.0 million. This partnership was organized to invest in other pooled investment portfolio funds investing primarily in private equity, including investments in U.S. and non-U.S. venture capital, leveraged buyout, distressed, turnaround, expansion capital, mezzanine and special situation funds.

At June 30, 2012, the Corporation has variable-rate interest investments, which reset in the frequency shown below, at 100% of an interest rate index plus a spread, as follows:

Investment Type	Reset	Amount
Mortgage–backed securities:		
CMO's issued and/or guaranteed by:		
GNMA	Monthly	$ 748,660
Corporate bonds and notes	Semiannually	1,019,960
Commercial mortgage bonds	Monthly	12,979,889
Government Bonds Sovereign Debt	Annual	2,746,065
Municipal Bonds	Quarterly	3,249,883
US Treasury Bonds	Semiannually	43,358,638
Investments held under securities lending transactions:		
Interest bearing deposits	Quarterly	2,000,000
Resell agreements	Daily	15,000,000
Total		$ 81,103,095

The credit risk related to investments is the risk that debt securities in the Corporation's portfolio will decline in price or fail to make principal and interest payments when due because the issuer of the security experiences a decline in the financial condition. The Corporation limits its credit risk by investing principally in high quality investments (rated BBB or better, according to Standard and Poor's or other equivalent rating agencies when maturities are longer than a year). In addition, the Corporation restricts investment in certain securities to avoid concentration and/or increase duration.

All of the Corporation's investments in U.S. Treasury securities and mortgage–backed securities guaranteed by GNMA carry the explicit guarantee of the U.S. government. The credit quality ratings for investments in debt securities, excluding U.S. Treasury securities and mortgage–backed securities guaranteed by GNMA, at June 30, 2012 are as follows:

Investment Type	Credit Risk Rating AAA to A-	BBB+	BBB	BBB-	Not Rated	Total
U.S. sponsored agencies bonds and notes:						
FHLB	$ 12,813,879	$ -	$ -	$ -	$ -	$ 12,813,879
FHLMC	11,636,779	-	-	-	-	11,636,779
FNMA	3,867,037	-	-	-	-	3,867,037
FFCB	4,605,762				-	4,605,762
Other	962,350				-	962,350
Mortgage–backed securities:						
FNMA	46,278,804	-	-	-	83,429,354	129,708,158
FHLMC		-	-	-	23,534,213	23,534,213
CMO's issued and/or guaranteed by:						
FNMA	-	-	-	-	14,425	14,425
FHLMC	-	-	-	-	2,141,952	2,141,952
Commercial mortgage	27,904,741	-	-	-	1,494,942	29,399,683
Other	1,799,219	-	-	-	-	1,799,219
Asset–backed securities	26,755,989	-	-	-	5,198,671	31,954,660
Corporate bonds and notes	349,234,289	60,694,084	43,329,498	10,013,700		463,271,571
Foreign government bonds and notes	11,102,159	-	-	-	-	11,102,159
U.S. municipal notes	90,219,114	-	40,978,741	-	-	131,197,856
Money market funds	-	-	-	-	51,844,316	51,844,316
External investments pool-fixed-income securities	1,038,659					1,038,659
Investments held under securities loans:						
Interest bearing deposits	13,001,423	-	-	-	-	13,001,423
Resell agreements	68,399,126	-	-	-	10,000,000	78,399,126
Commercial paper	20,659,256	-	-	-	-	20,659,256
Total	$ 690,278,587	$ 60,694,084	$ 84,308,239	$ 10,013,700	$ 177,657,872	$ 1,022,952,482

Interest bearing deposits with other banks held under securities lending transactions (see Note 10) are uninsured and uncollateralized. These deposits are exposed to custodial credit risk.

In accordance with its investment policy, the Corporation manages its exposure to declines in fair values by structuring the investment portfolio so that securities mature to meet cash requirements for compensation and medical benefit payments, thereby avoiding the need to sell securities on the open market prior to maturity. Investments in equity securities are not subject to the maximum maturity policy since they do not carry a maturity date. The Corporation is expected to achieve capital preservation and income generation by investing in a diversified portfolio of marketable, investment grade core fixed–income securities.

As of June 30, 2012, investment maturities as a percentage of total debt securities and fixed–income external investment pools are as follows:

Maturity	Maturity%
Within one year	16 %
After one to five years	34
After five years to ten years	22
After ten years	28

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The Corporation's investment policy permits investing in international stocks to diversify the risks of the investment portfolio. The Corporation limits its exposure to foreign currency risk by limiting the total amount invested to a 5% of the portfolio.

As of June 30, 2012, the Corporation had the following investments denominated in foreign currency:

Description	Currency	Fair value
Common stock	Australian Dollar	$ 5,350,876
	British Pound	6,218,925
	Canadian Dollar	2,014,354
	Danish Krone	625,778
	Euro	11,913,479
	Hong Kong Dollar	2,135,846
	Japanese Yen	17,298,284
	Norwegian Krone	2,421,487
	Singapore Dollar	1,460,609
	Swedish Krona	205,789
	Swiss Franc	4,303,647
Preferred Stock	Euro	1,113,112
Government Bonds	British Pound	4,329,594
	Euro	2,746,065
Total		$ 62,137,845

Custodial credit risk related to investments is the risk that, in the event of failure of the counterparty to a transaction, the Corporation may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. At June 30, 2012, all securities held in portfolio were registered in the name of the Corporation and were held in the possession of the Corporation's custodian banks, JP Morgan Chase Bank, N.A. and Santander Bank, except for securities lent (see Note 10).

Interest and dividend income for the year ended June 30, 2012, consist of the following:

Description	Amount
Interest income on interest bearing deposits with GDB	$ 496,826
Interest income on investments	38,629,145
Dividend income on investments	6,307,084
Dividend income on investment in PRGITF	1,128
Interest income on investments in cash and non--cash collateral received on securities lending transactions	417,034
Other interest income	981,623
	46,832,840
Less investment managers' fees	(3,973,224)
Total interest and dividend income — net	42,859,616

Net increase in the fair value of investments for the year ended June 30, 2012, consists of the following:

Description	Investments	Derivative Instruments	Total
Gross realized gains	$ 86,299,770	$ 254,682	$ 86,554,452
Gross realized losses	(36,662,617)	(440,857)	(37,103,474)
Net decrease in fair value	(20,371,857)	(72,305)	(20,444,162)
Total	$ 29,265,296	$ (258,480)	$ 29,006,816

4. ACCOUNTS RECEIVABLE-NET

Accounts receivable as of June 30, 2012, consist of:

Description		Amount
Insurance premiums receivable, including estimated additional premiums — net of allowance for uncollectible insurance premiums of $309,115,365	$	56,848,329
Interest and dividends receivable		9,648,935
Securities sold but not yet delivered		5,760,980
Employees' accounts receivable, collateralized with motor vehicles — net of allowance for uncollectible accounts of $840,816		6,877,942
Other accounts receivable — net of allowance for uncollectible accounts of $145,167,956		2,080,184
Total	$	81,216,370

Insurance premiums receivable include an estimate for additional premiums of $76,759,034. The Corporation follows a policy of not charging–off uncollectible insurance premiums against the related allowance for uncollectible accounts, except as discussed below. Other accounts receivable mainly include the portion of insurance premiums of previously uninsured employers considered to be collectible.

On June 6, 2012, pursuant to Act #13 of January 10, 2012, the Corporation approved an incentive plan for employers with unpaid premiums incurred prior to fiscal years ended on or before June 30, 2010. Employers that meet certain criteria are eligible for a 50% discount on such unpaid premiums. The incentive plan expired on December 6, 2012. Discounts under the incentive plan amounted to approximately $2.8 million for the year ended June 30, 2012.

5. INVENTORIES

Inventories as of June 30, 2012, consist of:

Description		Amount
Medicines and medical supplies	$	2,606,794
Office materials and supplies		618,665
Total	$	3,225,459

6. CAPITAL ASSETS — NET

The activity of capital assets for the year ended June 30, 2012 is as follows:

Description	Balance June 30, 2011	Increase	Decrease	Balance June 30, 2012
Capital assets not subject to depreciation and amortization:				
Land	$ 5,860,166	$ -	$ -	$ 5,860,166
Land–under capital lease	7,150,000	-	-	7,150,000
	13,010,166	-	-	13,010,166
Capital assets subject to depreciation and amortization:				
Buildings and improvements	106,189,910	12,382,731	(1,747,489)	116,825,152
Medical and office equipment	44,125,929	1,515,945	-	45,641,874
Software	12,206,055	16,074	-	12,222,129
Motor vehicles	942,921	-	-	942,921
Assets under capital leases:				
Building and improvements	27,850,000	-	-	27,850,000
	191,314,815	13,914,750	(1,747,489)	203,482,076
Less accumulated depreciation and amortization:				
Buildings and improvements	(43,814,141)	(2,942,691)	-	(46,756,832)
Medical and office equipment	(39,038,892)	(2,145,551)	1,747,489	(39,436,954)
Software	(11,984,453)	(128,743)	-	(12,113,196)
Motor vehicles	(795,964)	(36,424)	-	(832,388)
Assets under capital leases:				
Building and improvements	(10,211,666)	(928,334)	-	(11,140,000)
	(105,845,116)	(6,181,743)	1,747,489	(110,279,370)
Capital assets being depreciated and amortized — net	85,469,699	7,733,007	-	93,202,706
Capital assets — net	$ 98,479,865	$ 7,733,007	$ -	$ 106,212,872

As of June 30, 2012, the net carrying value of assets under capital leases amounted to \$23,860,000. Amortization of assets under capital leases amounted to \$928,334 for the year ended June 30, 2012.

7. LIABILITY FOR INCURRED BUT UNPAID BENEFITS AND BENEFIT ADJUSTMENT EXPENSES

The liability for incurred but unpaid benefits and benefit adjustment expenses is based on historical claims experience data, assumptions, and projections as to future events, including claims frequency, severity, persistency and inflationary trends determined by an independent actuarial study. This liability has been discounted at 3.66% in 2012. The actuarial study considered the experience of the Corporation from fiscal years 1997–1998 to 2010–2011, and included estimates for cases reported that have not been adjudged and cases incurred but not reported. The assumptions used in estimating and establishing the liability is reviewed annually based on current circumstances and trends. Any resulting adjustments are considered to be a change in an accounting estimate and accounted for as an increase (decrease) to expenses of the Corporation during the current period.

The Corporation has established a liability for both, reported and unreported insured events, which includes estimates of future payment of benefits and related benefit adjustment expenses. The liability for incurred but unpaid benefits and benefit adjustment expenses as of June 30, 2012, consists of:

	Amount
Compensation benefits:	
Cases adjudged:	
Long–term partial disability	$ 21,579,374
Long–term total disability	221,795,425
Death	34,859,849
	278,234,648
Cases reported not adjudged and cases incurred but not reported:	
Short-term disability (per diem)	121,347,455
Long–term partial disability	135,575,220
Long–term total disability	86,113,239
Death	(559,112)
	342,476,802
Total compensation benefits	620,711,450
Medical benefits	130,252,836
Loss adjustment expense, including legal fees	69,047,902
Total	$ 820,012,188

The following provides a reconciliation of the beginning and ending balance for the liability for incurred but unpaid benefits and benefits adjustment expenses for the year ended June 30, 2012:

Description	Amount
Liability for incurred but unpaid benefits and benefit adjustment expenses — beginning of year	$ 784,017,663
Incurred benefits related to:	
Insured events of the current year	465,996,355
Insured events of the prior years	60,613,266
Total incurred benefits	526,609,621
Benefit payments related to:	
Insured events of the current year	(298,211,377)
Insured events of the prior years	(192,403,719)
Total benefit payments	(490,615,096)
Liability for incurred but unpaid benefits and benefit adjustment expenses — end of year	$ 820,012,188

8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2012, consist of:

Description	Amount
Accounts payable:	
Securities purchased not yet received	$ 19,588,794
Due to employers	13,065,626
Suppliers, professional services and others	54,003,730
Total accounts payable	86,658,150
Accrued liabilities:	
Compensated absences–vacations and sick leaves	42,609,533
Accruals for Christmas bonus, salary increases, compensatory time and other fringe benefits	13,182,755
Postemployment benefits other than pensions (see Note 16 and 17)	20,089,265
Accruals for claims and contingencies (see Note 20)	6,429,591
Accrued interest payable	987,254
Total accued liabilities	83,298,398
Total	$ 169,956,548

9. ACCRUAL FOR REIMBURSEMENT OF PREMIUMS

As of June 30, 2012, the accrual for reimbursement of premiums as determined by the independent actuary was classified as current and non-current in the accompanying statement of net assets as follows:

Description	Amount
Due within one year	$ 55,057,078
Due in more than one year	63,545,490
Total	$ 118,602,568

The provision for reimbursement of insurance premiums for the year ended June 30, 2012 amounted approximately to $35,434,000, which includes a current year credit of $9,500,000 to reflect changes in the accrual for reimbursement of premiums determined by an independent actuary. A discount rate of 5.11% was used to determine present value.

10. SECURITIES LENDING OBLIGATIONS

The Commonwealth statutes and the Corporation's BOD policies permit the Corporation to use its investments to enter into securities lending transactions, whereby securities are transferred to an independent broker or dealer in exchange for collateral in the form of cash, securities and/or irrevocable bank letters of credit.

The Corporation's securities custodian, JP Morgan Chase Bank, N.A., as agent of the Corporation, manages the securities lending program and receives cash collateral, securities or irrevocable bank letters of credit as collateral. The collateral securities cannot be pledged or sold by the Corporation unless the borrower defaults. The collateral requirement is equal to 102 percent for securities issued in the United States and 105 percent for securities issued outside of the United States, of the fair value of the security lent. Additional collateral has to be provided by the next business day if the collateral fair value falls below the fair value of the securities lent. All security loans can be terminated on demand by either the Corporation or the borrower. In lending securities, the term to maturity of the securities loans is matched with the term to maturity of the investment made with the cash collateral. Such matching existed at year–end.

At year–end, the Corporation has no credit risk exposure to borrowers because the amounts the Corporation owes the borrowers exceed the amounts the borrowers owe the Corporation. Contracts with the lending agents require them to indemnify the Corporation if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the Corporation for income distributions by the securities' issuers while the securities are on loan.

Securities lent as of June 30, 2012 had a fair value of $174,520,817 and were secured with collateral received with a fair value of $178,433,395.

Securities lent for which cash was received as collateral as of June 30, 2012, consist of:

Description	Amount
U.S. Treasury notes and bonds	$ 34,741,170
U.S. sponsored agencies bonds and notes	8,469,188
Corporate bonds and notes	33,157,840
Equity securities	33,255,568
Total	$ 109,623,766

Cash collateral received as of June 30, 2012 amounted to $112,059,805 (see Note 3) and was invested as follows:

Description	Amount
Commercial paper	$ 20,659,256
Resell agreements	78,399,126
Interest bearing deposits:	
Certificates of deposit with other banks	13,001,423
Total	$ 112,059,805

In addition, the Corporation had the following lending obligations as of June 30, 2012 for which securities were received as collateral:

	Fair Value	
Description	Securities Lent	Collateral Received
U.S. Treasury notes and bonds	$ 58,578,847	$ 59,925,031
Equities	75,148	76,698
U.S. sponsored agencies bonds and notes	6,243,056	6,371,861
Total	$ 64,897,051	$ 66,373,590

Cost of securities lending transactions for the year ended June 30, 2012 consist of the following:

Description	Amount
Borrower rebates	$ (70,175)
Agent fees	194,875
Total	$ 124,700

11. NOTE PAYABLE

Note payable activity for the year ended June 30, 2012, is as follows:

June 30, 2011	Advances	Payments	June 30, 2012
$ 242,000,000	$ -	$ -	$ 242,000,000

On May 11, 2011, the Corporation entered into a loan agreement ("the Loan") with a private financial institution for the amount of $242,000,000. The Loan matures on May 1, 2028 and carries a variable interest rate of 30 day LIBOR plus a 2.25% spread. This loan requires the Corporation to comply with certain restrictive covenants, which, in the event of non–compliance, provide the financial institution the right to declare the outstanding debt as due and payable in cancellation of the loan agreement. One of the covenants requires the Corporation to pledge 130% of the outstanding principal on the loan in securities in its investment portfolio. Proceeds of the loan were used to repay a note payable and interest payable to the Government Development Bank for Puerto Rico($220,000,000 principal and $3,273,000 in interest), purchase of two buildings ($8,490,000 for building purchased before June 30, 2011 and $10,100,000 for building purchased during fiscal year 2012) and other purposes ($137,000).

The annual debt service requirements to maturity, including principal and interest, for the note payable are as follows:

Fiscal Year Ending June 30,		Principal		Interest
2013	$	-	$	6,025,195
2014		16,133,332		5,841,092
2015		16,133,332		5,439,412
2016		16,133,332		5,037,733
2017		16,133,332		4,636,053
2018-2022		80,666,660		17,155,070
2023-2027		80,666,660		7,113,079
2028		16,133,352		217,577
Total	$	242,000,000	$	51,465,211

Debt service requirements of this variable-rate debt assume that the interest rate effective at June 30, 2012 remains the same throughout the term of the debt.

12. OTHER NOTES PAYABLE

During 1999, the Corporation acquired the facilities where four regional offices are located. In consideration for the facilities acquired, the Corporation entered into non–interest bearing financing agreements with the sellers, payable on an installment basis and collateralized with first mortgages over the underlying facilities. The original terms of these notes payable are as follows:

Note	Description	Original Balance
1	Non–interest bearing note, due in September 2018, payable in 40 semiannual installments, effective interest rate of 6.54%	$ 35,001,060
2	Non–interest bearing note, due in September 2018, payable in 40 semiannual installments, effective interest rate of 6.54%	21,419,834
3	Non–interest bearing note, due in October 2018, payable in 40 semiannual installments, effective interest rate of 6.31%	16,619,468
4	Non–interest bearing note, due in March 2019, payable in 40 semiannual installments, effective interest rate of 6.84%	53,285,454
	Total payments	126,325,816
	Less imputed interest at the inception of the notes	(54,957,702)
	Total original balance	$ 71,368,114

The activity of these notes payable for the year ended June 30, 2012, is as follows:

Description	Balance June 30, 2011	Advances	Payments	Balance June 30, 2012
Note payable (gross):				
Note 1	$ 14,657,496	$ -	$ (1,912,896)	$ 12,744,600
Note 2	7,911,930	-	(1,004,305)	6,907,625
Note 3	5,594,674	-	(694,128)	4,900,546
Note 4	23,731,194	-	(2,872,752)	20,858,442
Total	$ 51,895,294	$ -	$ (6,484,081)	$ 45,411,213
Portion representing interest:				
Note 1	$ (2,757,768)	$ -	$ 696,441	$ (2,061,327)
Note 2	(1,502,772)	-	376,389	(1,126,383)
Note 3	(1,040,662)	-	258,804	(781,858)
Note 4	(4,950,796)	-	1,160,586	(3,790,210)
Total	$ (10,251,998)	$ -	$ 2,492,220	$ (7,759,778)
Principal of note payable:				
Note 1	$ 11,899,728	$ -	$ (1,216,455)	$ 10,683,273
Note 2	6,409,158	-	(627,916)	5,781,242
Note 3	4,554,012	-	(435,324)	4,118,688
Note 4	18,780,398	-	(1,712,166)	17,068,232
Total	$ 41,643,296	$ -	$ (3,991,861)	$ 37,651,435