

Puerto Rico Medical Services Administration
a Component Unit of the
Puerto Rico Department of Health

Financial Statements

June 30, 2014 and 2013

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Management's Discussion and Analysis

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Management's Discussion and Analysis

The following discussion and analysis of the Puerto Rico Medical Services Administration (the Administration) provides an overview of the Administration's financial performance during the years ended June 30, 2014 and 2013. Please read it in conjunction with the basic financial statements, which follow this section.

Financial Highlights

1. The Administration's net position as of June 30, 2014 and 2013 amounted to approximately (\$302) million and (\$269) million, respectively.
2. During the years ended June 30, 2014 and 2013 the Administration experienced operating losses of approximately \$65 million and \$77 million, respectively.
3. During the years ended June 30, 2014 and 2013, the Administration received approximately \$51 million and \$47 million, respectively, in contributions from governmental agencies, for payment of new recruitments, payroll contributions and other operating expenses.

Required Financial Statements

The required basic financial statements of the Administration consist of:

1. Statement of net position – The statement of net position includes all of the Administration's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for evaluating the net assets' structure of the Administration and assessing its liquidity and financial flexibility.
2. Statement of revenues, expenses and changes in net position – This statement measures the results of the Administration's operations and can be used to determine whether the Administration has successfully recovered operating costs and expenses through services revenues, contributions, and other non-operating income.
3. Statement of cash flows – This statement reports cash receipts, cash payments, and net changes resulting from operating, investing, and capital and non-capital related financing activities.

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Management's Discussion and Analysis (Continued)

Statement of Net Position

The Administration's statements of net position as of June 30, 2014 and 2013 consisted of (in thousands):

	<u>2014</u>	<u>2013</u>	<u>Increase (Decrease)</u>	<u>%</u>
Current assets	\$ 40,504	\$ 51,780	\$ (11,276)	-22%
Non-current assets:				
Capital assets, net	59,865	52,634	7,231	14%
Restricted cash	957	2,986	(2,029)	-68%
Other non-current assets	<u>20,171</u>	<u>3,500</u>	<u>16,671</u>	<u>476%</u>
	<u>80,993</u>	<u>59,120</u>	<u>21,873</u>	<u>37%</u>
	<u>\$ 121,497</u>	<u>\$ 110,900</u>	<u>\$ 10,597</u>	<u>10%</u>
Current liabilities	\$ 125,298	\$ 81,274	\$ 44,024	54%
Non-current liabilities	<u>298,525</u>	<u>298,691</u>	<u>(166)</u>	<u>0%</u>
	423,823	379,965	43,858	12%
Net position	<u>(302,326)</u>	<u>(269,065)</u>	<u>(33,261)</u>	<u>12%</u>
	<u>\$ 121,497</u>	<u>\$ 110,900</u>	<u>\$ 10,597</u>	<u>10%</u>
Net Position:				
Net investment in capital assets	\$ 59,865	\$ 52,634	\$ 7,231	14%
Restricted	271	1,244	(973)	100%
Unrestricted deficit	<u>(362,462)</u>	<u>(322,943)</u>	<u>(39,519)</u>	<u>12%</u>
	<u>\$ (302,326)</u>	<u>\$ (269,065)</u>	<u>\$ (33,261)</u>	<u>12%</u>

Puerto Rico Medical Services Administration
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Management's Discussion and Analysis (Continued)

The Administration's statements of net position as of June 30, 2013 and 2012 consisted of (in thousands):

	<u>2013</u>	<u>2012</u>	<u>Increase (Decrease)</u>	<u>%</u>
Current assets	\$ 51,780	\$ 61,329	\$ (9,549)	-16%
Non-current assets:				
Capital assets, net	52,634	54,730	(2,096)	-4%
Restricted cash	2,986	7,746	(4,760)	-61%
Other non-current asset	3,500	-	3,500	-
	<u>59,120</u>	<u>62,476</u>	<u>(3,356)</u>	<u>-5%</u>
	<u>110,900</u>	<u>123,805</u>	<u>(12,905)</u>	<u>-10%</u>
Current liabilities	81,274	57,772	23,502	41%
Non-current liabilities	<u>298,691</u>	<u>293,769</u>	<u>4,922</u>	<u>2%</u>
	379,965	351,541	28,424	8%
Net position	<u>(269,065)</u>	<u>(227,736)</u>	<u>(41,329)</u>	<u>18%</u>
	<u>110,900</u>	<u>123,805</u>	<u>(12,905)</u>	<u>-10%</u>
Net Position:				
Net investment in capital assets	52,634	54,649	(2,015)	-4%
Restricted	1,244	1,440	(196)	-14%
Unrestricted deficit	<u>(322,943)</u>	<u>(283,825)</u>	<u>(39,118)</u>	<u>14%</u>
	<u>\$ (269,065)</u>	<u>\$ (227,736)</u>	<u>\$ (41,329)</u>	<u>18%</u>

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Management's Discussion and Analysis (Continued)

Statement of Net Position

The decrease in current assets as of June 30, 2014, consisted of (in thousands):

	<u>2014</u>	<u>2013</u>	Increase (Decrease)	%
Unrestricted cash	\$ 1,098	\$ 904	\$ 194	21%
Receivable from member institutions and private insurances	35,018	37,387	(2,369)	-6%
Note receivable	-	8,000	(8,000)	-100%
Accounts receivable others	67	722	(655)	-91%
Inventories	3,469	3,275	194	6%
Prepaid expenses	<u>852</u>	<u>1,492</u>	<u>(640)</u>	<u>-43%</u>
	<u>\$ 40,504</u>	<u>\$ 51,780</u>	<u>\$ (11,276)</u>	<u>-22%</u>

The decrease in current assets as of June 30, 2013, consisted of (in thousands):

	<u>2013</u>	<u>2012</u>	Increase (Decrease)	%
Unrestricted cash	\$ 904	\$ 267	\$ 637	239%
Receivable from member institutions and private insurances	37,387	56,411	(19,024)	-34%
Note receivable	8,000	-	8,000	100%
Accounts receivable others	722	648	74	11%
Inventories	3,275	2,806	469	17%
Prepaid expenses	<u>1,492</u>	<u>1,197</u>	<u>295</u>	<u>25%</u>
	<u>\$ 51,780</u>	<u>\$ 61,329</u>	<u>\$ (9,549)</u>	<u>-16%</u>

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Puerto Rico Medical Services Administration
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Management's Discussion and Analysis (Continued)

Statement of Net Position – (continued)

The net decrease in accounts receivable from member institutions and private insurances, consisted of the following activity during the years ended June 30, 2014 and 2013 (in thousands):

As of June 30, 2014:

	Member Institutions	Private Insurance	Total
Gross services revenues	\$ 90,790	\$ 109,709	\$ 200,499
Revenue accounts reclassification	938	(564)	374
Contractual adjustments	-	(65,232)	(65,232)
Collections from prior years	-	2,096	2,096
Non cash transactions	(4,650)	-	(4,650)
Provision for bad debt expense	(528)	(13,691)	(14,219)
Collections	(91,288)	(29,949)	(121,237)
	<u>\$ (4,738)</u>	<u>\$ 2,369</u>	<u>\$ (2,369)</u>

As of June 30, 2013:

	Member Institutions	Private Insurance	Total
Gross services revenues	\$ 91,237	\$ 110,301	\$ 201,538
Revenue accounts reclassification	4,711	(3,717)	994
Contractual adjustments	-	(63,621)	(63,621)
Contractual adjustment reclassification	-	2,972	2,972
Non cash transactions	(6,156)	1,812	(4,344)
Provision for bad debt expense	(14,437)	(12,620)	(27,057)
Provision for bad debt expense reclassification	-	(2,960)	(2,960)
Collections	(82,244)	(32,802)	(115,046)
Reclassification of receivable from Municipality of San Juan	(11,500)	-	(11,500)
	<u>\$ (18,389)</u>	<u>\$ (635)</u>	<u>\$ (19,024)</u>

During 2014 the Administration improved the billing process, continued a collection plan and renegotiated some commercial health insurance contracts. As a result, there was an increase of \$6,191 in collections. The decrease of \$15,798 in the provision of bad debt expense is principally due to the negotiation with the Municipality of San Juan in 2013.

Puerto Rico Medical Services Administration
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Management's Discussion and Analysis (Continued)

Statement of Net Position – (continued)

Non-Current Assets - Capital Assets

As of June 30, 2014:

Description	Balance June 30, 2013	Increase	Decrease	Balance June 30, 2014
Capital assets not being depreciated	\$ 6,872	\$ -	\$ -	\$ 6,872
Capital assets being depreciated	167,486	11,894	(1,342)	178,038
Accumulated depreciation	(121,724)	(4,589)	1,268	(125,045)
Capital assets being depreciated, net	45,762	7,305	(74)	52,993
Capital assets, net	<u>\$ 52,634</u>	<u>\$ 7,305</u>	<u>\$ (74)</u>	<u>\$ 59,865</u>

As of June 30, 2013:

Description	Balance June 30, 2012	Increase	Decrease	Balance June 30, 2013
Capital assets not being depreciated	\$ 6,872	\$ -	\$ -	\$ 6,872
Capital assets being depreciated	165,908	2,429	(851)	167,486
Accumulated depreciation	(118,050)	(4,517)	843	(121,724)
Capital assets being depreciated, net	47,858	(2,088)	(8)	45,762
Capital assets, net	<u>\$ 54,730</u>	<u>\$ (2,088)</u>	<u>\$ (8)</u>	<u>\$ 52,634</u>

The increase in capital assets during the year ended June 30, 2014 is mainly due to the fact that current year acquisitions of equipment and building improvements exceeded depreciation expense.

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Puerto Rico Medical Services Administration
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Management's Discussion and Analysis (Continued)

Statement of Net Position – (continued)

Liabilities

Current liabilities

The increase in current liabilities consisted of (in thousands):

	2014	2013	Increase (Decrease)	%
Accounts payable	\$ 68,899	\$ 58,753	\$ 10,146	17%
Accrued expenses	9,424	11,588	(2,164)	-19%
Accrued interest	16,671	-	16,671	-
Current portion accrued pension costs	25,859	8,907	16,952	190%
Current portion of compensated absences	314	309	5	2%
Liabilities payable from restricted assets	<u>4,131</u>	<u>1,717</u>	<u>2,414</u>	<u>141%</u>
	<u>\$ 125,298</u>	<u>\$ 81,274</u>	<u>\$ 44,024</u>	<u>54%</u>

	2013	2012	Increase (Decrease)	%
Accounts payable	\$ 58,753	\$ 39,512	\$ 19,241	49%
Accrued expenses	11,588	9,274	2,314	25%
Current portion accrued pension costs	8,907	6,252	2,655	42%
Current portion of compensated absences	309	136	173	127%
Liabilities payable from restricted assets	<u>1,717</u>	<u>2,598</u>	<u>(881)</u>	<u>-34%</u>
	<u>\$ 81,274</u>	<u>\$ 57,772</u>	<u>\$ 23,502</u>	<u>41%</u>

The increase of \$10,146 in accounts payable and \$16,952 in accrued pension cost was mainly due to the deficiency of cash flow to pay debts in the Administration during the year ended June 30, 2014. The increase of \$16,671 correspond to interest incurred on GDB line of credit that were not reimbursed by the Commonwealth of Puerto Rico as of June 30, 2014 so that the Administration could make the corresponding interest payment for fiscal year 2014.

Puerto Rico Medical Services Administration
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Management's Discussion and Analysis (Continued)

Statement of Net Position – (continued)

Non-current liabilities

The increase in non-current liabilities as of June 30, 2014, consisted of (in thousands):

	<u>2014</u>	<u>2013</u>	<u>Increase (Decrease)</u>	<u>%</u>
Government Development Bank of Puerto Rico line of credit in connection with Law #66 of June 22, 1978, as amended	\$ 278,292	\$ 273,344	\$ 4,948	2%
Accrued pension costs, net of current portion	4,091	9,386	(5,295)	-56%
Compensated absences, net of current portion	11,508	11,199	309	3%
Other post-employment benefit obligations	1,834	1,572	262	17%
Liabilities payable from restricted assets-Self insurance fund	<u>2,800</u>	<u>3,190</u>	<u>(390)</u>	<u>-12%</u>
	<u>\$ 298,525</u>	<u>\$ 298,691</u>	<u>\$ (166)</u>	<u>0%</u>

The decrease in non-current liabilities is mainly due to the increase in the GDB line of credit due to payments made to suppliers, net by the decrease in accrued pension cost due to payments made under the payment agreement with the Commonwealth of Puerto Rico and the Employees' Retirement System for repayment of a debt.

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Puerto Rico Medical Services Administration
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Management's Discussion and Analysis (Continued)

Statement of Net Position – (continued)

Non-Current Liabilities

The following is the activity of long-term debts for the years ended June 30, 2014 and 2013 (in thousands):

As of June 30, 2014:

Description	Balance June 30, 2013	Increase	Decrease	Balance June 30, 2014
Self-insurance fund	\$ 3,190	\$ 2	\$ (392)	\$ 2,800
Accrued pension costs, net of current portion	9,386	-	(5,295)	4,091
Compensated absences, net of current portion	11,199	309	-	11,508
Other post-employment benefit obligation	1,572	262		1,834
Government Development Bank of Puerto Rico line of credit in connection with Law #66 of June 22, 1978 as amended	<u>273,344</u>	<u>4,948</u>	<u>-</u>	<u>278,292</u>
	<u>\$ 298,691</u>	<u>\$ 5,521</u>	<u>\$ (5,687)</u>	<u>\$ 298,525</u>

As of June 30, 2013:

Description	Balance June 30, 2012	Increase	Decrease	Balance June 30, 2013
Self-insurance fund	\$ 6,626	\$ 51	\$ (3,487)	\$ 3,190
Accrued pension costs, net of current portion	10,300	-	(914)	9,386
Compensated absences, net of current portion	11,063	136	-	11,199
Other post-employment benefit obligation	1,345	227		1,572
Government Development Bank of Puerto Rico line of credit in connection with Law #66 of June 22, 1978 as amended	<u>264,434</u>	<u>9,988</u>	<u>(1,078)</u>	<u>273,344</u>
	<u>\$ 293,768</u>	<u>\$ 10,402</u>	<u>\$ (5,479)</u>	<u>\$ 298,691</u>

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Management's Discussion and Analysis (Continued)

Revenues, Expenses and Changes in Net Position

The Administration's statements of revenue, expenses, and changes in net position for the years ended June 30, 2014 and 2013, consisted of (in thousands):

	2014	2013	Increase (Decrease)	%
Net service revenues	\$ 123,143	\$ 110,872	\$ 12,271	11%
Operating costs and expenses:				
Cost of services	166,613	166,452	161	0%
General and administrative	17,068	16,558	510	3%
Depreciation and amortization	4,589	4,516	73	2%
	<u>188,270</u>	<u>187,526</u>	<u>744</u>	<u>0%</u>
Operating loss	<u>(65,127)</u>	<u>(76,654)</u>	<u>11,527</u>	<u>-15%</u>
Non-operating income (expenses):				
Contributions from the Commonwealth of Puerto Rico	50,533	47,370	3,163	7%
Other income	745	1,316	(571)	-43%
Decrease in self-insurance reserve	145	3,175	(3,030)	-
Interest expenses	(17,234)	(16,528)	(706)	4%
Loss on disposition of capital assets	(73)	(8)	(65)	813%
	<u>34,116</u>	<u>35,325</u>	<u>(1,209)</u>	<u>-3%</u>
Transfer to Commonwealth of Puerto Rico	(2,250)	-	(2,250)	100%
Net change in net position	(33,261)	(41,329)	10,318	-25%
Net position, at beginning of year	<u>(269,065)</u>	<u>(227,736)</u>	<u>(41,329)</u>	<u>18%</u>
Net position, at end of year	<u>\$ (302,326)</u>	<u>\$ (269,065)</u>	<u>\$ (33,261)</u>	<u>12%</u>

Puerto Rico Medical Services Administration
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Management's Discussion and Analysis (Continued)

The Administration's statements of revenue, expenses, and changes in net position for the years ended June 30, 2013 and 2012, consisted of (in thousands):

	2013	2012	Increase (Decrease)	%
Net service revenues	\$ 110,872	\$ 122,571	\$ (11,699)	-10%
Operating costs and expenses:				
Cost of services	166,452	155,976	10,476	7%
General and administrative	16,558	14,975	1,583	11%
Depreciation and amortization	4,516	7,126	(2,610)	-37%
	<u>187,526</u>	<u>178,077</u>	<u>9,449</u>	<u>5%</u>
Operating loss	<u>(76,654)</u>	<u>(55,506)</u>	<u>(21,148)</u>	<u>38%</u>
Non-operating income (expenses):				
Contributions from the Commonwealth of Puerto Rico	47,370	23,892	23,478	98%
Interest income and other	1,316	1,668	(352)	-21%
Interest expenses	(16,528)	(15,303)	(1,225)	8%
Gain on debt forgiveness	-	11	(11)	-100%
Loss on disposition of capital assets	(8)	(34)	26	-76%
	<u>35,325</u>	<u>10,234</u>	<u>25,091</u>	<u>245%</u>
Net change in net position	(41,329)	(45,272)	3,943	-9%
Net position, at beginning of year	<u>(227,736)</u>	<u>(182,464)</u>	<u>(45,272)</u>	<u>25%</u>
Net position, at end of year	<u>\$ (269,065)</u>	<u>\$ (227,736)</u>	<u>\$ (41,329)</u>	<u>18%</u>

Puerto Rico Medical Services Administration
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Management's Discussion and Analysis (Continued)

Revenues, Expenses and Changes in Net Position – (continued)

Net patient service revenues

The increase in net service revenues for the year ended June 30, 2014, consisted of (in thousands):

	2014	2013	Increase (Decrease)	%
Member institutions	\$ 90,790	\$ 91,237	\$ (447)	0%
Revenue accounts reclassification	-	2,972	(2,972)	-100%
Private and insurance	<u>44,476</u>	<u>46,680</u>	<u>(2,204)</u>	-5%
Subtotal	<u>135,266</u>	<u>140,889</u>	<u>(5,623)</u>	
Provision for bad debts	(14,219)	(30,017)	15,798	-53%
Collection from prior years	<u>2,096</u>	<u>-</u>	<u>2,096</u>	0%
Subtotal	<u>(12,123)</u>	<u>(30,017)</u>	<u>17,894</u>	
	<u>\$ 123,143</u>	<u>\$ 110,872</u>	<u>\$ 12,271</u>	11%

Approximately 74% of the Administration's net patient service revenues are derived from services rendered to member institutions. The increase of \$12,271 in net patient service revenue is principally caused by a reduction of 60% in bad debts. The decrease of \$17,894 in the provision of bad debt expense is principally due to the negotiation with the Municipality of San Juan in 2013.

The decrease in service revenues for the year ended June 30, 2013, consisted of (in thousands):

	2013	2012	Increase (Decrease)	%
Member institutions	\$ 91,237	\$ 91,703	\$ (466)	-1%
Recovery prior year	-	879	(879)	-100%
Revenue accounts reclassification	2,972	(109)	3,081	-2827%
Private and insurance	46,680	43,087	3,593	8%
Provision for bad debts	<u>(30,017)</u>	<u>(12,989)</u>	<u>(17,028)</u>	<u>131%</u>
	<u>\$ 110,872</u>	<u>\$ 122,571</u>	<u>\$ (11,699)</u>	<u>-10%</u>

Puerto Rico Medical Services Administration
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Management's Discussion and Analysis (Continued)

Revenues, Expenses and Changes in Net Position – (continued)

Net patient service revenues – (continued)

Approximately 69% of the Administration's service revenues are derived from services rendered to member institutions. The decrease in service revenue is principally caused by a reduction of member institution billing of decentralization services. The decrease of \$15,798 in the provision for bad debts expense is principally due to the negotiation with the Municipality of San Juan in 2013.

Operating Costs and Expenses

Increase in operating costs and expenses for the year ended June 30, 2014, consisted of (in thousands):

	2014	2013	Increase (Decrease)	%
Salaries payroll taxes and fringe benefits	\$ 104,736	\$ 100,644	\$ 4,092	4%
General and administrative	17,068	16,558	510	3%
Costs of materials and services	52,863	50,768	2,095	4%
Depreciation and amortization	4,589	4,516	73	2%
Utilities	9,014	15,040	(6,026)	-40%
	<u>\$ 188,270</u>	<u>\$ 187,526</u>	<u>\$ 744</u>	<u>0%</u>

Increase in operating costs and expenses for the year ended June 30, 2013, consisted of (in thousands):

	2013	2012	Increase (Decrease)	%
Salaries payroll taxes and fringe benefits	\$ 100,644	\$ 98,724	\$ 1,920	2%
General and administrative	16,558	14,975	1,583	11%
Costs of materials and services	50,768	47,002	3,766	8%
Depreciation and amortization	4,516	7,126	(2,610)	-37%
Utilities	15,040	10,250	4,790	47%
	<u>\$ 187,526</u>	<u>\$ 178,077</u>	<u>\$ 9,449</u>	<u>5%</u>

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Management's Discussion and Analysis (Continued)

Revenues, Expenses and Changes in Net Assets (Deficit) – (continued)

Non-Operating Income (Expenses)

The decrease in non-operating income (expenses) for the year ended June 30, 2014 consists of (in thousands):

	<u>2014</u>	<u>2013</u>	<u>Increase (Decrease)</u>	<u>%</u>
Governmental contributions	\$ 50,534	\$ 47,370	\$ 3,164	7%
Other income	745	1,316	(571)	-43%
Decrease in self-insurance reserve	145	3,175	(3,030)	-
Interest expense	(17,234)	(16,528)	(706)	4%
Loss on disposition of capital assets	<u>(74)</u>	<u>(8)</u>	<u>(66)</u>	<u>825%</u>
	<u>\$ 34,116</u>	<u>\$ 35,325</u>	<u>\$ (1,209)</u>	<u>-3%</u>

The governmental contributions consisted of the following activity during the year ended June 30, 2014:

- \$114 thousand received in connection with Joint Resolution No. 4533 approved by the Commonwealth's Legislature Assembly on August 12, 2004, assigning \$40.5 million to the Administration for the construction of new Trauma facilities, the establishment of Gamma Knife Center, a Flood Fort, improvement to the Emergency Room and purchase of equipment.
- \$194 thousand received in connection with Joint Resolution No. 116 approved by the Commonwealth's Legislature Assembly on July 23, 2007, assigning \$2.9 million to the Administration for the acquisition of medical equipment.
- \$814 thousand received in connection with Joint Resolution No. 242 approved by the Commonwealth's Legislature Assembly on December 13, 2011, assigning to the Administration \$3.4 million for the acquisition of medical equipment.
- \$15.7 million received in connection with Joint Resolution No. 17 approved by the Commonwealth's Legislature Assembly on June 30, 2013, for operating expenses, payment of payroll and for the Trauma facilities.

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Management's Discussion and Analysis (Continued)

Revenues, Expenses and Changes in Net Position – (continued)

- \$1.4 million received in connection with Joint Resolution No. 22 approved by the Commonwealth's Legislature Assembly on June 30, 2013, assigning \$3.5 million to the Administration for the acquisition of medical equipment.
- \$5 million received from the Treasury Department on December 30, 2013 for the payment of payroll.
- \$6 million received in connection with Law 161-2012 approved by the Commonwealth's Legislature Assembly on August 8, 2012, for the San Juan Trauma facilities.
- \$16.7 million receivable in connection with Law 66 approved by the Commonwealth's Legislature Assembly on June 22, 1978, for the payment of principal and interest of the GDB line of credit.
- \$2.1 million received from the Department of Health for operating expenses.
- \$1.9 million received in connection with Joint Resolution of Special Assignment No. 17-2013 approved by the Commonwealth's Legislature Assembly on January 31, 2013, for the contribution to the Retirement System.
- \$506 thousand received for the electronic medical records.
- \$125 thousand received from the Department of Health for the acquisition of medical equipment and \$10 thousand in donations.

Non-Operating Income (Expenses)

Interest expense during the years ended on June 30, 2014 and 2013 consisted of approximately \$16.5 million each year billed mainly by the Government Development Bank of Puerto Rico.

Contacting the Administration's Financial Management

The financial report is designed to provide our suppliers and creditors with a general overview of the Administration's finances and to show the Administration's accountability for the funds it receives. If you have questions about this report or need additional financial information, contact the Administration's Finance Director Office at P.O. Box 2129 San Juan Puerto Rico 00936, phone no. (787) 777-3535 Ext. 2903.

INDEPENDENT AUDITORS' REPORT

The Secretary of the Puerto Rico Department of Health
and Board of Member Institutions of
Puerto Rico Medical Services Administration

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the Puerto Rico Medical Services Administration (the Administration), a component unit of the Puerto Rico Department of Health (the Department), as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the Administration's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

The Secretary of the Puerto Rico Department of Health
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Puerto Rico Medical Services Administration
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Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Puerto Rico Medical Services Administration, as of June 30, 2014 and 2013, and the respective changes in net position, and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As described in Note 11 to the financial statements, the Administration derives a substantial portion of its revenues from services rendered to member institutions. In addition, the Administration provides services to the medical indigent population, some of them uninsured, which do not have formal means of repayment. Amounts due from member institutions and medical indigent population may be subject to periodic revisions and/or adjustments, based on the availability of funds from the member institutions and/or the entities adhered to the Commonwealth of Puerto Rico.

As described in Note 13 to the financial statements, the financial condition of the Administration has been weakened by high operating costs and recurring operating losses. In addition, the Administration has been affected by the delay in the collection of billings for services rendered to member institutions. As of June 30, 2014 and 2013, the Administration has a total deficit of \$302,325,876 and \$269,065,190, respectively, and a deficiency in working capital of \$84,794,211 and \$29,494,165, respectively. The Administration's operations will depend on obtaining additional contributions from the Secretary of the Puerto Rico Department of Health and the Commonwealth of Puerto Rico to partially subsidize existing and future operating losses, resulting from high operating costs and services provided to the medical indigent population not covered under any private health insurance or non-participating in the Health Reform Program Administered by the Puerto Rico Health Insurance Administration (ASES). The Administration has made formal requests to various Commonwealth's agencies, including the Office of Management and Budget, requesting additional funds to subsidize its operating deficit and improve its existing financial condition.

As discussed in Note 1 to the financial statements, the accompanying financial statements present only the financial position and transactions attributable to the Administration. They do not intent to present, and do not present, the financial position and transactions of the Puerto Rico Department of Health in conformity with the accounting principles generally accepted in the United States of America.

The Secretary of the Puerto Rico Department of Health
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Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis information on pages 1 to 15 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 9, 2015, on our consideration of the Administration's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. 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. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Administration's internal control over financial reporting and compliance.



FPV Galindez

San Juan, Puerto Rico
 February 9, 2015

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Statements of Net Position

June 30, 2014 and 2013

	2014	2013
Assets		
Current assets:		
Unrestricted cash	\$ 1,098,255	\$ 903,726
Accounts receivable:		
Member institutions, net of allowance for doubtful accounts of \$55,747,405 in 2014 and \$76,345,776 in 2013	14,676,975	19,414,885
Private insurance, net of allowance for doubtful accounts of \$117,730,516 in 2014 and \$112,732,336 in 2013	20,341,232	17,972,373
Note receivable from Municipality of San Juan	-	8,000,000
Other, net of allowance for doubtful accounts of \$881,841 in 2014 and \$192,879 in 2013	66,425	722,020
	35,084,632	46,109,278
Inventories	3,469,089	3,274,764
Prepaid expenses	851,650	1,492,504
Total current assets	40,503,626	51,780,272
Non-current assets:		
Restricted cash	956,915	2,986,106
Note receivable from Municipality of San Juan	3,500,000	3,500,000
Due from Commonwealth of Puerto Rico	16,670,985	-
Capital assets, net	59,865,508	52,634,049
	80,993,408	59,120,155
Total non-current assets	80,993,408	59,120,155
Total assets	\$ 121,497,034	\$ 110,900,427

(Continues)

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Statements of Net Position (Continued)

June 30, 2014 and 2013

Liabilities and Net Position

	2014	2013
Current liabilities:		
Accounts payable	\$ 68,899,067	\$ 58,753,404
Accrued expenses	9,424,137	11,588,082
Accrued interest	16,670,985	-
Current portion of accrued pension costs	25,858,824	8,907,242
Current portion of compensated absences	313,684	308,500
Liabilities payable from restricted assets - improvements to medical facilities and equipment purchased	4,131,140	1,717,209
Total current liabilities	125,297,837	81,274,437
Non-current liabilities:		
Line of credit	278,291,784	273,344,177
Accrued pension costs, net of current portion	4,090,831	9,385,559
Compensated absences, net of current portion	11,508,157	11,199,657
Other post-employment benefit obligations	1,834,301	1,571,982
Liabilities payable from restricted assets - Self-insurance fund	2,800,000	3,189,805
Total non-current liabilities	298,525,073	298,691,180
Total liabilities	423,822,910	379,965,617
Net position:		
Net invested in capital assets	59,865,508	52,634,049
Restricted for:		
Permanent improvements	-	1,238,607
Other	271,112	5,203
Unrestricted deficit	(362,462,496)	(322,943,049)
Total net position	(302,325,876)	(269,065,190)
Total liabilities and net position	\$ 121,497,034	\$ 110,900,427

See notes to financial statements

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Statements of Revenues, Expenses and Changes in Net Position

For the years ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Patient service revenue, net of contractual allowance	\$ 135,266,851	\$ 140,889,097
Provision for bad debts	<u>12,123,417</u>	<u>30,017,250</u>
Net patient service revenue	<u>123,143,434</u>	<u>110,871,847</u>
Operating costs and expenses:		
Cost of services	166,613,266	166,451,540
General and administrative	17,068,520	16,558,116
Depreciation and amortization	<u>4,588,793</u>	<u>4,516,367</u>
Total operating cost and expenses	<u>188,270,579</u>	<u>187,526,023</u>
Operating loss	<u>(65,127,145)</u>	<u>(76,654,176)</u>
Non-operating income (expenses):		
Contributions from the Commonwealth of Puerto Rico	50,533,801	47,370,262
Other income	744,945	1,316,169
Loss on disposition of capital assets	(73,500)	(8,203)
Decrease in self-insurance reserve	145,403	3,175,255
Interest expense	<u>(17,234,190)</u>	<u>(16,528,393)</u>
Total non-operating income, net	<u>34,116,459</u>	<u>35,325,090</u>
Transfer to the Commonwealth of Puerto Rico	<u>(2,250,000)</u>	<u>-</u>
Net change in net position	(33,260,686)	(41,329,086)
Net position, at beginning of year	<u>(269,065,190)</u>	<u>(227,736,104)</u>
Net position, at end of year	<u>\$ (302,325,876)</u>	<u>\$ (269,065,190)</u>

See notes to financial statements

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Statements of Cash Flows

For the years ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Receipts from service revenues	\$ 128,862,485	\$ 118,395,599
Payments to suppliers for goods and services and, salaries and related benefits	<u>(152,814,585)</u>	<u>(160,139,840)</u>
Net cash used in operating activities	<u>(23,952,100)</u>	<u>(41,744,241)</u>
Cash flows from non capital and related financing activities:		
Intergovernmental contributions	32,729,717	38,732,000
Interest paid	<u>(563,204)</u>	<u>(10,572,456)</u>
Net cash provided by non capital and related financing activities	<u>32,166,513</u>	<u>28,159,544</u>
Cash flows from capital and related financing activities:		
Intergovernmental contributions	1,099,735	8,563,985
Acquisition of machinery and equipment	(3,950,871)	(2,106,001)
Improvements to emergency room and other facilities	(7,942,881)	(322,550)
Principal payments on line of credit	-	(1,078,439)
Principal payments on obligations under capital leases	<u>-</u>	<u>(86,400)</u>
Net cash provided by (used in) capital and related financing activities	<u>(10,794,017)</u>	<u>4,970,595</u>
Cash flows from investing activities:		
Change in restricted cash	2,029,191	4,759,637
Receipts from interest and other income	<u>744,942</u>	<u>4,491,424</u>
Net cash provided by investing activities	<u>2,774,133</u>	<u>9,251,061</u>
Net change in cash	194,529	636,959
Unrestricted cash, beginning of year	<u>903,726</u>	<u>266,767</u>
Unrestricted cash, end of year	<u>\$ 1,098,255</u>	<u>\$ 903,726</u>

(Continues)

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Statements of Cash Flows (Continued)

For the years ended June 30, 2014 and 2013

	2014	2013
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (65,127,145)	\$ (76,654,176)
Adjustments to reconcile operating loss to net cash used in operating activities		
Depreciation and amortization	4,588,793	4,516,367
Provision for bad debts	12,812,379	30,017,250
Write down of prepaid expenses	717,666	-
Changes in assets and liabilities		
(Increase) decrease in:		
Accounts receivable	(6,404,366)	(22,493,498)
Inventories	(194,325)	(468,800)
Prepaid expenses	(76,811)	(295,283)
Increase (decrease) in:		
Accounts payable	19,743,269	23,273,608
Accrued expenses and other	9,988,440	360,291
	41,175,045	34,909,935
Net cash used in operating activities	\$ (23,952,100)	\$ (41,744,241)

Non-cash capital investing and financing activities

Retirement of capital assets	\$ 1,341,326	\$ 850,749
Payments to suppliers with proceeds from line of credit	\$ 4,947,607	\$ 4,032,418
Non-cash interest expense charged from line of credit	\$ -	\$ 6,000,000
Intergovernmental contribution for the payment of interest expenses	\$ 16,670,985	\$ -

See notes to financial statements

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements

June 30, 2014 and 2013

Note 1 - Organization and summary of significant accounting policies

Organization

The Puerto Rico Medical Services Administration (the Administration), is a public corporation and an instrumentality of the Commonwealth of Puerto Rico (the Commonwealth) adhered to the Puerto Rico Department of Health (the Department). The Administration was created by Law Number 66 of June 22, 1978, as amended, to plan, organize, operate and administer the centralized health services, provided in support of hospitals and other functions offered by the member institutions and consumers of the complex known as Puerto Rico Medical Center. As a component unit of the Department, the Administration is also included as part of the Department's reporting entity.

As an instrumentality of the Commonwealth, the Administration is exempt from income, property and municipal license tax.

The Administration's capital is funded by non-reimbursable legislature appropriations from the Commonwealth, in-kind donations or cash from various governmental agencies or instrumentalities of the Commonwealth, federal grants and other contributions.

Summary of significant policies

The accounting and reporting policies of the Administration conform to accounting principles generally accepted in the United States of America, as applicable to governmental units. The following is a description of the most significant accounting policies:

Basis of presentation

The Administration's financial statements are presented as an enterprise fund and conform to the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34 (GASB No. 34), *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*. GASB 34, as amended, establishes standards for external financial reporting for all state and local government entities, which includes a statement of net position, a statement of revenues, expenses and changes in net position, and a statement of cash flows. It requires the classification of net assets into three components: net invested in capital assets, restricted, and unrestricted.

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 1 - Organization and summary of significant accounting policies - (continued)

Basis of presentation – (continued)

These classifications are defined as follows:

- Net invested in capital assets – This component of net assets consists of capital assets, net of accumulated depreciation, reduced by outstanding balances of any bonds, mortgage notes, or other borrowings that are attributable to and spent in the acquisition, construction, or improvement of those assets.

If there are significant unspent related debt proceeds at year end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of net invested in capital assets; rather, that portion of the debt is included in the same net assets component as the unspent proceeds. As of June 30, 2014 and 2013, net assets invested in capital assets, net of related debt consisted of the balance of capital.

- Restricted – This component of net assets consists of constraints placed on net assets use through external constraints imposed by creditors (such as through debt covenants), contributions, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation. As of June 30, 2014 and 2013, net assets restricted consisted mainly of cash available from governmental contributions received for improvements to the Administration's facilities and other capital additions.
- Unrestricted deficit – This component of net assets consist of net assets that do not meet the definition of "restricted" or "net invested in capital assets".

Measurement focus and basis of accounting

The financial statements of the Administration are presented using the economic resources measurement focus and the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America, as applicable to governmental units. Under this basis, revenues are recognized when earned, regardless of when received, and expenses are recognized when incurred, regardless of when paid.

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 1 - Organization and summary of significant accounting policies - (continued)

Use of estimates

The preparation of the 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, including estimated uncollectable for accounts receivable for services to patients, and liabilities, including estimated malpractice liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amount of revenue and expenses incurred during the reporting period. The reserve for doubtful accounts, and the estimated malpractice liabilities, among other accounts, require the significant use of estimates. Actual results could differ from those estimates.

Accounts receivable

Accounts receivable from member institutions are presented net of advances received by the Administration from these institutions. These advances are received on a quarterly basis and are applied to the accounts receivable as services are rendered. During the year ended June 30, 2014, approximately \$55,747,000 and \$117,731,000, representing receivables from member institutions and private insurance, respectively, are not expected to be collected which are included as part of the allowance for doubtful accounts within accounts receivable in the accompanying statements of net position.

Valuation of accounts receivable

The Administration makes judgments as to the collectability of accounts receivables based on historical trends and future expectations. Management estimates an allowance for doubtful accounts, which represents the collectability of patient service accounts receivables.

This allowance adjusts gross patient service accounts receivable downward to their estimated net realizable value. To determine the allowance for doubtful accounts, management reviews specific customer risk for accounts over 365 days using the Administration's accounts receivable aging subsidiary.

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 1 - Organization and summary of significant accounting Policies - (continued)

Fair value of financial instruments

The carrying amounts reported in the statement of net position for cash, receivables, other receivables and payables approximate their fair value due to their short-term duration.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market. Inventories consist of drugs, medicines, provisions and materials.

Capital assets

Capital assets are stated at cost and equipment under capital leases at the present value of minimum lease payments, in accordance with the provision of the Financial Accounting Standards Board *FASB Accounting Standards Codification Topic of Accounting for Leases*. Capital assets are defined by the Administration as assets with an individual cost of more than \$100.

Depreciation and amortization are computed using the straight-line method over the estimated useful life of the related assets or the lease term, as follows:

<u>Description</u>	<u>Useful Life</u>
Land improvements	40 years
Building	40 years
Building improvements	5 years
Machinery and equipment	3-20 years
Equipment under capital leases	Lease term (useful live or lease term, whichever is shorter)

At the time capital assets are sold or otherwise disposed of, the cost and related accumulated depreciation is removed from the Administration's books and the resulting gain or loss, if any, is credited or charged to operations.

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 1 - Organization and summary of significant accounting policies - (continued)

Accounting for the impairment of capital assets

The Administration accounts for assets impairment under the provisions of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This statement establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its services utility has declined significantly and unexpectedly. This statement also establishes accounting requirements for insurance recoveries. A capital asset generally should be considered impaired if both, (a) the decline in service utility of the capital asset is large in magnitude, and (b) the event of change in circumstance is outside the normal life cycle of the capital asset. Impaired capital assets that will no longer be used by the government should be reported at the lower of carrying value or fair value.

Compensated absences

The vacation and sick policy of the Administration provides for de accumulation of thirty (30) days of vacation and eighteen (18) days of sick leave annually. Vacation time is fully vested to the employees from the first day of work. Under the collective bargain agreement, which went into effect on January 1, 2013, employees are entitled to the payment of the excess of sixty (60) days of vacation at a rate equal to double of their hourly rate. On the other hand, employees not covered under the collective bargain agreement are entitled to the payment of the excess of sixty (60) days of vacation at their hourly rate. However, as per Law No. 66 of June, 17, 2014, payment of the excess of sixty (60) days of vacation cannot be completed for employees not covered under the collective bargain agreement.

Under the collective bargain agreement and the Administration policies, all employees are entitled to the payment of the excess of fifteen (15) days in accumulated sick leave, up to a maximum of eighteen (18) days. However, as per Law No. 66 of June, 17, 2014, and the collective bargain agreement required by it, the payment previously mentioned cannot be completed for employees not covered under the collective bargain agreement. Employees covered under the collective bargain agreement would receive the payment only during the 2014-2015 fiscal year.

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 1 - Organization and summary of significant accounting policies - (continued)

Net patient service revenue

The Administration has agreements with third-party payors that provide for payments to the Administration at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursement costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

During 2013, the Administration adopted the requirements of the FASB Accounting Standards Update No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts and the Allowance for Doubtful Accounts for Certain Healthcare Entities*. The standard update requires healthcare entities that recognize a significant amount of patient service revenue at the time the services are rendered, even though they do not assess the patient's ability to pay at that moment, to present as a separate line item on the face of the statement of revenues, expenses and changes in net position, the provision for bad debts, related to patient service revenue, as a deduction from patient revenue (net of contractual allowances and discounts).

The standard update also requires disclosing by major payor source of revenue; the Administration's policy for assessing collectability in determining the timing and amount of patient service revenue to be recognized, and qualitative and quantitative information about significant changes in the allowance for doubtful accounts related to patient accounts receivable.

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Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 1 - Organization and summary of significant accounting policies - (continued)

Post-employment benefits other than pension benefits

The Administration adopted the provisions of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*. The Administration provides post-retirement benefits to all employees who meet certain age and years of services requirements. Such benefits consist principally of health care benefits and a post-employment payment. Healthcare benefits are provided for a period of six (6) months after retirement. A lump-sum payment is made for post-employment bonus after retirement. However, as per Law No. 66 of June, 17, 2014, employees not covered under the collective bargain agreement will not receive the post-employment bonus after retirement. Substantially, all the Administration's employees may become eligible for those benefits if they reach normal retirement age while working for the Administration. However, as per Law No. 66 of June, 17, 2014, employees not covered under the collective bargain agreement will not receive the post-employment bonus after retirement.

Revenues

Consist primarily of services provided to member institutions, third party payors, others, and are reported at the estimated net realizable amounts for services rendered to patients.

Operating revenues and expenses

Operating revenues and expenses are those that result from operating service activities. Interest income and expenses related mainly with restricted deposits, obligations under capital leases and other are not included as part of operating revenues and expenses.

Insurance

The Administration carries commercial insurance to cover for casualty, theft, claims and other losses. The Commonwealth negotiates the commercial insurance coverage, and the cost is paid by the Administration. The Administration is self-insured for medical malpractice claims and judgments, as discussed in Note 6. The Administration also pays for workers' compensation insurance to another component unit of the Commonwealth.

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 1 - Organization and summary of significant accounting policies - (continued)

Non-exchange transactions

GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange Transactions*, establishes accounting and financial reporting standards for non-exchange transactions involving financial or capital resources (for example, grants, and contributions). In a non-exchange transaction, a government gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal value. Under the provisions of the GASB 33, the provider and the recipient should recognize the non-exchange transaction as an expense and revenue, respectively, when all eligibility requirements are satisfied.

Deposits and investment risks

The Administration follows the GASB Statement No. 40, *Deposit and Investment Risk Disclosure* – an amendment of GASB Statement No. 3. The Statement addresses common deposit and investment risks related to credit, concentration, interest rate and foreign currency. Among other disclosures, the Statement requires certain disclosures applicable to deposits or investments having fair values that are highly sensitive to changes in interest rate.

Reclassifications

Certain reclassifications have been made to the 2013 financial statements to conform them to the 2014 financial statements presentation.

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Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 1 - Organization and summary of significant accounting policies - (continued)

New Accounting Standards Adopted

The following new accounting standards were adopted by the Administration effective July 1, 2013:

- In March 2012 the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. In addition, this Statement amends or supersedes requirements for the determination of major funds and addresses other statement of net position and government funds balance sheet presentation issues. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2012. There was no impact on the Administration's financial statement as a result of the implementation of GASB Statement No. 65.
- In March 2012 the GASB issued Statement No. 66, *Technical Corrections 2012, an amendment of GASB Statements No. 10 and No. 62*. The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2012. There was no mayor impact on the Administration's financial statement as a result of the implementation of GASB Statement No. 66.
- In June 2012, the GASB issued Statement No. 67, *Financial Reporting for Pension Plans, an amendment of GASB Statement No. 25*. The objective of this Statement replaces the requirements of Statements No. 25, *Financial Reporting for Defined Benefits Pension Plans, and Note Disclosures for Defined Contribution Plans*, and No. 50, *Pension Disclosures*, as they related to pension plans that are administered through trusts or equivalent arrangements (hereafter jointly referred to as trust) that meet certain criteria. This Statement is effective for financial statements for fiscal years beginning after June 15, 2013. There was no impact on the Administration's financial statement as a result of the implementation of GASB Statement No. 67.

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 1 - Organization and summary of significant accounting policies - (continued)

New Accounting Standards Adopted

- In April 2013, the GASB issued Statement No. 70, *Accounting and Financial Reporting for Non-exchange Financial Guarantees*. The objective of this Statement is to improve accounting and financial reporting by state and local governments that extend and receive non-exchange financial guarantees. This Statement requires a government that extends a non-exchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. The amount of the liability to be recognized should be the discounted present value of the best estimate of the future outflows expected to be incurred as a result of the guarantee. When there is no best estimate but a range of the estimated future outflows can be established, the amount of the liability to be recognized should be the discounted present value of the minimum amount within the range. This Statement requires a government that has issued an obligation guaranteed in a non-exchange transaction to report the obligation until legally released as an obligor. This Statement also requires a government that is required to repay a guarantor for making a payment on a guaranteed obligation or legally assuming the guaranteed obligation to continue to recognize a liability until legally released as an obligor. When a government is released as an obligor, the government should recognize revenue as a result of being relieved of the obligation. This Statement also provides additional guidance for intra-entity non-exchange financial guarantees involving blended component units. This Statement specifies the information required to be disclosed by governments that extend non-exchange financial guarantees. In addition, this Statement requires new information to be disclosed by governments that receive non-exchange financial guarantees. The provisions of this Statement are effective for reporting periods beginning after June 15, 2013. There was no mayor impact on the Administration's financial statement as a result of the implementation of GASB Statement No. 70.

Recently issued accounting standards

The GASB has issued the following accounting pronouncements that have effective dates after June 30, 2014:

- In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions Plans an amendment of GASB Statement No. 27*. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This Statement replaces the

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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 1 - Organization and summary of significant accounting policies - (continued)

Recently issued accounting standards

requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements 27 and 50 remain applicable for pensions that are not covered by the scope of this Statement. The Statement is effective for fiscal years beginning after June 15, 2014.

- In January 2013, the GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*. This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term *government combination* includes a variety of transactions referred to as mergers, acquisitions, and transfers of operations. The distinction between a government merger and a government acquisition is based upon whether an exchange of significant consideration is present within the combination transaction. Government mergers include combinations of legally separate entities without the exchange of significant consideration. This Statement requires the use of carrying values to measure the assets and liabilities in a government merger. Conversely, government acquisitions are transactions in which a government acquires another entity, or its operations, in exchange for significant consideration. This Statement requires measurements of assets acquired and liabilities assumed generally to be based upon their acquisition values. This Statement also provides guidance for transfers of operations that do not constitute entire legally separate entities and in which no significant consideration is exchanged. This Statement defines the term *operations* for purposes of determining the applicability of this Statement and requires the use of carrying values to measure the assets and liabilities in a transfer of operations. A disposal of a government's operations results in the removal of specific activities of a government. This Statement provides accounting and financial reporting guidance for disposals of government operations that have been transferred or sold. This Statement requires disclosures to be made about government combinations and disposals of government operations to enable financial statement users to evaluate the nature and financial effects of those transactions. The requirements of this Statement are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013.

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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 1 - Organization and summary of significant accounting policies - (continued)

Recently issued accounting standards – (continued)

The impact of these statements on the Administration's basic financial statements has not yet been determined.

Note 2 - Restricted cash

Restricted cash as of June 30, 2014 and 2013 consisted of:

Description	2014	2013
Cash-restricted for:		
Improvements to medical facilities and purchase of equipment	\$ 644,650	\$ 2,947,311
Self-insurance fund	39,956	32,395
Gamma Knife	2,210	444
Other	<u>270,099</u>	<u>5,956</u>
	<u>\$ 956,915</u>	<u>\$ 2,986,106</u>

The Administration's restricted cash are comprised of deposits held in custody by a banking institution. These deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000, with the remaining balance collateralized with financial instruments held by a trust of the Commonwealth. Based on these provisions, deposits are not considered to be subject to custodial credit risk, which is the risk that in the event of a bank's failure, the Administration's deposits may not be returned.

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Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 3 - Net patient service revenue

Patient services revenue

The Administration has agreements with medical insurance companies and the Medicare program for payments to the Administration, at amounts different from its established rates. A summary of the most significant agreements, with these entities is as follows:

Medicare - Inpatient acute care services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient capital costs are paid based on the fully prospective method. Medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The Administration is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of an annual cost report by the Administration and audits thereof by the Medicare fiscal intermediary.

The Administration's Medicare cost reports have been reviewed by the Medicare fiscal intermediary through 2012.

The cost reports for 2014 and 2013 are subject to the Medicare fiscal intermediary examination. Laws and regulations governing the Medicare program are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change in the near term.

Member institutions - The Administration has agreements with different governmental entities of the Commonwealth of Puerto Rico for payments to the Administration, at its established rates.

Others - Also, the Administration has entered into payment agreements with some commercial insurance carriers and other healthcare organizations. The basis for payment to the Administration under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 3 - Net patient service revenue – (continued)

Patient services revenue – (continued)

A summary of patient service revenue, net of contractual allowances and discounts, for the years ended June 30, 2014 and 2013 consisted of:

	<u>2014</u>	<u>2013</u>
Third-party payors - member institutions	\$ 90,262,232	\$ 76,800,001
Third-party payors	32,865,671	34,072,140
Self-pay patients	<u>15,531</u>	<u>(294)</u>
Patient service revenue (net of contractual allowances and discounts and provision for bad debts)	<u>\$ 123,143,434</u>	<u>\$ 110,871,847</u>

Changes in the allowance for doubtful accounts on patient's account receivable for the years ended June 30, 2014 and 2013 consisted of:

	<u>2014</u>	<u>2013</u>
Balance, beginning of year	\$ 189,078,112	\$ 161,250,142
Provision for bad debts	12,123,417	30,017,250
Write-off of uncollectible accounts	<u>(27,723,608)</u>	<u>(2,189,280)</u>
Balance, end of year	<u>\$ 173,477,921</u>	<u>\$ 189,078,112</u>

Net patient service revenue from third-party payors is estimated fully collectible and it is recorded when the health care services are provided. Also, health care services provided to uninsured patients is recorded when the services are provided. Provision for bad debts related to receivables from third-party payors and uninsured patients and for patients for whom it was assessed the patient does not has the ability to pay is recorded as a deduction of net patient service revenue in the accompanying statements of revenues, expenses and changes in net position. At June 30, 2014 and 2013, 79% and 85%, respectively, of the amounts reserved as uncollectible are related to third-party payors, 21% and 15%, respectively, are related to self-pay patients, which includes deductibles and co-insurance which the Administration accounts for as patient balance.

Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 4 - Capital assets

Capital assets as of June 30, 2014 and 2013, and activity during the years then ended consisted of:

Description	Balance June 30, 2013	Acquisitions	Retirements	Reclassification	Balance June 30, 2014
Capital assets not being depreciated:					
Land	\$ 6,871,955	\$ -	\$ -	\$ -	\$ 6,871,955
Capital assets being depreciated:					
Land improvements	11,867,399	-	-	-	11,867,399
Building and improvements	83,314,128	7,942,881	-	4,107	91,261,116
Machinery and equipment	53,705,454	3,950,871	(1,198,898)	(4,107)	56,453,320
Equipment under capital leases	18,598,758	-	(142,428)	-	18,456,330
	<u>167,485,739</u>	<u>11,893,752</u>	<u>(1,341,326)</u>	<u>-</u>	<u>178,038,165</u>
Accumulated depreciation and amortization:					
Land improvements	11,838,435	15,963	-	-	11,854,398
Building and improvements	50,075,557	1,695,904	-	-	51,771,461
Machinery and equipment	41,210,894	2,876,926	(1,125,398)	-	42,962,422
Equipment under capital leases	18,598,759	-	(142,428)	-	18,456,331
	<u>121,723,645</u>	<u>4,588,793</u>	<u>(1,267,826)</u>	<u>-</u>	<u>125,044,612</u>
Capital assets being depreciated, net	<u>45,762,094</u>	<u>7,304,959</u>	<u>(73,500)</u>	<u>-</u>	<u>52,993,553</u>
Capital assets, net	<u>\$ 52,634,049</u>	<u>\$ 7,304,959</u>	<u>\$ (73,500)</u>	<u>\$ -</u>	<u>\$ 59,865,508</u>

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 4 - Capital assets – (continued)

Description	Balance June 30, 2012	Acquisitions	Retirements	Reclassification	Balance June 30, 2013
Capital assets not being depreciated:					
Land	\$ 6,871,955	\$ -	\$ -	\$ -	\$ 6,871,955
Capital assets being depreciated:					
Land improvements	11,867,399	-	-	-	11,867,399
Building and improvements	82,991,578	322,550	-	-	83,314,128
Machinery and equipment	50,849,863	2,106,001	(777,929)	1,527,519	53,705,454
Equipment under capital leases	20,199,097	-	(72,820)	(1,527,519)	18,598,758
	<u>165,907,937</u>	<u>2,428,551</u>	<u>(850,749)</u>	<u>-</u>	<u>167,485,739</u>
Accumulated depreciation and amortization:					
Land improvements	11,815,508	22,927	-	-	11,838,435
Building and improvements	48,320,938	1,754,619	-	-	50,075,557
Machinery and equipment	37,714,280	2,738,821	(769,726)	1,527,519	41,210,894
Equipment under capital leases	20,199,098	-	(72,820)	(1,527,519)	18,598,759
	<u>118,049,824</u>	<u>4,516,367</u>	<u>(842,546)</u>	<u>-</u>	<u>121,723,645</u>
Capital assets being depreciated, net	<u>47,858,113</u>	<u>(2,087,816)</u>	<u>(8,203)</u>	<u>-</u>	<u>45,762,094</u>
Capital assets, net	<u>\$ 54,730,068</u>	<u>\$ (2,087,816)</u>	<u>\$ (8,203)</u>	<u>\$ -</u>	<u>\$ 52,634,049</u>

Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 5 - Note receivable from the Municipality of San Juan

On November 14, 2013 the Administration and the Municipality of San Juan (MSJ) signed an agreement to settle the accounts receivable from the Hospital of the Municipality of San Juan related to medical services rendered by the Administration to the MSJ covering inpatient and outpatient services, laboratory, pharmacy, general services and other ancillary services billed to the MSJ. The settlement was for the amount of \$11,500,000 and covers the period from July 1, 2002 to June 30, 2012. The agreement is to be paid in five installments beginning in fiscal year 2014 for \$8 million, \$800,000 in 2016, \$850,000 in 2017, \$900,000 in 2018 and the last payment is due August 2019 for \$950,000, bearing no interest.

Note 6 - Self-insurance fund

Beginning in fiscal year 1986, the Administration decided to stop carrying commercial insurance because of its prohibitive cost and approved the establishment of a Self-Insurance Fund (the Fund) to account for and finance its uninsured risks of loss related to professional liability claims. Patient and non-patient general liability exposures are insured elsewhere and are not covered by the Fund.

The Administration maintains in the Fund cash of \$39,956 and \$32,395 as of June 30, 2014 and 2013, respectively, to provide for the payment of possible claims. Funding requirements are determined based on actuarial report and the Administration's Internal Council Office. The most recent actuarial reports as of June 30, 2014 and 2013, presented estimated liabilities of approximately \$2,800,000 and \$3,189,805, respectively, which were related with claims incurred during the years ended June 30, 1989 to June 30, 2014.

The following is the activity of the restricted cash available and liabilities payable from restricted assets under the Self-Insurance Fund for the years ended June 30, 2014 and 2013.

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Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 6 - Self-insurance fund – (continued)

June 30, 2014:

Description	Restricted Cash	Liabilities Payable
Balances as of beginning of year	\$ 32,395	\$ 3,189,805
Funds received from operations	295,526	2,371
Claims paid and other disbursements	(287,965)	(246,773)
Decrease in self-insurance reserve	-	(145,403)
Balance as of end of year	<u>\$ 39,956</u>	<u>\$ 2,800,000</u>

June 30, 2013:

Description	Restricted Cash	Liabilities Payable
Balances as of beginning of year	\$ 5,268,335	\$ 6,626,033
Funds received from operations	22,667	51,027
Claims paid and other disbursements	(316,236)	(312,000)
Decrease in self-insurance reserve	(4,942,371)	(3,175,255)
Balance as of end of year	<u>\$ 32,395</u>	<u>\$ 3,189,805</u>

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Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 7 - Accrued pension costs

Accrued pension costs as of June 30, 2014 and 2013 consisted of:

June 30, 2014:

Description	Amount
Employer's contributions	\$ 6,055,607
Employee's contributions	5,027,591
Employee's and employer's contributions under System 2000	2,111,912
Withholdings of employees' loans	891,273
Interest and other	15,863,272
	29,949,655
Less: current portion	(25,858,824)
Accrued pension cost, net of current portion	\$ 4,090,831

June 30, 2013:

Description	Amount
Employer's contributions	\$ 2,102,527
Employee's contributions	1,709,464
Employee's and employer's contributions under System 2000	3,850,921
Withholdings of employees' loans	356,327
Interest and other	10,273,562
	18,292,801
Less: current portion	(8,907,242)
Accrued pension cost, net of current portion	\$ 9,385,559

Accrued pension cost current portion presented in the accompanying statements of net position at June 30, 2014, consists of accrued pension costs current portion corresponding to fiscal year 2013-2014 amounting to \$22,790,700 and those related to fiscal year 2010-2011 under the below payment plan amounting to \$3,068,124.

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 7 - Accrued pension costs (continued)

On November 1, 2011, the Administration entered into a payment plan agreement (the Agreement) with the Administration of the Employee's Retirement System of the Government of the Commonwealth of Puerto Rico and Judiciary (Retiro) for repayment of a debt amounting to \$15,340,620, at such date, corresponding to fiscal year 2010-2011. Beginning on November 15, 2011, the agreement calls for sixty (60) monthly installments of \$255,677 bearing no interest. Default payments of less than one year in default, will bear interest at 9%, and 12% for those in excess of one year.

Future minimum payments for the next three (3) years are as follows:

<u>Year</u>	<u>Amount</u>
2015	\$ 3,068,124
2016	3,068,124
2017	<u>1,022,707</u>
Total	<u>\$ 7,158,955</u>

Note 8 - Employees' retirement plan

Retirement System

The Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (the Retirement System), created pursuant to Act No. 447 of May 15, 1951, as amended, is a cost-sharing, multiple-employer, defined benefit pension plan sponsored by and reported as a component unit of the Commonwealth. The Retirement System consists of different benefit structures, including a cost-sharing, multi-employer, defined benefit program, a defined contribution program (System 2000 Program) and a defined contribution hybrid program.

Defined Benefit Program

Pursuant to Act No. 447 of May 15, 1951, as amended, all regular employees of the Administration hired before January 1, 2000 and less than 55 years of age at the date of employment became members of the Retirement System, under the Defined Benefit Program, as a condition of their employment. No benefits are payable if the participant receives a refund of their accumulated contributions.

Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 8 - Employees' retirement plan

Defined Benefit Program – (continued)

The Defined Benefit Program provides retirement, death, and disability benefits pursuant to legislation enacted by the Legislature. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after 10 years of plan participation. Disability benefits are available to members for occupational and non-occupational disabilities. However, a member must have at least 10 years of service to receive non-occupational disability benefits.

Members who have attained 55 years of age and have completed at least 25 years of creditable service, or members who have attained 58 years of age and have completed 10 years of creditable service, are entitled to an annual benefit payable monthly for life. The amount of the annuity shall be 1.5% of the average compensation, as defined, multiplied by the number of years of creditable service up to 20 years, plus 2% of the average compensation, as defined, multiplied by the number of years of creditable service in excess of 20 years. The annuity for which the participant is eligible, is limited to a minimum of \$500 per month and a maximum of 75% of the average compensation, as defined.

Participants who have completed 30 years of creditable service are entitled to receive the Merit Annuity. Under the Merit Annuity, participants who have not attained 55 years of age will receive 65% of the average compensation, as defined; otherwise, they will receive 75% of the average compensation, as defined.

Commonwealth's legislation requires employees to contribute 10% of their monthly gross salary to the Defined Benefit Program.

Act No. 1 of February 16, 1990, made certain amendments applicable to new participating employees joining the Retirement System effective April 1, 1990. These changes consist principally of an increase in the retirement date from 55 to 65, a decrease in the benefit percentage of the average compensation in the occupational disability and occupational death benefits annuities from 50% to 40%, and the elimination of the Merit Annuity for participating employees who have completed 30 years of creditable service.

On September 24, 1999, the Legislature enacted Act No. 305 which amended Act No. 447 to establish a new retirement program (System 2000 Program). In addition, on April 4, 2013, the Legislature enacted Act No. 3 which amended the provisions of the different benefit structures under the Retirement System, including the Defined Benefit Program.

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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 8 - Employees' retirement plan – (continued)

System 2000 Program

The Legislature enacted Act No. 305 on September 24, 1999, which amended Act No. 447 to create, among other things, the System 2000 Program, a new benefit structure, similar to a cash balance plan (defined contribution plan). All regular employees hired for the first time on or after January 1, 2000, and former employees who participated in the Defined Benefit Program, received a refund of their contributions, and were rehired on or after January 1, 2000, became members of the System 2000 Program as a condition to their employment. In addition, employees who at December 31, 1999 were participants of the Defined Benefit Program had the option, up to March 31, 2000, to irrevocably transfer their prior contributions to the Defined Benefit Program plus interest thereon to the System 2000 Program.

Commonwealth's legislation requires employees to contribute 10% of their monthly gross salary to the System 2000 Program. Employee contributions are credited to individual accounts established under the System 2000 Program. Participants have three options to invest their contributions to the System 2000 Program. Investment income is credited to the participant's account semiannually.

Under the System 2000 Program, contributions received from participants are pooled and invested by the Retirement System, together with the assets corresponding to the Defined Benefit Program. Future benefit payments under the Defined Benefit Program and the System 2000 Program will be paid from the same pool of assets. As a different benefit structure, the System 2000 Program is not a separate plan and the Commonwealth does not guarantee benefits at retirement age.

Corresponding employers' contributions will be used by the Retirement System to reduce the unfunded status of the Defined Benefit Program.

The System 2000 Program reduced the retirement age from 65 years to 60 years for those employees who joined this plan on or after January 1, 2000.

Upon retirement, the balance in each participant's account will be used to purchase an annuity contract, which will provide for a monthly benefit during the participant's life and 50% of such benefit to the participant's spouse in case of the participant's death. Participants with a balance of \$10,000 or less at retirement will receive a lump-sum payment. In case of death, the balance in each participant's account will be paid in a lump sum to the participant's beneficiaries. Participants have the option of receiving a lump sum or purchasing an annuity contract in case of permanent disability.

Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 8 - Employees' retirement plan – (continued)

Defined Contribution Hybrid Program

On April 4, 2013, the Legislature enacted Act No. 3 which amended Act No. 447, Act No. 1 and Act No. 305 to establish, among other things, a defined contribution program similar to the System 2000 Program (the Defined Contribution Hybrid Program) to be administered by the Retirement System. All regular employees hired for the first time on or after July 1, 2013, and former employees who participated in the Defined Benefit Program and the System 2000 Program, and were rehired on or after July 1, 2013, become members of the Defined Contribution Hybrid Program as a condition to their employment. In addition, employees who at June 30, 2013, were participants of previous plans will become part of the Defined Contribution Hybrid Program. Act No. 3 froze all retirement benefits accrued through June 30, 2013 under the Defined Benefit Program, and thereafter, all future benefits will accrue under the defined contribution formula used for the 2000 System Program participants.

Participants in the Defined Benefit Program who as of June 30, 2013, were entitled to retire and receive some type of pension, may retire on any later date and will receive the annuity corresponding to their retirement program, as well as the annuity accrued under the Defined Contribution Hybrid Program. Participants who as of June 30, 2013, have not reached the age of 58 and completed 10 years of service or have not reached the age of 55 and completed 25 years of service can retire depending on the new age limits defined by the Defined Contribution Hybrid Program and will receive the annuity corresponding to their retirement program, as well as the annuity accrued under the Defined Contribution Hybrid Program.

Participants in the System 2000 Program who as of June 30, 2013, were entitled to retire because they were 60 years of age may retire on any later date and will receive the annuity corresponding to their retirement program, as well as the annuity accrued under the Defined Contribution Hybrid Program. Participants in the System 2000 Program who as of June 30, 2013, have not reached the age of 60 can retire depending on the new age limits defined by the Defined Contribution Hybrid Program and will receive the annuity corresponding to their retirement program, as well as the annuity accrued under the Defined Contribution Hybrid Program.

Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 8 - Employees' retirement plan – (continued)

Defined Contribution Hybrid Program – (continued)

In addition, Act No. 3 amended the provisions of the different benefit structures under the Retirement System, including, but not limited to, the following:

1. Increased the minimum pension for current retirees from \$400 to \$500 per month.
2. The retirement age for the Act No. 447 participants will be gradually increased from age 58 to age 61.
3. The retirement age for the active System 2000 Program participants will be gradually increased from age 60 to age 65.
4. Eliminated the "Merit Annuity" available to participants who joined the Retirement System prior to April 1, 1990.
5. The retirement age for new employees was increased to age 67.
6. The employee contribution rate was increased from 8.275% to 10%.
7. For the System 2000 Program participants, the retirement benefits will no longer be paid as a lump sum distribution, instead, they will be paid through a lifetime annuity.
8. Eliminated or reduced various retirement benefits previously granted by special laws, including Christmas and summer bonuses. The Christmas bonus payable to current retirees was reduced from \$600 to \$200 and was eliminated for future retirees. The summer bonus was eliminated. Resulting employer contribution savings will be contributed to the Retirement System.
9. Disability benefits were eliminated and substituted for a mandatory disability insurance policy.
10. Survivor benefits were modified.

Employee contributions are credited to individual accounts established under the Defined Contribution Hybrid Program. In addition, a mandatory contribution equal to or less than point twenty five percent (0.25%) is required for the purchase of disability insurance.

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 8 - Employees' retirement plan – (continued)

Defined Contribution Hybrid Program – (continued)

Upon retirement, the balance in each participant's account will be used to purchase an annuity contract, which will provide for a monthly benefit during the participant's life. In case of the pensioner's death the designated beneficiaries will continue receiving the monthly benefit until the contributions of the participant are completely consumed. In case of the participants in active service a death benefit will be paid in one lump sum in cash to the participant's beneficiaries. Participants with a balance of less than \$10,000 or less than five years of computed services at retirement will receive a lump-sum payment. In case of permanent disability the participants have the option of receiving a lump sum or purchasing an annuity contract.

For the year ended June 30, 2014, the Administration was required to contribute 12.275% of each participant's gross salary under the different benefit structures. The Retirement System will use these contributions to increase its level of assets and to reduce the actuarial deficit. Beginning on July 1, 2014, and up until June 30, 2016, the employer's contribution rate shall be annually increased by one percent (1%). Beginning July 1, 2016, and up until June 30, 2021, the employer's contribution rate that is in effect on June 30 of every year shall be annually increased on every successive July 1st by one point twenty-five percent (1.25%).

Total employee required contributions for the Defined Contribution Hybrid Program during the year ended June 30, 2014, amounted to approximately \$7,069,673. The Administration required contributions during the years ended June 30, 2014, 2013 and 2012 amounted to approximately \$7,022,405, \$6,896,924, and \$6,218,577, respectively. These amounts represented 100% of the required contribution for the corresponding year. Individual information for each option is not available since the allocation is performed by the Retirement System itself.

Additional information on the Retirement System is provided on its standalone financial statements for the year ended June 30, 2013, a copy of which can be obtained from the Employees' Retirement System of the Commonwealth of Puerto Rico, P.O. Box 42004, San Juan PR 00940-2004.

As of June 30, 2014 and 2013, the total unpaid employee and employer contributions, due to the Retirement System including interest, amounted to \$29,949,655 and \$18,292,801.

For the years ended June 30, 2014 and 2013, total covered payroll for employees was approximately \$62,770,325 and \$61,174,292, respectively. Covered payroll refers to all compensation paid by the Administration to employees covered by the Retirement System on which contributions to the pension are based.

Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 9 - Post-employment benefits - other than pensions

Healthcare benefits

The Administration provides certain health care benefits (for a six-month period after retirement) and a post-employment bonus payment to eligible retired employees, financed on a pay-as-you-go basis. Substantially, all the Administration's employees may become eligible for those benefits if they reach normal retirement age while working for the Administration.

The Administration's annual other postemployment benefit (OPEB) cost (expense) for each plan is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty (30) years. The actuarial cost method used is the projected unit credit method.

The calculation was based on the types of benefits provided under the terms of employees' collective bargain agreements. The calculation involves estimates of the value of reported amounts and assumptions about the probability of events far into the future, and such determined amounts are subject to continual revision as actual results compared to past experience and new estimates are made about the future. The required schedule of funding progress as of June 30, 2014 and 2013, presented as required supplementary information provides multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

During fiscal year 2014 the health care benefits plan valuation determined in accordance with GASB 45 was segregated from the post-employment bonus plan, which valuation was performed in accordance with GASB 27 "Accounting for Pension by State and Local Government Employers". The actuaries allocated the June 30, 2012 benefits obligations between the healthcare benefit and the post-employment bonus based on their weight on the unfunded liability as of July 1, 2013.

Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 9 - Post-employment benefits other than pensions – (continued)

Healthcare benefits

Description	2014	2013
Benefit obligation, beginning of year	\$ 1,571,982	\$ 1,345,480
Benefit obligation related to GASB 27 reclassified	(176,250)	-
Change in benefit obligation:		
Annual required contribution	515,708	504,410
Interest on net OPEB obligation	55,829	-
Adjustment to annual required contribution	(89,344)	(32,308)
Benefits paid	(289,059)	(245,600)
Increase in net OPEB obligation	16,884	226,502
Benefit obligation accrued at end of year reflected in statement of net position	\$ 1,588,866	\$ 1,571,982
Assumptions:		
Discount rate	4.0%	4.0%
Expected long-term rate of return on plan assets	0.00%	0.00%
Health care cost trend rate:		
Initial	5.90%	6.80%
Ultimate	4.60%	4.60%
Retirement age	65 years	65 years

Required supplementary information

Schedule of Funding Progress

(\$ 000s)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Accrued Liability (b)	Unfunded Accrued Liability (UAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAL as a Percentage of Covered Payroll ((b-a)/c)
July 1, 2013	\$ -	\$4,851	\$4,851	0.0%	\$72,326	6.7%
July 1, 2011	\$ -	\$4,676	\$4,676	0.0%	\$70,184	6.7%
July 1, 2009	\$ -	\$3,869	\$3,869	0.0%	\$72,395	5.3%

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 9 - Post-employment benefits other than pensions – (continued)

Required supplementary information – (continued)

Schedule of Employer Contributions

(\$ 000s)

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
June 30, 2014	\$482	60.0%	\$1,589
June 30, 2013	\$472	52.0%	\$1,572
June 30, 2012	\$456	62.7%	\$1,345

Post-employment bonus

The Administration has collective bargain agreements that provide all union employees who work for the Administration upon retirement with a lump-sum bonus payable at the retirement date of \$2,300 up to June 30, 2014. However, as per Law No. 66 of June 17, 2014, the bonus was reduced to \$1,000 for the next three fiscal years, up to June 30, 2017. In addition, the non-union employees will not receive the post-employment bonus after retirement.

The Plan can be amended by action of the Administration subject to applicable collective bargaining and employment agreements. The Plan does not issue a stand-alone financial report since there are no assets legally segregated for the sole purpose of paying benefits under the Plan.

Funding Policy

The obligations of the employer are established by action of the Administration pursuant to applicable collective bargaining and employment agreements. There is no participants' contribution. The Administration currently contributes enough money to the Plan to satisfy current obligations on a pay-as-you-go basis. The costs of administering the Plan are paid by the Administration.

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 9 - Post-employment benefits other than pensions – (continued)

Post employment bonus plan

The Administration's annual pension expense is calculated based on the ARC. The Administration engaged an actuary to calculate the ARC and related information per the provisions of GASB Statement No. 27 "Accounting for Pensions by State and Local Governmental Employers" (GASB 27) for employers with more than one hundred total plan members. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

The following table shows the Administration's annual pension cost for the year ended June 30, 2014 and the amount actually contributed at June 30, 2014:

Description	2014
Benefit obligation, beginning of year	\$ 176,250
Change in benefit obligation:	
Annual required contribution	78,847
Interest on net pension obligation	7,050
Adjustment to annual required contribution	<u>(11,560)</u>
Annual pension cost	74,337
Benefits paid	<u>(5,152)</u>
Increase in net pension obligation	<u>69,185</u>
Benefit obligation accrued at end of year reflected in statement of net position	<u>\$ 245,435</u>

Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 9 - Post-employment benefits other than pensions – (continued)

Post employment bonus plan – (continued)

Schedule of Employer Contributions			
(\$ 000s)			
Fiscal Year Ended	Annual Pension Cost	Percentage of Annual Pension Cost Contributed	Net Pension Obligation
June 30, 2014	\$74	6.9%	\$245

The following assumptions were used to determine the annual required contributions of the benefit obligation as of June 30, 2014:

	2014
Discount rate	4.00%
Mortality table	RP-2000

As of June 30, 2014, the actuarial accrued liability for benefits amount to \$670,934 all of which was unfunded.

The projection of future benefit payments for an ongoing plan involves estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment and mortality. Amounts determined regarding the funded status of the Plan and the ARC of the employer are subject to continuous revisions as actual results are compared with past expectations and new estimates are made about the future.

Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the Substantive Plan (the Plan as understood by the employer and plan members) and include the types of benefits provided at the time of valuation and the historical pattern of benefit costs paid by the employer to date.

Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 9 - Post-employment benefits other than pensions – (continued)

Methods and Assumptions – (continued)

The methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The valuation date was July 1, 2013 and the Projected Unit Credit Cost Method was used. The actuarial assumptions were based on a set of assumptions supplied by the Administration. Turnover rates were based on service and age-related turnover. A discount rate of 4% was used. This rate is the best actuarial estimate of expected long-term experience and is in accordance with guidelines for selection of these rates under GASB 27.

Note 10 - Commitments and contingencies

Commitments

Operating leases and other commitments

The Administration leases certain equipment under various operational lease agreements expiring at various dates through year 2018. In addition, other commitments exist related to contracts for materials and maintenance. Total rental expense under operating leases amounted to approximately \$1,193,000 and \$1,307,000 for the years ended June 30, 2014 and 2013, respectively.

Future minimum rental under the non-cancelable operating leases are as follows:

Year ending June 30,	Amount
2015	\$ 4,402,171
2016	2,586,876
2017	914,438
2018	334,749
	<u>\$ 8,238,234</u>

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 10 - Commitments and contingencies – (continued)

Commitments – (continued)

Government Development Bank Line of Credit

On October 14, 2010, the Legislature of the Commonwealth of Puerto Rico approved a new article 9A to the Law 66 of June 22, 1978, by which it authorized the Administration to incur on obligation up to \$285,000,000, under such terms and conditions approved by the Board of Member Institutions (the Board) of the Administration and the Government Development Bank (GDB), as fiscal agent of the Government of Puerto Rico and its instrumentalities.

These additional funds shall be deposited in a special GDB account and may only be used for the following:

- a. payment of debts to suppliers, agencies, institutions, reserve fund for the self-insurance (professional responsibility and inter-fund debt) of the Administration; and
- b. to provide operational liquidity to ease their fiscal situation, as determined by the agreement with the GDB.

From savings generated as a result of the debt renegotiations with the agencies and institutions will create a fund to cover operating expenses related to maintenance, overhaul and reconditioning of the physical plant. The GDB, in its role as fiscal agent, shall possess the administrative mechanisms as it deems necessary to ensure that these funds will be used solely and exclusively for the purposes set forth in Article 9A to law 66 of June 22, 1978. The special bank account created with this subsection and the funds deposited therein shall not be seized, syndicated, frozen, encumbered or otherwise affected by decisions, judgments, orders or rulings issued by courts of Justice of the Government of Puerto Rico or the agencies or public corporations of the Government of Puerto Rico, during any adjudicative proceeding of administrative or judicial nature, regardless of whether they were initiated by private individuals or public institutions.

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 10 - Commitments and contingencies – (continued)

Commitments – (continued)

Government Development Bank Line of Credit – (continued)

The Administration was required to develop and implement within one hundred eighty (180) days from the approval of this Article 9A, an aggressive collection plan for the recovery of accounts receivable. The Directors shall report periodically to the GDB on the implementation of that plan, and report annually to the Board and GDB the collection proceeds arising from the execution of the plan. GDB was authorized as fiscal agent to undertake any necessary measures in order to, within a reasonable period of time, help the Administration to become and operate as an independent fiscal instrumentality.

However, once the collection plan is working as expected, and providing the Administration the funds resources required, and became a financially independent institution as determined by GDB, the Administration will be required to assume the remaining established obligations.

The Commonwealth of Puerto Rico will honor the payment of the obligations authorized, with legislative appointments made by the Legislative Body of Puerto Rico on the functional budgets of every fiscal year, beginning with the fiscal year 2012-2013 and ending in the fiscal year 2023-2024.

Also, for the fiscal years 2012-2013 and 2013-2014, the Director of the Office of Management and Budget of Puerto Rico, will consign on the functional budgets of the Commonwealth of Puerto Rico submitted annually by the Governor to the Legislative Body of Puerto Rico, the amount corresponding to interests on the obligations incurred and, beginning on the fiscal year 2014-2015, and for the next nine (9) years, the amount of \$31,522,222 plus interests on the obligations incurred. If in any moment the legislative contributions or other income of the Administration weren't enough to cover up the payment of the obligations authorized and the accrued interests, the Secretary of Treasury of Puerto Rico will withdraw from any amounts available in the General Fund of the Commonwealth of Puerto Rico the necessary amounts to repay the principal and interests of the line of credit.

As of June 30, 2014, the amount corresponding to the payment of interests incurred for fiscal year 2014 amounting to \$16,670,985 was not received from OGP and it was recorded as a non-current receivable from the Commonwealth of Puerto Rico in the accompanying statement of net position and a contribution from the Commonwealth of Puerto Rico in the statement of revenues, expenses and changes in net position.

Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 10 - Commitments and contingencies – (continued)

Contingencies

The Administration is a party in certain legal actions and claims related to medical malpractice arising in the ordinary conduct of its business. Although the Administration appears as a defendant in the claims, many of them involve medical personnel of the member institutions, and in effect, these claims are against said institutions. As a result of the deficiency as of June 30, 2014 and 2013, of funds available in the Self-Insurance Fund, any unfavorable outcome may have a significant effect on the financial condition of the Administration.

Based on a review of current facts and circumstances management has provided for what is believed to be a reasonable estimate of the exposure to loss associated to litigation. The Administration has established an accrual reserve for claim losses in the amount of \$2,800,000 and \$3,189,805 at June 30, 2014 and 2013, respectively.

Regulatory issues

The healthcare industry is subject to numerous laws and regulations which include, among other things, matters such as government healthcare participation requirements, various licenses and accreditations, reimbursements for patient services and Medicare and Medicaid fraud and abuse. Government action has increased with respect to investigations and/or allegations concerning possible violations of fraud and abuse and false claims statues and/or regulations by healthcare providers. Providers that are found to have violated these laws and regulations may be subjected to fines or penalties. While management of the Administration believes its policies, procedures and practices comply with governmental regulations, no assurance can be given that the Administration will not be subject to governmental inquires or actions.

Health Insurance Portability and Accountability Act

The Health Insurance Portability and Accountability Act (HIPAA) was enacted in August 1996 to assure health insurance portability, reduce healthcare fraud and abuse, guarantee security and privacy of health information and enforce standards for health information. Organizations are required to be in compliance with HIPAA provisions. Organizations are subject to significant fines and penalties if found not to be compliant with the provisions outlined in the regulations. The Administration's management believes that they are in compliance.

Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 10 - Commitments and contingencies – (continued)

Contingencies – (continued)

Implementation requirements of an Electronic Health Record System

The Health Information Technology for Economic and Clinical Health Act set meaningful use of interoperable Electronic Health Record (EHR) adoption in the health system as a critical national goal and incentivize the EHR adoption. Its goal is not adoption alone but meaningful use of EHRs, that is, their use by providers to achieve significant improvements in care. Meaningful use compliance is required before the Federal Fiscal Year 2016 or otherwise the hospital will incur penalties for non-compliance that may reduce future Medicare payments and potentially Medicare Advantage program payments.

The Centers for Medicare and Medicaid Services (CMS) manages and has implemented an incentive program for those hospitals that implement EHR and that also, comply with certain specific requirements. CMS EHR Incentive Programs provide incentive payments to eligible hospitals as they adopt, implement, upgrade or demonstrate meaningful use, as defined by CMS, of certified EHR technology. As of June 30, 2014, the Administration is under the implementation of its EHR system.

Note 11 - Services to member institutions and medical indigent population

The Administration derives a substantial portion of its revenues from services provided to member institutions. In addition, the Administration provides services to the medical indigent population, which does not have formal means of repayment. Amounts due from member institutions and medical indigent population may be subject to periodic revisions, and/or adjustments based on the availability of funds of the member institutions and/or the Commonwealth of Puerto Rico.

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Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 12 - Contributions from the Commonwealth of Puerto Rico

Governmental contributions during the years ended June 30, 2014 and 2013, consist of the following:

<u>Description</u>	<u>2014</u>	<u>2013</u>
Funds received in connection with Joint Resolution No. 4533 approved by the Commonwealth's Legislature on August 12, 2004, assigned \$40.5 million to the Administration for the construction of new Trauma facilities, the establishment of a Gamma Knife Center, a blood bank, improvement to the emergency room and purchase of equipment.	\$ 114,531	\$ 793,730
Funds received in connection with Joint Resolution No. 116 approved by the Commonwealth's Legislature on July 23, 2007, assigned \$2.9 million to the Administration for the acquisition of medical equipment.	193,941	316,404
Funds received in connection with Law No. 242 approved by the Commonwealth's Legislature on December 13, 2011, assigned \$3.4 million to the Administration for the acquisition of medical equipment.	814,300	1,528,128
Funds received in connection with Joint Resolution No. 17 approved by the Commonwealth's Legislature on June 30, 2013, for operating expenses, payroll and the Trauma facilities.	15,704,000	-

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 12 - Contributions from the Commonwealth of Puerto Rico – (continued)

<u>Description</u>	<u>2014</u>	<u>2013</u>
Funds received in connection with Joint Resolution No. 22 approved by the Commonwealth's Legislature on June 30, 2013, assigned \$3.5 million to the Administration for the acquisition of medical equipment.	1,408,275	-
Funds received in connection with Joint Resolution No. 84 approved by the Commonwealth's Legislature on July 1, 2012, for the payment of payroll and for the completion of the Trauma facilities in Mayagüez.	-	24,710,000
Government appropriation from the General Fund granted on December 30, 2013 and June 24, 2013, respectively, for the payment of payroll.	5,000,000	5,000,000
Funds received in connection with Law 161-2012 approved by the Commonwealth's Legislature on August 8, 2012 for the San Juan Trauma facilities.	6,000,000	4,000,000
Funds receivable in connection with Law 66 approved by the Commonwealth's Legislature on June 22, 1978, for the payment of principal and interest on the GDB line of credit.	16,670,985	11,022,000
Funds received from the Department of Health for operating expenses.	2,126,755	-
Funds received in connection with Joint Resolution of Special Assignment No. 17-2013 approved by the Commonwealth's Legislature on January 31, 2013, for the contribution to the Retirement System.	1,859,665	-

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 12 - Contributions from the Commonwealth of Puerto Rico – (continued)

<u>Description</u>	<u>2014</u>	<u>2013</u>
Funds received for the electronic medical records	506,021	-
Funds received from the Department of Health for the acquisition of medical equipment	125,000	-
Donations	<u>10,328</u>	<u>-</u>
	<u>\$ 50,533,801</u>	<u>\$ 47,370,262</u>

Note 13 - Plans to improve the administration's financial condition

The financial condition of the Administration has been weakened by high operating costs and recurring operating losses, which have affected its ability to pay its suppliers, governmental agencies and other creditors on a regular basis. In addition, the Administration has been affected by the delay in the collection of billings for services rendered to member institutions due to the lack of cash flow among said institutions. As of June 30, 2014 and 2013, the Administration has total deficit of \$302,325,876 and \$269,065,190, respectively. The Administration's operations will depend on the following critical factors to partially subsidize existing and future operating losses:

1. Implementation Law 66 (Fiscal Sustainability) – Effective June 17, 2014, Rule 66 was deployed in the Administration. As a result, operational costs will decrease by \$34 million in the following 3 fiscal years. This includes re-negotiation and new agreements reached with the union organization (UGT-“Union General de Trabajadores).

Puerto Rico Medical Services Administration
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 13 - Plans to improve the administration's financial condition-(continued)

2. Transformation in financial model –ACAA – Effective July 1, 2014, a new financial model was agreed, signed off and implemented by the Administration and ACAA (Administración de Compensaciones por Accidentes de Automóviles). Under this agreement, ACAA corresponded to pay off existing accumulated balance of \$6 million, \$4 million were paid upfront in July 2014, and to date, existing balance of \$2 million should be paid off before March, 2015. In addition, the agreement includes a contracting structure change from a “fee for service” universal platform to a monthly lump sum capitation payment of \$700,000. This is a 40% payment increase compared to contracts in place during previous years. From the management standpoint, the agreement includes ACCA-Administration monthly meetings geared towards the ongoing evaluation of medical costs incurred for ACCA patients, actuarial insights regarding submitted claims, and better operational results regarding the efficiency of the claims management process incurred by both parties.
3. Redefinition of actual Private and Government Insurer Contracts and Rates - Effective January, 2015, the Administration has initiated the following strategies regarding existing insurance contracts:
 - a. *Revision and analysis of contracted versus actual services provided and distributed by Emergency Room, Ancillary, Respiratory, Hospital, and Outpatient medical services* - Non contracted services will be included in existing contracts with corresponding negotiated rates.
 - b. *Re-distribution of contracted bundled services* – Existing bundled services and rates will be revised. Services which prove to be more costly will be re-negotiated and billed separately with corresponding rates.
 - c. *Revision of overall rate structure and billing model* – Rates of existing contracts will be re-negotiated based on the cost of providing medical services, frequency and severity of claims, types of services provided (tertiary and supra-tertiary), and the risk assumed by the Administration which is dictated by its public policy. The financial model will be negotiated based on a monthly lump sum capitation, rather than the universal “fee for service” platform.

Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 13 - Plans to improve the administration's financial condition-(continued)

4. Aggressive collection efforts regarding Private and Government Insurance Receivables- Effective January, 2015, an aggressive collections management plan including Rule 65-2013 has been deployed by the Administration personnel. This plan includes but is not limited to:
 - a. Ongoing account receivable key performance measurements and aging by insurer
 - b. Ongoing account receivable key performance measurements and aging for non-insured patients
 - c. Follow up collections system for segments a. and b.

By December 31, 2015, the Administration is expected to collect \$5 million in accounts over 365.

5. Aggressive collection efforts regarding Administration Consumer Institution Receivables – Effective January, 2015 and aggressive collections management plan has been deployed for this segment of the Administration which represents approximately 58% of its total revenue. This plan includes but is not limited to:
 - a. Request non-government consumer institutions, at the beginning of each fiscal year, to provide the Administration with certified financial statements including a certification of payment for services to be provided.
 - b. Regarding participating institutions, the Director of the OMB (Office of Management and Budget) will be notified of existing debts. According to the Administration's Rule 66, the OMB office can transfer these quantities directly.
 - c. Request the Treasury Secretary to send the Administration payments directly on behalf of government consumer institutions which are in debt.

Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 13 - Plans to improve the administration's financial condition-(continued)

6. Deployment of a new management Platform : "Hacia la Reconceptualización del Centro Médico de Puerto Rico" - focused on the following strategic initiatives:
 - a. Systemic Thinking
 - b. Integrated Management based the identification of core business processes, measurements, corrective and preventive actions
 - c. Continuous Education
 - d. Internal and External Communication

7. Transformation of the Administration's Structure:
 1. Governor Executive Orders OE-2013-050 and 2014- 011 which order requirements to comply with the integration and consolidation of ASEM and the University District Hospital (UDH). This order highlights the following recommendations:
 - a. To obtain more relevant information of all the Medical Center Components, in addition to the information included in the report, to determine necessary changes and to establish the feasibility criteria for a transformation of the Medical Center.

Note 14 - Concentration of credit – patients' accounts receivable

The Administration grants credit without collateral to its patients, most of whom are residents of Puerto Rico and are insured under third-party payor agreements.

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Puerto Rico Medical Services Administration
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Notes to Financial Statements (Continued)

June 30, 2014 and 2013

Note 14 - Concentration of credit – patients’ accounts receivable-(continued)

The mix of receivables from patients and third-party payors at June 30 2014 and 2013, is as follows:

	2014	2013
ACAA	8%	7%
Humana Insurance	7%	6%
Triple S	13%	9%
Self payors	44%	56%
Other Insurances	15%	12%
MCS	6%	5%
Medicare	4%	3%
Correctional Health Sevices	<u>3%</u>	<u>2%</u>
	<u>100%</u>	<u>100%</u>

Note 15- Functional expenses

The Administration provides general health care services. Expenses, related to providing these services for the years ended June 30 2014 and 2013, are as follow:

	2014	2013
Health care services	\$ 166,613,266	\$ 166,451,540
General and administrative and depreciation	<u>21,657,313</u>	<u>21,074,483</u>
	<u>\$ 188,270,579</u>	<u>\$ 187,526,023</u>

Note 16- Subsequent events

The Administration evaluated subsequent events through February 9, 2015 which is the date the financial statements were available to be issued. No events have occurred subsequent to the statement of net position date that would require additional adjustment to, or disclosure in the financial statements.