

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and
Required Supplemental Information

June 30, 2013 and 2012

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of the
Puerto Rico Health Insurance Administration

We have audited the accompanying financial statements of the Puerto Rico Health Insurance Administration (the Administration), a component unit of the Commonwealth of Puerto Rico as of and for the year ended June 30, 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Puerto Rico Health Insurance Administration as of June 30, 2013 and the changes in financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

To the Board of Directors of the
 Puerto Rico Health Insurance Administration
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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, on pages 3 to 10, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other

As disclosed in Note 3, the Administration has a deficit of approximately \$171 million which increased by approximately \$17 million during the year ended June 30, 2013. The continued operations of the Administration dependent about its ability to comply with the management plans described in Note 3. This condition raises substantial doubt about the Administration's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The financial statements of the Administration as of June 30, 2012 were audited by other auditors whose report dated September 28, 2012 expressed an unqualified opinion on those statements.



APV Galindez

September 30, 2013
 San Juan, Puerto Rico

Puerto Rico Health Insurance Administration
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Management's Discussion and Analysis

June 30, 2013 and 2012

This section of the financial statements is classified by the Governmental Accounting Standards Board (GASB) as required supplementary information. It is intended to provide an objective and easily readable analyses of the government's financial activities. Along with the notes to the financial statements, the management's discussion and analysis should provide the user with the most relevant information regarding the financial condition of the Puerto Rico Health Insurance Administration (the Administration) as of June 30, 2013 and 2012.

Overview of the Financial Statements

The annual report includes the management's discussion and analysis report, the independent auditors' report, and the basic financial statements. The financial statements also include notes that explain in more detail the information contained in the financial statements. The discussion will focus on major components of the financial statements. These statements and information represent the actual financial condition of the Administration. Below, you will find a brief explanation of these statements and notes.

Financial Analysis of the Administration as a Whole

The balance sheet and the statement of revenue, expenses, and changes in net deficit present the net assets of and the changes in them. Net deficit—the difference between assets and liabilities is one way to measure financial health or financial position. Increase or a decrease in net deficit is one indicator of whether its financial health is improving or deteriorating. However, one will need to consider other nonfinancial factors such as changes in economic conditions and new or changes in government legislation.

The Balance Sheet presents the Administration's total assets and liabilities at the end of the year. The difference between the two is reported as net assets (deficit), which represents the Administration's net worth, in its total assets, as opposed to the creditor's interest or total liabilities. Any changes in net assets (deficit) are used as a useful indicator as to whether the Administration's financial health is improving or deteriorating.

The Statement of Revenues, Expenses, and Changes in Net Assets shows how the Administration's net assets changed during the fiscal year. The changes in net assets are reported on an accrual basis of accounting, which reports the events as they occur.

~~The Statement of Cash Flows shows how the Administration's cash and cash equivalents increased or decreased during the year. It also shows how cash and cash equivalents were provided by and used in the Administration's operating, non-capital financing, capital and related financing, and investing activities. The net increase or decrease in the Administration's cash and cash equivalents is added to the beginning balance at the beginning of the year to arrive at the cash and cash equivalents balance at the end of the year. This statement is presented on a cash basis and only presents cash receipts and cash disbursements information. The Administration uses the direct method of presenting cash flows, which includes a reconciliation of operating loss (accrual basis) to operating activities (cash basis).~~

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The Notes to the Financial Statement are an integral part of the financial statements, in which information is disclosed that is essential for a full understanding of the Administration's financial health.

Financial Highlights

The current year financial statements reflect that the Administration has incurred in an operating deficit while providing essential services. As result, net deficit has increased by \$17 million from last year. The table below details the changes in assets, liabilities, and net assets.

The condensed net deficit information is presented as follows:

	June 30, 2013	June 30, 2012	Change	
			In dollars	Percentage
Current assets	\$ 310,666,844	\$ 371,855,910	\$ (61,189,066)	(16)%
Capital assets, net	<u>210,651</u>	<u>147,947</u>	<u>62,704</u>	42%
Total assets	<u>310,877,495</u>	<u>372,003,857</u>	<u>(61,126,362)</u>	(16)%
Current liabilities	277,315,162	296,522,280	(19,207,118)	(6)%
Non current liabilities	<u>204,264,978</u>	<u>229,461,539</u>	<u>(25,196,561)</u>	(11)%
Total liabilities	<u>481,580,140</u>	<u>525,983,819</u>	<u>(44,403,679)</u>	(8)%
Net deficit:				
Invested in capital assets, net of related debt	210,651	147,947	62,704	42%
Deficit	<u>(170,913,296)</u>	<u>(154,127,909)</u>	<u>(16,785,387)</u>	11%
Total net deficit	<u>(170,702,645)</u>	<u>(153,979,962)</u>	<u>(16,722,683)</u>	11%
Total liabilities and net deficit	<u>\$ 310,877,495</u>	<u>\$ 372,003,857</u>	<u>\$ (61,126,362)</u>	(16)%

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Net Assets at June 30, 2013 and 2012

As of June 30, 2013 the Administration's total assets are \$311 million representing a net decrease of 16% since the total assets as of June 30, 2012 amounted \$372 million. The decrease is mostly reflected in the current assets section, which is the result of a reduction in cash and cash equivalents available as of June 30, 2013. During 2012, current assets increased by 51% compared to 2011 due to a nonrecurring transaction that increased revenues and cash available from federal funds requests. Due to the 2012 nonrecurring transaction, cash and revenues were higher than 2013. However, if this nonrecurring transaction is not taken into consideration, cash and revenues for 2013 would have been higher than any previous year, mostly due to more efficient and effective procedures implemented during this fiscal year in response to the request of federal funds assigned.

During 2013, the Administration's total liabilities exceeded its total assets by \$171 million, of this amount \$204 million approximately represent noncurrent liabilities, representing a net decrease of eleven percent 11% compared to 2012. Non-current liabilities decreased by \$25 million mostly due to a decrease of \$27 million in long term debt with insurance companies.

Changes in the Administration's net deficit showed \$17 million for 2013 and a reduction of the deficit of \$124 million for 2012. The increase in deficit for 2013 responds to an increase in claims reflected at the end of the fiscal year. Compared to last year, during 2012 revenues were increased by \$320 million mostly due to a special non-recurrent request of federal funds from prior years.

	June 30,	June 30,	Change	
	2012	2011	In dollars	Percentage
Current assets	\$ 371,855,910	246,879,635	\$ 124,976,275	51%
Capital assets, net	147,947	166,934	(18,987)	(11)%
Total assets	<u>372,003,857</u>	<u>247,046,569</u>	<u>124,957,288</u>	51%
Current liabilities	296,522,280	285,655,006	10,867,274	4%
Non current liabilities	229,461,539	239,719,844	(10,258,305)	(4)%
Total liabilities	<u>525,983,819</u>	<u>525,374,850</u>	<u>608,969</u>	0%
Net deficit:				
Invested in capital assets, net of related debt	147,947	166,934	(18,987)	(11)%
Deficit	<u>(154,127,909)</u>	<u>(278,495,215)</u>	<u>124,367,306</u>	(45)%
Total net deficit	<u>(153,979,962)</u>	<u>(278,328,281)</u>	<u>124,348,319</u>	(45)%
Total liabilities and net deficit	<u>\$ 372,003,857</u>	<u>247,046,569</u>	<u>\$ 124,957,288</u>	51%

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June 30, 2013 and 2012

Net Assets at June 30, 2012 and 2011

Total net deficit of \$153.9 million is composed of \$147,947, invested in capital assets, net of related debt; and a net deficit of \$154.1 million. Total deficit decreased from \$278 million to \$154.1 million, a change of approximately \$124 million or 44.68%. This decrease is the result of an increase in operating revenues of \$595.7 million, a decrease in non-operating revenues of \$275.8 million and an increase in operating expenses of \$164.7 million.

Current assets increased from \$246.9 million to \$371.9 million, an increase of \$124.9 million or 50.62% mainly due to an increase in cash and cash equivalents of \$96.9 million as a result of an improvement in handling and drawing federal funds, and a net increase of \$26.2 million in accounts receivable from the federal government, municipalities and others.

Current liabilities increased from \$285.7 million to \$296.5 million or approximately \$10.8 million or 3.8%, mostly as a result of an increase in claims incurred at year end.

Non-current liabilities decreased from \$239.7 million to \$229.5 million or approximately \$10.3 million or 4.28%, due to a decrease in premiums payable for \$21.2 million net of an increase in interests payable and other long term liabilities of \$10.9 million.

The Administration's investment in capital assets as of June 30, 2013 and 2012 amounted to \$210,651 and \$147,947, respectively, net of accumulated depreciation. Capital assets include equipment, furniture, leasehold improvements, and vehicles. During the years ended June 30, 2013, and 2012, the Administration invested \$136,943 and \$83,171 in capital assets, respectively. Depreciation and amortization expense for the years ended June 30, 2013 and 2012 amounted to \$74,239 and \$102,158, respectively.

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The condensed changes in net deficit information are presented below:

	Year Ended June 30,		Change	
	2013	2012	In dollars	Percentage
Operating revenue:				
Contributions from: Department of Health of Puerto Rico, municipalities, employers and rebates	\$ 1,406,189,589	\$ 1,360,124,160	\$ 46,065,429	3%
Non operating revenue:				
Interest income and transfers	949,561,072	946,235,755	3,325,317	0%
 Total revenue	 2,355,750,661	 2,306,359,915	 49,390,746	 2%
Operating expenses:				
Medical insurance premiums	1,072,214,089	1,362,709,939	(290,495,850)	(21)%
Claims incurred and health care costs	1,262,981,997	775,761,309	487,220,688	63%
General and administrative	37,203,019	43,438,190	(6,235,171)	(14)%
Depreciation and amortization	74,239	102,158	(27,919)	(27)%
 Total operating expenses	 2,372,473,344	 2,182,011,596	 190,461,748	 9%
 Decrease (increase) in net deficit	 (16,722,683)	 124,348,319	 (141,071,002)	 (113)%
Net deficit, beginning of year	(153,979,962)	(278,328,281)	124,348,319	(45)%
Net deficit, end of year	\$ (170,702,645)	\$ (153,979,962)	\$ (16,722,683)	11%

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	Year Ended June 30,		Change	
	2012	2011	In dollars	Percentage
Operating revenue:				
Contributions from: Department of Health of Puerto Rico, municipalities, employers and rebates	\$ 1,360,124,160	\$ 764,425,586	\$ 595,698,574	78%
Non operating revenue:				
Interest income and transfers	946,235,755	1,222,040,036	(275,804,281)	(23)%
Total revenue	<u>2,306,359,915</u>	<u>1,986,465,622</u>	<u>319,894,293</u>	16%
Operating expenses:				
Medical insurance premiums	1,362,709,939	1,897,765,202	(535,055,263)	(28)%
Claims incurred and health care costs	775,761,309	96,782,956	678,978,353	702%
General and administrative	43,438,190	22,655,286	20,782,904	92%
Depreciation and amortization	102,158	90,748	11,410	13%
Total operating expenses	<u>2,182,011,596</u>	<u>2,017,294,192</u>	<u>164,717,404</u>	8%
Decrease (increase) in net deficit	124,348,319	(30,828,570)	155,176,889	(503)%
Net deficit, beginning of year	<u>(278,328,281)</u>	<u>(247,499,711)</u>	<u>(30,828,570)</u>	12%
Net deficit, end of year	<u>\$ (153,979,962)</u>	<u>\$ (278,328,281)</u>	<u>\$ 124,348,319</u>	(45)%

Results of Operations for the year ended June 30, 2013 and June 30, 2012

Operating revenues reflect a 3% increase mostly due to an increase in contributions from employers and pharmacy rebates.

Operating expenses increased \$190 million (9%) mainly due to an increase in insured population and the increase in claims received and paid based on the third party administrator (TPA) structure for the previous regions managed by MCS Health Management Options, Inc. (MCS) as explained under the economic factors section included below. This increase accounts for the increase in deficit of \$17 million for the year end.

Results of Operations for the year ended June 30, 2012 and June 30, 2011

The increase in operating revenues is mostly due to an increase in federal grant awards of \$575.4 million mainly due to having access to the Affordable Care Act funds effective July 1, 2011. These funds were not available the previous year. In addition, contributions from Municipalities, Employers and pharmacy rebates increased by \$20.3 million.

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Operating expenses increased \$164.7 million mainly due to an increase in insured population and the increase in claims received and paid.

Non-operating revenues decreased \$275.8 million.

Economic Factors

Debt Administration

On March 14, 2011, the Administration entered into a Credit Agreement with the Government Development Bank for Puerto Rico in order to meet its obligations incurred prior to fiscal year 2009-2010 to insurers. As of June 30, 2013 and 2012, the principal outstanding balance amounted to \$171,080,000 and the accrued interest amounted to \$12,281,253 and \$12,446,175, respectively. The Administration will pay the principal and interest with the appropriations to be received from the Legislature of Puerto Rico. During fiscal year 2013, the Office of Management and Budget paid interest amounting to \$11,160,000 on behalf of the Administration.

On October 18, 2011, the Legislature approved Law Number 205. This Law authorizes the Administration to open a revolving line of credit either with the Government Development Bank or with a commercial bank for the sole purpose of paying health insurance premiums and health services providers. The bank will make credit advances to the Administration which will be used to fund premiums expenses and will be reimbursed with federal funds. The amount of the line of credit will be limited to and guaranteed by the amount of federal funds to be received by the Commonwealth of Puerto Rico from the Federal Government's Medicaid Program as certified by the Administration's Board of Directors and by the Puerto Rico Medicaid Program. The Administration will be obliged to use any federal funds received to pay the line of credit. The Government of Puerto Rico (the Government) will guarantee and will make the necessary appropriations to cover any balance of the line of credit in excess of federal funds received.

According to Law Number 205, the Government Development Bank offered an interim revolving line of credit. Effective March 7, 2012, the Administration signed the Credit Agreement with Banco Bilbao Vizcaya Argentaria (BBVA), today Oriental Bank, Banco Popular de Puerto Rico (BPPR), Firstbank Puerto Rico, and Banco Santander Puerto Rico. This group of Banks, led by BBVA, offered a line of credit of up to \$250 million. With the proceeds from this revolving line of credit, the Administration repaid the interim line of credit. The line of credit is up to the lesser of \$250 million and 85% of undisbursed federal grant awards. The Government of Puerto Rico guarantees this revolving line of credit.

Effective November 29, 2012, this agreement was amended and the commitment was reduced to \$100 million. As of June 30, 2013, the Administration did not have an outstanding balance under this line of credit.

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Direct Contracting Project

Starting on July 1st, 2003 and through June 30, 2013, the Administration has entered into direct contracting projects in different regions. Effective October 1, 2010, in compliance with the Government plan, a new integrated health model named "Mi Salud" was developed.

Effective October 1, 2011, the Administration decided to expand the direct contracting project to cover (in addition to Vieques and Guaynabo) the West, the Metro North, the North, the San Juan, the Northeast and the Virtual Regions. These regions, previously covered by MCS Health Management Options, Inc (MCS) under coverage for premium arrangement, are now managed by Triple-S Salud, Inc. (Triple-S) as a third party administrator (TPA) starting on November 1, 2011.

As of the date of this report Humana, APS and Triple-S were the main contractors of the Administration. However, in July 2013, the Executive Director of the Administration announced the cancellation of Humana's contract effective September 30, 2013. Humana administered three regions, with approximately 515,000 insured, of the "Mi Salud" program. On July 1, 2013, the Administration and Triple-S entered into an agreement pursuant to which Triple-S will administer the provision of healthcare services to insured in the eight regions previously administered by MCS (five regions) and Humana (remaining three regions). Pursuant to the agreement, Triple-S has acted as a third party administrator and has been compensated based on a per member per month (pmpm) administrative fee. In contrast to the agreement with MCS and Humana, the Commonwealth has been financially responsible and bears the risk for the provision of services to insured in the eight regions administered by Triple-S.

Projections for fiscal year 2013-2014

The budget for fiscal year 2013-2014 estimates that revenue will cover all projected costs. The most relevant assumptions are as follows:

- \$885,000,000 of revenues from legislative appropriations
- \$1,103,745,000 of revenues from federal funds
- \$221,000,000 of revenues from municipalities, rebates and employers
- \$9,120,000 of revenues from legislative appropriation to pay operational expenses of the Administration

Contacting the Administration Financial Management

This financial report is designed to provide our customers and creditors with a general overview of the Administration's finances and to demonstrate the Administration's accountability for the money it receives. If you have questions about this report or need additional information, contact The Puerto Rico Health Insurance Administration, P.O. Box 195661 San Juan, Puerto Rico, 00926-2706.

Puerto Rico Health Insurance Administration
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Balance Sheets

June 30, 2013 and 2012

Assets	<u>2013</u>	<u>2012</u>
Current assets:		
Cash and cash equivalents	\$ 69,581,233	\$ 222,739,737
Accounts receivable:		
Puerto Rico Department of Health	68,610,693	115,180,271
Municipalities - net of allowance for doubtful accounts of \$11,239,611 in 2013 and \$49,228,900 in 2012	66,351,540	9,921,384
Pharmacy rebates program	25,867,693	17,023,180
Legislature appropriations and others - net of allowance for doubtful accounts of \$744,765 in 2013 and \$744,814 in 2012	44,609,567	2,203,992
Due from Employers - net of allowance for doubtful accounts of \$25,607,458 in 2013 and \$22,550,060 in 2012	<u>31,356,199</u>	<u>2,909,447</u>
Total accounts receivable	<u>236,795,692</u>	<u>147,238,274</u>
Prepaid expenses	<u>4,289,919</u>	<u>1,877,899</u>
Total current assets	<u>310,666,844</u>	<u>371,855,910</u>
Capital assets - net	<u>210,651</u>	<u>147,947</u>
Total assets	<u>\$ 310,877,495</u>	<u>\$ 372,003,857</u>
Liabilities and Deficit		
Current liabilities:		
Premiums and pharmacy rebates payable	\$ 115,231,042	\$ 69,977,391
Claims payable	150,004,784	213,172,813
Due to other governmental agencies	7,239,104	7,239,104
Accounts payable and accrued expenses	3,964,167	5,343,762
Accrued termination benefits	391,573	245,120
Accrued compensated absences	<u>484,492</u>	<u>544,090</u>
Total current liabilities	<u>277,315,162</u>	<u>296,522,280</u>
Non-current liabilities:		
Line of credit	171,080,000	171,080,000
Interest payable	12,281,253	12,446,175
Premium payable	16,237,334	43,081,936
Accrued termination benefits	4,343,397	2,490,702
Accrued compensated absences	<u>322,994</u>	<u>362,726</u>
Total non-current liabilities	<u>204,264,978</u>	<u>229,461,539</u>
Total liabilities	<u>481,580,140</u>	<u>525,983,819</u>
Net deficit:		
Invested in capital assets, net of related debt	210,651	147,947
Deficit	<u>(170,913,296)</u>	<u>(154,127,909)</u>
Total net deficit	<u>(170,702,645)</u>	<u>(153,979,962)</u>
Total liabilities and net deficit	<u>\$ 310,877,495</u>	<u>\$ 372,003,857</u>

See accompanying notes to financial statements

Puerto Rico Health Insurance Administration
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Statements of Revenue, Expenses and Changes in Net Assets

Years Ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Operating revenue:		
Contributions from:		
Puerto Rico Department of Health	\$ 1,093,733,430	\$ 1,104,658,113
Municipalities	151,135,177	168,328,168
Employers	78,686,527	29,496,205
Pharmacy rebate program - net	<u>82,634,455</u>	<u>57,641,674</u>
Total operating revenue	<u>1,406,189,589</u>	<u>1,360,124,160</u>
Operating expenses:		
Medical insurance premiums	1,072,214,089	1,362,709,939
Claims incurred and other health care costs	1,262,981,997	775,761,309
General and administrative	25,173,465	30,065,142
Interest expense	12,029,554	13,373,048
Depreciation and amortization	<u>74,239</u>	<u>102,158</u>
Total operating expenses	<u>2,372,473,344</u>	<u>2,182,011,596</u>
Loss from operations	<u>(966,283,755)</u>	<u>(821,887,436)</u>
Non-operating revenue:		
Transfers from the Commonwealth of Puerto Rico	887,724,800	945,033,000
Interest income and other	<u>61,836,272</u>	<u>1,202,755</u>
Total non-operating revenue	<u>949,561,072</u>	<u>946,235,755</u>
Decrease (increase) in net deficit	(16,722,683)	124,348,319
Net deficit at beginning of year	<u>(153,979,962)</u>	<u>(278,328,281)</u>
Net deficit at end of year	<u>\$ (170,702,645)</u>	<u>\$ (153,979,962)</u>

See accompanying notes to financial statements

Puerto Rico Health Insurance Administration
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Statements of Cash Flows

Years Ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Cash flows from operating activities:		
Cash receipts from contributions	\$ 1,283,048,480	\$ 1,271,464,023
Cash receipts from pharmacy rebate program	73,789,942	62,461,480
Cash payments of premiums	(1,052,622,800)	(1,554,201,506)
Cash payments to employees	(2,207,993)	(3,747,461)
Cash payments to vendors for goods and services	(38,233,985)	(27,108,552)
Cash payments to health care organizations and third party administrators	<u>(1,326,150,026)</u>	<u>(598,042,291)</u>
Net cash used in operating activities	<u>(1,062,376,382)</u>	<u>(849,174,307)</u>
Cash flows from non-capital and related financing activities:		
Transfers from the Commonwealth of Puerto Rico	887,724,800	945,033,000
Collections of other income	<u>21,232,819</u>	<u>995,876</u>
Net cash provided by non-capital and related financing activities	<u>908,957,619</u>	<u>946,028,876</u>
Purchase of capital assets and net cash used in capital and related financing activities	<u>(136,943)</u>	<u>(83,171)</u>
Interest collected and net cash provided by investing activities	<u>397,202</u>	<u>206,879</u>
Net (decrease) increase in cash and cash equivalents	(153,158,504)	96,978,277
Cash and cash equivalents, at beginning of year	<u>222,739,737</u>	<u>125,761,460</u>
Cash and cash equivalents, at end of year	<u>\$ 69,581,233</u>	<u>\$ 222,739,737</u>

(Continue)

Puerto Rico Health Insurance Administration
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Statements of Cash Flows (Continued)

Years Ended June 30, 2013 and 2012

	2013	2012
Reconciliation of operating loss to net cash used in operating activities:		
Loss from operations	\$ (966,283,755)	\$ (821,887,436)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	74,239	102,158
Bad debt expense	5,274,310	16,011,511
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Accounts receivable:		
Puerto Rico Department of Health	46,569,578	(59,367,667)
Municipalities	(18,440,867)	4,394,740
Pharmacy rebate	(8,844,513)	4,819,806
Legislature appropriations and others	(42,405,525)	337,432
Due from Employers	(31,504,150)	7,605,521
Prepaid expenses	(2,412,020)	(1,799,341)
Increase (decrease) in:		
Premiums and pharmacy rebates payable	(3,915,419)	(191,491,567)
Claims payable	(63,168,029)	177,719,018
Accounts payable and accrued expenses	20,944,873	3,287,999
Interest payable	(164,922)	10,380,840
Accrued termination benefits	1,999,148	568,590
Accrued compensated absences	(99,330)	144,089
Net cash used in operating activities	\$ (1,062,376,382)	\$ (849,174,307)

See accompanying notes to financial statements

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Statements of Assets and Liabilities – Agency Fund

June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Assets		
Cash	<u>\$ 1,321,142</u>	<u>\$ 1,321,142</u>
Total assets	<u>\$ 1,321,142</u>	<u>\$ 1,321,142</u>
Liabilities		
Accounts payable	<u>\$ 1,321,142</u>	<u>\$ 1,321,142</u>
Total liabilities	<u>\$ 1,321,142</u>	<u>\$ 1,321,142</u>

See accompanying notes to financial statements

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013 and 2012

Note 1 - Reporting entity

The Puerto Rico Health Insurance Administration (the Administration) is a governmental entity and a component unit of the Commonwealth of Puerto Rico (the Commonwealth), created by Act No. 72 (the Act), as amended, of the Legislature of the Commonwealth on September 7, 1993. The Administration commenced operations on February 1, 1994 and is considered a public corporation with full autonomy.

The Administration is responsible for implementing, administering and negotiating a health insurance system, through contracts with health insurers, mental health organizations, pharmacy benefit managers, third party administrators, Medicare advantage organizations, among others. The purpose is to eventually give all Puerto Rico residents access to quality medical and hospital care, regardless of their financial condition and capacity to pay.

The Administration is the Sub-Grantee of federal funds provided by, the Medicaid Program under Title XIX of the Social Security Act and Title XXI of the State Children's Health Insurance Program (CHIP). The Single State Medicaid Agency is the Puerto Rico Department of Health (the Department). Within the Department, the Medicaid Program administers the eligibility program of federal and Commonwealth beneficiaries and is responsible for administering or supervising the administration of, and is the primary grantee of federal funds while delegating the administration of the Commonwealth's managed health care structure to the Administration pursuant to a Memorandum of Understanding.

A regionalization system was implemented to establish a network of participating providers throughout the Island and ensure the closest possible service to beneficiaries. The Administration pays a monthly premium to such insurance underwriters based on a contracted premium and the number of members subscribed in the health plan. Funds to pay for such premiums are requested from the Commonwealth net of funds available for such purposes from all other sources. The Administration is exempt from taxation on taxes imposed by the Commonwealth of Puerto Rico.

Under the provisions of Act 105 of July 19, 2002, which amends Act No. 72 of 1993, the Administration was authorized to negotiate directly with health providers under a pilot program. The Administration has, since then, entered into different direct contracts to cover the insured population of different regions and municipalities. Since November 1, 2006 through September 1, 2010, the Administration directly contracted providers that served approximately 190,000 lives from the metro-north region. Since June 30, 2011, the Administration has direct contracting projects with the Municipalities of Vieques and Guaynabo.

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 1 - Reporting entity – (continued)

Effective October 1, 2010, in compliance with the Government plan, a new integrated health care model named MI SALUD was developed with the following changes:

1. Set up a standard premium per region as established by the Administration.
2. Eliminate the referrals when the beneficiary needs the service of a specialist.
3. Better access to prescribed medicines without the authorization of the primary health care provider.
4. Extended hours for health care providers of basic services.
5. Tele-emergency services available 24 hours.
6. Integration of the physical and mental health care in one place.
7. The risk of the primary health provider in relation to medicines, emergency and preventive health care test was decreased and was transferred to the health care insurance companies.
8. Increase the coverage to include the middle class working force.
9. Set up a ceiling in relation to administrative expenses and gains of the health care insurance companies.

Effective October 1, 2011, the Administration decided to expand the direct contracting project to cover, in addition to Vieques and Guaynabo, the West, the Metro North, the North, the San Juan, the Northeast and the Virtual Regions. These regions, previously covered by MCS Health Management Options, Inc. (MCS) under coverage for premium arrangement are now managed by Triple-S Salud, Inc. (Triple-S) as third party administrator (TPA) which started on November 1, 2011. Under this arrangement, Triple-S receives a per member per month (pmpm) for performing administrative services and the Administration bears the risk for the provision of services to beneficiaries. In addition, the Administration implemented certain cost containment strategies to control costs. Among these strategies are establishing a co-payment that applies for the unjustified use of emergency rooms, detection and control of prescription drug overuse, implementation of disease management program for respiratory conditions, modification in provider fees and better coordination of benefits for the population having other medical insurance.

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 2 - Basis of presentation and summary of significant accounting policies

Basis of accounting

The financial statements are presented on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. Under this method, revenues are recognized when earned, regardless of when received, and expenses when incurred, regardless of when paid.

Basis of presentation

The financial statements are presented as an enterprise fund and conform to the provisions of Governmental Accounting Standards Board Statement No. 34 (GASB No. 34), Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments. GASB No. 34, as amended, establishes standards for external financial reporting for all state and local governmental entities, which includes a statement of net assets, a statement of revenues, expenses and changes in net assets and a statement of cash flows.

The Administration applied the provisions of Governmental Accounting Standards Board Statement No. 20 (GASB No. 20), Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting. In applying GASB No. 20, the Administration applied all Statements and Interpretations of the Financial Accounting Standards Board (ASC), Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued before and after November 30, 1989, unless these pronouncements conflict with, or contradict, GASB pronouncements.

Cash and cash equivalents

The Administration considers all highly liquid investments with maturities of three months or less to be cash equivalents.

Allowance for doubtful accounts

The allowance for doubtful accounts is an amount that management believes will be adequate to absorb possible losses on existing accounts receivable that may become uncollectible based on evaluations of collectability of accounts receivable and prior credit loss experience. Because of uncertainties inherent in the estimation process, management’s estimate of credit losses inherent in the existing accounts receivable and related allowance may change in the future.

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 2 - Basis of presentation and summary of significant accounting policies – (continued)

Transfers from the Commonwealth of Puerto Rico

Transfers from the Commonwealth represent legislative appropriations for the payment of administrative expenses and premiums.

Contributions from the Puerto Rico Department of Health

Contributions received from Puerto Rico Department of Health represent payments to the Administration by the Medicaid Program which consist of a determined monthly amount of the funds allocated to Puerto Rico under Title XIX of the Social Security Act and State Plan. In order to comply with the match of received federal funds, the Administration is assigned funds from the Commonwealth. The Medicaid Program is the recipient of CHIPS and Prescription Drugs funds which are in whole transfers to the Administration of health care services for the eligible population of these funds.

Contributions from municipalities

Contributions from Municipalities represent the budgetary appropriations of the municipal governments for direct health services in areas covered by health insurance plans. The charges made by the Administration are based on established percentages applied to the corresponding Municipalities' operational budget for the lesser of current fiscal year or fiscal year 2004-2005 as set forth in Act No. 72 of September 7, 1993, as amended. These contributions are withheld by the Municipal Revenue Collection Center from money assigned to the municipalities and remitted to the Administration on a monthly basis.

Fund accounting

The Commonwealth reports its financial position and results of operations in funds, which are considered separate accounting entities and discrete presentations of those component units which are not required to be blended. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions. The new model as defined in GASB No. 34 establishes criteria for the determination of major funds. The Administration reports the following major funds:

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 2 - Basis of presentation and summary of significant accounting policies – (continued)

Proprietary fund

This fund accounts for those activities for which the intent of management is to recover, primarily through premiums, the cost of providing health insurance services to the general public.

Agency fund

Agency funds are custodial in nature (assets equal liabilities) and do not involve measurement of the results of operations.

Use of estimates

The process of preparing financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenses. Such estimates primarily related to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from those estimates.

Revenue recognition

The Administration distinguishes operating revenue from non-operating revenue. Revenue associated with the Puerto Rico Department of Health, Municipalities, Employers and Pharmacy Rebate Programs are recorded as operating revenue. Revenue associated with transfers from the Commonwealth of Puerto Rico and interests are recorded as non-operating revenue.

Capital assets

Capital assets are stated at cost. Donated property is reported at estimated fair value at the date received. When assets are retired or otherwise disposed of, the cost and accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recorded in the operations for the period.

Expenditures for repairs and maintenance that do not extend the useful lives of the assets are charged to operations in the year incurred.

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 2 - Basis of presentation and summary of significant accounting policies – (continued)

Depreciation and amortization

Depreciation is provided over the estimated useful life of each class of depreciable asset which range from four to ten years and is computed using the straight-line method.

Compensated absences

The employees of the Administration are granted thirty (30) days of vacation and eighteen (18) days of sick leave annually. Vacation time accumulated is fully vested to the employees from the first day of work. In the event of resignation, an employee is reimbursed for accumulated vacation days up to the maximum allowed. Separation of employment prior to the use of all or part of the sick leave terminates all rights for compensation except that, in the event of retirement, an employee is reimbursed for accumulated sick leave days up to the maximum allowed of ninety (90) days.

According to the Administration's personnel protocol, the employee has the right to accumulate the excess of sixty (60) days in vacation and ninety (90) days in sick leave until December 31 of each year. The excess should be paid to the employee before March 31 of the following year.

Compensated absences are accrued when incurred using the pay or salary rates in effect at the date of the balance sheet.

Risk management

The Administration is exposed to various risks of loss from torts, theft of, damage to, and destruction of assets, errors and omissions, employee injuries and illnesses, natural disasters, and other losses. Commercial insurance coverage is obtained for claims arising from such matters.

The commercial insurance coverage is negotiated by the Department of Treasury of the Commonwealth of Puerto Rico and the cost is billed to the Administration.

Statement of cash flows

The accompanying statements of cash flows are presented in accordance with the provisions of Governmental Accounting Standards Board Statement No. 9, Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities that Use Proprietary Fund Accounting.

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 2 - Basis of presentation and summary of significant accounting policies – (continued)

Pharmacy rebate program

The Administration established a governmental pharmacy rebate program which consists of agreements negotiated for the purpose of obtaining pharmaceutical rebates and discounts with respect to the utilization of prescription branded drugs dispensed to beneficiaries. The Administration contracted a private corporation for the implementation and pharmacy program administration. The Administration retains 100% of the income derived from this program based on a Puerto Rico Department of Justice Ruling.

Accounting for pension costs

The Administration accounted for pension costs in accordance with the provisions of Governmental Accounting Standards Board Statement (GASB) No. 27, Accounting for Pensions by States and Local Government Employers.

The GASB No. 27 establishes standards of accounting and financial reporting for pension liabilities, pension assets, note disclosures, and required supplementary information in the financial reports of state and local governmental employers. The statement defines that the pension expense is equal to the statutory required contribution to the employees' retirement system. A pension liability or asset is reported equal to the cumulative difference between statutory required and actual contributions.

Claims liabilities

Claims liabilities represent the estimated amount of claims incurred but unpaid to providers based on experience and accumulated statistical data under Mi Salud Program. The estimates of medical claims incurred but not reported and other medical expense payments are developed by an independent actuary using assumptions based upon payment patterns for medical, pharmacy and dental claims, inflation of medical costs, historical developments and other relevant factors.

The above liabilities are necessarily based on estimates and while management believes that the amounts are adequate, the ultimate liability may be in excess of or less than the amounts provided. The methods for making such estimates and for establishing the resulting liability are continually reviewed, and any adjustments are reflected in the statement of revenues and expenses for the current year.

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 2 - Basis of presentation and summary of significant accounting policies – (continued)

Medical cost recognition

Medical costs include claim payments, capitation payments, and other costs incurred to provide health care to beneficiaries as well as estimates of future payments for health care provided prior to the date of the statement of net assets. Capitation payments represent monthly prepaid fees disbursed to participating primary care physicians and other providers who are responsible for providing health care to beneficiaries. Risks related to catastrophic or high-risk conditions are assumed by the Administration.

Reclassifications

Certain prior years amounts have been reclassified to conform to the current year presentation.

Subsequent events

The Administration has evaluated the impact of subsequent events through September 30, 2013, which is the date these financial statements were issued. There are no significant subsequent events to report except as disclosed in Note 14.

Note 3 - Management plans

As reflected in the accompanying basic financial statements, the Administration has a deficit of approximately \$171 million which increased by approximately \$17 million during the fiscal year ended June 30, 2013.

The revised budget for fiscal year 2013-2014 projects that revenues will cover all projected costs. The most relevant assumptions are as follows:

- \$885,000,000 of revenues from legislative appropriations
- \$1,103,745,000 of revenues from federal funds
- \$221,000,000 of revenues from municipalities, rebates and employers
- \$9,120,000 of revenues from legislative appropriations to pay operational expenses of the Administration

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 3 - Management plans – (continued)

On March 14, 2011 the Administration requested an \$186,000,000 non-revolving line of credit from the Government Development Bank of Puerto Rico (GDB). On that same date, a Fiscal Oversight Agreement (FOA) was subscribed between the Administration and the GDB in order to provide assistance and monitoring of the Administration's finances. The FOA authorizes the GDB to assist the Administration to adopt a fiscal stabilization plan and to take measures it deems necessary to ensure the Administration's financial self-sufficiency.

The Fiscal Stabilization Plan for fiscal year 2013-2014 includes the following measures:

- Maximization of discounts or rebates with respect to prescription drugs dispensed to beneficiaries.
- Implementation of a monitoring program with all insurance companies through audits and imposition of penalties and fines for noncompliance.
- Maximization of process of petitions of federal funds through more efficient segregation of Commonwealth and Federal beneficiaries.
- Improvement and implementation of an effective accounts receivables collections process.

Note 4 - Custodial credit risk - deposits

Custodial credit risk is the risk that, in an event of a bank failure, the Administration deposits might not be recovered. The Commonwealth requires that public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance coverage. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. Deposits at the Government Development Bank for Puerto Rico and the Economic Development Bank of Puerto Rico are uninsured and uncollateralized, as these entities, which are component units of the Commonwealth, are exempt from compliance with the collateralization requirement.

For the year ended June 30, 2013 and 2012, the custodial risk of the administration amounted to \$75 million and \$234 million, respectively, which is the bank balance of cash and cash equivalents deposited at the Government Development Bank for Puerto Rico. These deposits are exempt from the collateral requirement established by the Commonwealth.

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 5 - Accounts receivable

Accounts receivable and the allowance for doubtful accounts as of June 30, 2013 and 2012 consist of the following:

	2013	2012
Puerto Rico Department of Health	\$ 68,610,693	\$ 115,180,271
Municipalities	77,591,151	59,150,284
Pharmacy rebate program	25,867,693	17,023,180
Legislature appropriations and others	45,354,332	2,948,806
Due from Employers	56,963,657	25,459,507
	274,387,526	219,762,048
Allowance for doubtful accounts	(37,591,834)	(72,523,774)
Account receivable, net	\$ 236,795,692	\$ 147,238,274

Allowance for doubtful accounts is divided in three sections. The first section is related to governmental agencies for employer contributions for the medical health plan amounting to approximately \$25 million and \$23 million for 2013 and 2012, respectively. The second section of the reserve is related to municipalities amounting to approximately \$11 million and \$49 million for 2013 and 2012, respectively. The third one represents mainly uncollected premiums amounting to \$745 thousand for 2013 and 2012.

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Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 6 - Capital assets

The activities of the capital assets accounts of the Administration for the fiscal years ended June 30, 2013 and 2012 was as follows:

	June 30, 2013			
	Beginning Balance	Additions	Retirements	Ending Balance
Equipment, computer and software	\$ 1,271,369	\$ 136,943	\$ (20,973)	\$ 1,387,339
Vehicles	78,459	-	-	78,459
Leasehold improvements	121,545	-	-	121,545
Furniture and others	294,031	-	(961)	293,070
	1,765,404	136,943	(21,934)	1,880,413
Accumulated depreciation	(1,617,457)	(74,239)	21,934	(1,669,762)
Capital assets, net	\$ 147,947	\$ 62,704	\$ -	\$ 210,651
	June 30, 2012			
	Beginning Balance	Additions	Retirements	Ending Balance
Equipment, computer and software	\$ 1,200,191	\$ 71,178	\$ -	\$ 1,271,369
Vehicles	78,459	-	-	78,459
Leasehold improvements	121,545	-	-	121,545
Furniture and others	282,038	11,993	-	294,031
	1,682,233	83,171	-	1,765,404
Accumulated depreciation	(1,515,299)	(102,158)	-	(1,617,457)
Capital assets, net	\$ 166,934	\$ (18,987)	\$ -	\$ 147,947

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 7 - Line of credit with government development bank

On March 14, 2011, the Administration entered into a Credit Agreement with the Government Development Bank for Puerto Rico in order to pay its obligations to insurers incurred prior to fiscal year 2009-2010. The aggregate principal amount of the non-revolving line of credit is \$186,000,000 and will be payable in nine payments of \$20,666,667 each due on March 14 of the years 2015 through 2023. Interests are accrued at a fluctuating annual rate of interest equal to the greater of (i) 1.5% over prime rate, and (ii) 6%. As of June 30, 2013 and 2012, the outstanding principal balance amounted to \$171,080,000 each year and the accrued interest amounted to \$12,281,253 and \$12,446,175, respectively. The Administration will pay the principal and interest with the appropriations to be received from the Legislature of Puerto Rico pursuant to Act No. 173.

During fiscal year 2013, the Office of Management and Budget (OMB) paid interest amounting to \$11,160,000 on behalf of the Administration. No payments were made by OMB during fiscal year 2012.

Note 8 - Revolving line of credit with commercial banks

On October 18, 2011, the Legislature approved Act No. 205. This Law authorized the Administration to open a revolving line of credit either with the Government Development Bank or with a commercial bank for the sole purpose of paying health insurance premiums and health services providers.

As provided by Act No.205, the Government Development Bank offered an interim revolving line of credit through March 7, 2012 exclusively for payment of health care services by insurance companies and health care providers of Mi Salud Program. Effective March 7, 2012, the Administration signed the Credit Agreement with Banco Bilbao Vizcaya Argentaria (BBVA), today Oriental Bank, Banco Popular de Puerto Rico (BPPR), Firstbank Puerto Rico, Banco Santander Puerto Rico and Oriental Bank and Trust. This group of Banks, led by BBVA, offered a line of credit of up to \$250 million. With the proceeds from this revolving line of credit, the Administration repaid the interim line of credit. The line of credit cannot exceed the lesser of \$250 million and 85% of the remaining amount of federal funds available for future disbursement under Available Medicaid Grants. The Government of Puerto Rico guarantees this revolving line of credit. The revolving line of credit bears interest on the unpaid principal amount at an interest rate per annum of (i) the higher of, LIBOR as in effect from time to time or an interest rate equal to fifty basis points (0.50%), plus (ii) 250 basis points per annum (2.50%).

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 8 - Revolving line of credit with commercial banks – (continued)

Effective November 29, 2012, this agreement was amended whereas the total commitment of the lenders was decreased and reduced to the aggregate sum of \$100 million and each lender's commitment was modified to 25% or \$25 million equally among Oriental Bank (as successor in merger to BBVA), Banco Popular de Puerto Rico, Firstbank Puerto Rico and Banco Santander Puerto Rico.

As of June 30, 2013 and 2012, the Administration did not have an outstanding balance under this line of credit.

This revolving line of credit has a final availability date of October 31, 2013 and a termination date of November 30, 2013. It is management's intention to renew this revolving line of credit.

Note 9 - Premium payable

During the fiscal year 2013, the Administration signed loan agreements with three insurance companies renegotiating payment terms of recorded liabilities up to September 2010. Maturities of premium payable at June 30, 2013 are as follows:

Year Ending June 30,	Amount
2015	\$ 7,763,354
2016	8,473,981
	\$ 16,237,335

Note 10 - Liability for incurred but unpaid claims

The claims liability for incurred but unpaid claims is based on historical claims experience data, assumptions, and projections as to future events, including claims frequency, persistency and inflationary trends determined by an independent actuarial study. The assumptions used in estimating and establishing the liability is reviewed annually based on current circumstances and trends. The actuarial study considered the experience of the Administration from the date Triple S began administering Mi Salud Program, November 2011 through June 2013 including the amount paid in July 2013 for claims incurred in the period of November 1, 2011 to June 30, 2013 and amounts incurred but not reported as of June 30, 2013. Any resulting adjustments are considered to be a change in an accounting estimate and accounted for as an increase (decrease) to current period expenses.

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 10 - Liability for incurred but unpaid claims – (continued)

The Administration has established a liability for both, reported and unreported claims, which includes estimates of future payments of claims and claims adjustment expenses. The liability for incurred but unpaid claims expenses as of June 30, 2013 for Mi Salud Program consists of:

Incurred but not reported (IBNR)	
Medical & Dental Claims	\$ 80,525,000
Pharmacy	4,972,000
Claims paid by July 2013 incurred June 2013 and Prior	
Medical & Dental Claims	55,169,000
Pharmacy	<u>3,862,000</u>
 Total	 <u>\$ 144,528,000</u>

The claims liabilities balance as of June 30, 2013 is \$150,004,784. The difference of \$5,422,784 between total balance and Mi Salud Program IBNR corresponds to unreported claims corresponding to phase-out third party administrative programs.

As of June 30, 2012, historical claims experience data only comprised an eight month period for which the method to estimate the liability for incurred but unpaid claims was based on variable assumptions and therefore, not comparable with current year.

Note 11 - Retirement system

Defined benefit pension plan

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. All regular employees of the Administration hired before January 1, 2000 and less than fifty five (55) years of age at the date of employment became members of the Retirement System as a condition to their employment. No benefits are payable if the participant receives a refund of his/her accumulated contributions.

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 11 - Retirement system – (continued)

The Retirement System provides retirement, death and disability benefits pursuant to legislation enacted by the Commonwealth's legislature. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after ten (10) years of plan participation. Disability benefits are available to members for occupational and non-occupational disability benefits.

Members who have attained at least fifty five (55) years of age and have completed at least twenty five (25) years of creditable service or members who have attained fifty eight (58) years of age and have completed at least ten (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 twenty (20) years, plus 2% of the average compensation, as defined, multiplied by the number of years of creditable service in excess of twenty (20) years. In no case will the annuity be less than \$400 per month.

Participants who have completed at least thirty (30) years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty five (55) years of age will receive 65% of the average compensation, as defined; otherwise they will receive 75% of the average compensation.

Commonwealth legislation requires employees hired on or before March 31, 1990 to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$550 of monthly gross salary. Employees hired on or after April 1, 1990 are required to contribute 8.275% of their monthly salary. The Administration is required by the same statute to contribute 11.525% of the participants' gross-salary.

Defined Contribution Plan

The Legislature of the Commonwealth enacted Act No. 305 on September 24, 1999, which amends Act No. 447, to establish, among others, a defined contribution savings plan program (the Program) to be administered by the Retirement System. All regular employees hired for the first time on or after January 1, 2000 and former employees who participated in the defined benefit pension plan, received a refund of their contribution and are rehired on or after January 1, 2000, become members of the Program as a condition to their employment. In addition, employees who at December 31, 1999 were participants of the defined benefit pension plan, had the option, up to March 31, 2000, to irrevocably transfer their prior contributions to the defined benefit pension plan plus interest thereon to the Program.

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 11 - Retirement system – (continued)

Act No. 305 requires employees to contribute 8.275% of their monthly gross salary to the Program. Employees may elect to increase their contribution up to 10% of their monthly gross salary. Employee contributions are credited to his/her individual account established under the Program. Participants have three options to invest their contributions to the Program. Investment income is credited to the participant account semi-annually.

The Administration is required by Act No. 305 to contribute 10.275% of the participant's gross salary. The Retirement System will use these contributions to increase its asset level and reduce the unfunded status of the defined benefit pension plan.

Upon retirement, the balance in the participant's account will be used to purchase an annuity contract, which will provide for monthly benefit during the participant's life and 50% of such monthly 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 the participant's account will be paid in a lump sum to his/her beneficiaries. Participants have the option of a lump sum or purchasing an annuity contract in case of permanent disability.

Total employee contributions to the above mentioned plans during the year ended June 30, 2013 and 2012 amounted to approximately \$332,000 and \$281,000, respectively.

Furthermore, on April 4, 2013 the Governor of Puerto Rico signed into law Act No. 3 of 2013 which represents a comprehensive reform of the Employee Retirement System (ERS). Act No. 3 became effective on July 1, 2013 and amends the provisions of the different structures under the ERS, including, but not limited, the following:

- For active participants of the contributory defined benefits program under Act No. 447 of 1951 and Act No. 1 of 1990, all retirement benefits accrued through June 30, 2013 will be frozen, and thereafter, all future benefits will accrue under the defined contribution formula used for System 2000 participants, and will be paid at retirement through a lifetime annuity.
- Increases the minimum pension for current retirees from \$400 to \$500 per month.
- The retirement age for Act No. 447 participants will be gradually increased from age 58 to age 61.
- The retirement age for current System 2000 participants is increased gradually from age 60 to age 65.
- Eliminates the "merit annuity" available to participants who joined the ERS prior to April, 1, 1990.

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 11 - Retirement System – (continued)

- The retirement age for new employees is increased to age 67, except for new state and municipal police officers, firefighters, and custody officers, which will be age 58.
- The employee contribution rate will increase from 8.275% to 10%.
- For System 2000 participants, the retirement benefits will no longer be paid as a lump sum distribution, instead, they will be paid through a lifetime annuity.
- Eliminates or reduces various retirement benefits previously granted by special laws, including Christmas and summer bonuses. The Christmas bonus payable to current retirees is reduced from \$600 to \$200 and is eliminated for future retirees. The summer bonus will be eliminated.
- Disability benefits will be eliminated and substituted for a mandatory disability insurance policy.
- Survivor benefits will be modified.

Additional information on the Retirement System is provided in its financial statements, a copy of which can be obtained from the Retirement System Administration, P.O. Box 42003, San Juan, Puerto Rico, 00949.

Note 12 - Early termination benefits

On July 2, 2010, the Commonwealth enacted Act No. 70 to establish a program that provides benefits for early retirement or economic incentives for voluntary employment termination to eligible employees, as defined, including employees of the Administration. Act No. 70 established that early retirement benefits will be provided to eligible employees that have completed between 15 to 29 years of creditable services and will consist of biweekly benefits ranging from 37.5% to 50% of each employee's salary, as defined. In this early retirement benefit program, the Administration will pay the employer contributions to the Retirement System and the corresponding pension until the employee complies with the age requirements and 30 years of creditable services applicable to the Retirement System. Economic incentives are available to eligible employees that qualify for retirement benefits. Economic incentives consist of a payment ranging from one to six months of salary. Additionally, eligible employees that choose to participate in this program, other than those qualifying for retirement benefits, are eligible to receive health plan coverage for up to 12 months in a health plan selected by management of the Commonwealth of Puerto Rico.

At June 30, 2013 and 2012, unpaid long-term benefits granted on this program were discounted 3%. Total accrued terminations benefits as of June 30, 2013 and 2012 amounted to \$4,734,970 and \$2,735,822, respectively.

Puerto Rico Health Insurance Administration
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Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 13 - Commitments and contingencies

Commitments

The Administration conducts its operations in a leased facility under a long-term operating lease agreement expiring on June 30, 2013. Rent expense for the years ended June 30, 2013 and 2012 amounted to \$255,408 and \$205,038, respectively. On July 1, 2013 the lease agreement was renewed until September 4, 2013 and subsequently extended an additional sixty days until November 4, 2013.

Contingencies

The Administration is defendant and/or co-defendant in legal proceedings pertaining to matters incidental to the performance of its operations. With respect to the pending and threatened litigations, the Administration, in consultation with legal counsel, has advised that at this stage of the proceedings they cannot offer an opinion as to the probable outcome. Accordingly, management does not consider necessary making any provision in its books for these cases and intends to contest them vigorously.

The Administration has been requested to repay the Puerto Rico Treasury Department approximately \$103 million representing additional transfers of money from the central government during the fiscal years 2001-2003. After consultation with external legal counsel, the Administration is of the opinion that the money does not have to be repaid and believes that the likelihood of an unfavorable outcome is remote. Therefore, no reserve has been recorded in the Administration financial statements.

Federal grants

The Administration receives as a sub-grantee financial assistance from the federal government corresponding to Medicaid Program passed through the Puerto Rico Department of Health, the grantee. Federal grants are subject to financial and compliance audits by grantor agencies in order to determine the Administration's compliance with the regulations and conditions of such grants. It is management's opinion that no additional material unrecorded liabilities will arise from audits previously performed or to be performed.

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Notes to Basic Financial Statements (Continued)

June 30, 2013 and 2012

Note 14 - Subsequent events

In July 2013, the Executive Director of the Administration announced the cancellation of Humana's contract effective September 30, 2013. Humana administered three regions (East, Southeast, Southwest), with approximately 515,000 beneficiaries of the Mi Salud Program. On July 1, 2013, the Administration and Triple-S entered into an agreement pursuant to which Triple-S will administer the provision of healthcare services to beneficiaries in the eight regions previously administered by MCS (five regions) and Humana (remaining three regions). Pursuant to the agreement, Triple-S has acted as a third party administrator and has been compensated based on a per member per month administrative fee. In contrast to the agreement with MCS and Humana, the Commonwealth has been financially responsible and bears the risk for the provision of services to beneficiaries in the eight regions administered by Triple-S.