

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

*Basic Financial Statements and Required Supplemental  
Information as of and for the Year Ended June 30, 2010  
and Independent Auditors' Report*

***Puerto Rico Health Insurance Administration***

***(A Component Unit of the Commonwealth of Puerto Rico)***

***Basic Financial Statements and Required Supplemental Information as of and for the  
Year Ended June 30, 2010 and Independent Auditors' Report***

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**PARISSI P.S.C.**  
Certified Public Accountants, Tax & Business Advisors

## Independent Auditors' Reports

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

We have audited the accompanying basic financial statements of the Puerto Rico Health Insurance Administration (the Administration), a component unit of the Commonwealth of Puerto Rico, as of June 30, 2010 and for the year then ended, as listed in the table of contents. These basic financial statements are the responsibility of the Administration's management. Our responsibility is to express an opinion on these basic 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 basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Puerto Rico Health Insurance Administration as of June 30, 2010 and the results of its operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

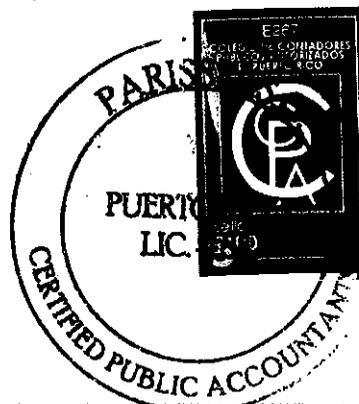
As disclosed in Note 3, the Administration has a deficit of approximately \$248 million and incurred in an increase in net deficit of approximately \$70 million during the year ended June 30, 2010.

The management's discussion and analysis on pages 2 to 8 is not a required part of the basic financial statements but is supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*Parissi P.S.C.*

December 23, 2010  
San Juan, Puerto Rico

Stamp No. E267 was affixed  
to the original of this report.  
License No. 88 Exp. December 1, 2011



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

*Management's Discussion and Analysis*  
*June 30, 2010*

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 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, 2010 and 2009.

**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 mayor components of the financial statements.

**Financial Analysis of the Administration as a Whole**

The balance sheet and the statement of revenue, expenses, and changes in net assets present the net assets of and the changes in them. Net assets—the difference between assets and liabilities is one way to measure financial health or financial position. Increase or a decrease in net assets 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 condensed net deficit information is presented as follows:**

	<u>June 30</u>		<u>Change</u>	
	<u>2010</u>	<u>2009</u>	<u>In dollars</u>	<u>Percentage</u>
Current assets	\$ 245,342,437	180,569,739	64,772,698	35.87%
Capital assets, net	210,419	208,854	1,565	0.75%
Total assets	<u>\$ 245,552,856</u>	<u>180,778,593</u>	<u>64,774,263</u>	<u>35.83%</u>
Current liabilities	\$ 492,704,009	357,927,384	134,776,625	37.65%
Non current liabilities	348,558	245,358	103,200	42.06%
Total liabilities	<u>493,052,567</u>	<u>358,172,742</u>	<u>134,879,825</u>	<u>37.66%</u>
Net deficit:				
Invested in capital assets, net of related debt	210,419	208,854	1,565	0.75%
Unrestricted deficit	<u>(247,710,130)</u>	<u>(177,603,003)</u>	<u>(70,107,127)</u>	<u>39.47%</u>
Total net deficit	<u>(247,499,711)</u>	<u>(177,394,149)</u>	<u>(70,105,562)</u>	<u>39.52%</u>
Total liabilities and net deficit	<u>\$ 245,552,856</u>	<u>180,778,593</u>	<u>64,774,263</u>	<u>35.83%</u>

***Puerto Rico Health Insurance Administration***  
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*Management's Discussion and Analysis*  
*June 30, 2010*

	<u>June 30</u>		<u>Change</u>	
	<u>2009</u>	<u>2008</u>	<u>In dollars</u>	<u>Percentage</u>
Current assets	\$ 180,569,739	77,850,227	102,719,512	131.95%
Capital assets, net	208,854	384,973	(176,119)	(45.75)%
Total assets	<u>\$ 180,778,593</u>	<u>78,235,200</u>	<u>102,543,393</u>	131.07%
Current liabilities	\$ 357,927,384	173,030,977	184,896,407	106.86%
Non current liabilities	245,358	309,509	(64,151)	(20.73)%
Total liabilities	<u>358,172,742</u>	<u>173,340,486</u>	<u>184,832,256</u>	106.63%
Net deficit:				
Invested in capital assets, net of related debt	208,854	384,973	(176,119)	(45.75)%
Unrestricted deficit	<u>(177,603,003)</u>	<u>(95,490,259)</u>	<u>(82,112,744)</u>	85.99%
Total net deficit	<u>(177,394,149)</u>	<u>(95,105,286)</u>	<u>(82,288,863)</u>	86.52%
Total liabilities and net deficit	<u>\$ 180,778,593</u>	<u>78,235,200</u>	<u>102,543,393</u>	131.07%

***Analysis of Net Assets at June 30, 2010 and 2009***

Total net deficit of \$247.5 million is composed of \$210 thousands invested in capital assets, net of related debt; and an unrestricted net deficit of \$247.7 million. Total deficit changed from \$177.4 million to \$247.5 million, an increase of approximately \$70.1 million or 39.52%, mainly because during this fiscal year, the Administration did not received the assigned funds of alcohol and cigarettes of \$63 million. Current assets increased by approximately \$64.8 million because at the end of the year, the Administration received an additional contribution from the Commonwealth of \$103 million and the payments of premiums had not been generated. Current liabilities increased by approximately \$134.8 million because the Administration had not generated the payments of premiums of approximately two months.

***Analysis of Net Assets at June 30, 2009 and 2008***

Total net deficit of \$177.4 million is composed of \$209 thousand invested in capital assets, net of related debt; and an unrestricted net deficit of \$177.6 million. Total deficit changed from \$95.1 million to \$177.4 million, an increase of approximately \$82.2 million or 87%. Current assets increased by approximately \$102.7 million mainly due to an increase in cash and cash equivalents which is principally related with the increase in current liabilities of approximately \$184.8 million.

Net assets invested in capital assets, net of related debt, decreased by \$176 thousands mostly as a net result of a decrease in purchase of equipment.

***Puerto Rico Health Insurance Administration***  
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The condensed changes in net deficit information are presented below:

	<u>Year Ended June 30,</u>		<u>Change</u>	
	<u>2010</u>	<u>2009</u>	<u>In dollars</u>	<u>Percentage</u>
Operating revenue:				
Contributions from: Department of Health of Puerto Rico, municipalities, employers and rebates	\$ 721,864,201	767,243,395	(45,379,194)	(5.91)%
Non operating revenue:				
Interest income and transfers	1,170,582,718	1,011,588,127	158,994,591	15.72%
Total revenue	<u>1,892,446,919</u>	<u>1,778,831,522</u>	<u>113,615,397</u>	6.39%
Operating expenses:				
Medical insurance premiums	1,554,435,330	1,563,847,759	(9,412,429)	(0.60)%
Claims incurred and health care costs	324,269,231	245,081,004	79,188,227	32.31%
General and administrative	83,775,439	51,945,552	31,829,887	61.28%
Depreciation and amortization	72,481	246,070	(173,589)	(70.54)%
Total operating expenses	<u>1,962,552,481</u>	<u>1,861,120,385</u>	<u>101,432,096</u>	5.45%
Increase in net deficit	(70,105,562)	(82,288,863)	12,183,301	(14.81)%
Net deficit, beginning of year	<u>(177,394,149)</u>	<u>(95,105,286)</u>	<u>(82,288,863)</u>	86.52%
Net deficit, end of year	<u>\$ (247,499,711)</u>	<u>(177,394,149)</u>	<u>(70,105,562)</u>	39.52%

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***Puerto Rico Health Insurance Administration***  
***(A Component Unit of the Commonwealth of Puerto Rico)***  
*Management's Discussion and Analysis*  
*June 30, 2010*

	<u>Year Ended June 30,</u>		<u>Change</u>	
	<u>2009</u>	<u>2008</u>	<u>In dollars</u>	<u>Percentage</u>
Operating revenue:				
Contributions from: Department of Health of Puerto Rico, municipalities, employers and rebates	\$ 767,243,395	1,583,271,584	(816,028,189)	(51.54)%
Non operating revenue:				
Interest income and transfers	1,011,588,127	10,539,878	1,001,048,249	9,497.72%
Total revenue	1,778,831,522	1,593,811,462	185,020,060	11.61%
Operating expenses:				
Medical insurance premiums	1,563,847,759	1,415,714,836	148,132,923	10.46%
Claims incurred and health care costs	245,081,004	268,208,307	(23,127,303)	(8.62)%
General and administrative	51,945,552	51,246,232	699,320	1.36%
Depreciation and amortization	246,070	334,213	(88,143)	(26.37)%
Total operating expenses	1,861,120,385	1,735,503,588	125,616,797	7.24%
Decrease in net assets	(82,288,863)	(141,692,126)	59,403,263	(41.92)%
Net assets (deficit), beginning of year	(95,105,286)	46,586,840	(141,692,126)	(304.15)%
Net deficit, end of year	\$ (177,394,149)	(95,105,286)	(82,288,863)	86.52%

**Year Ended June 30, 2010 and June 30, 2009**

The Administration's revenue increased by approximately \$113.6 million or 6.39% mostly as a result of: an increase of \$164 million from Commonwealth transfers due to additional contribution related to Puerto Rico Sales Tax Financing Corporation (Cofina) funds, an increase of \$63 million from pharmacy rebate program due to the Department of Justice Ruling, effective at the beginning of the fiscal year, which established that 100% of the rebate funds should be retained by the Administration, an increase of \$29 million in municipality contributions due to a retroactive adjustment recorded during the year, a decrease of \$123 million in federal funds mainly because the Administration did not receive the American Recovery Reinvestment Act (ARRA) funds during this year, a decrease of \$14 million in employers contributions because during prior year the Administration recorded a retroactive adjustment, and a decrease of \$5 million in interest income and other.

The Administration's expenses increased by \$101.4 million or 5.45% mostly as a result of the increase in claims and health care cost incurred of approximately \$79.1 million mainly because the claims paid in the metro-north region increased, a decrease in medical insurance premiums of \$9.4 million and an increase in general administrative expenses of \$31.8 million due to the increase in the allowance for bad debts of \$21 million and in the administrative fees paid to third party administrator of \$10 million. This was offset by a \$174 thousand decrease in depreciation and amortization expenses.

***Puerto Rico Health Insurance Administration***  
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***Year Ended June 30, 2009 and June 30, 2008***

The Administration's revenue increased by approximately \$185 million or 11.61% mostly as a result of an increase of \$15 million in transfers from the Commonwealth representing amounts assigned by the Legislature each year from the General Fund as part of the budgetary process. There were transfers for fiscal year ended June 30, 2009 of \$1 billion versus for the fiscal year ended June 30, 2008 of \$989 million. In addition an increase of \$207 million received from federal funds of the Department of Health assigned to Puerto Rico for the Medicaid program, for the State Children's Health Insurance Program (CHIP) and Medicare Advantage Plans. This was offset by approximately \$34 million, mostly composed of a decrease on municipality contributions of \$27.8 million and \$2.6 million of employer's contributions coming from governmental agencies whose employees choose the government health plan and \$3.5 million of net revenues from the pharmacy rebate program. In addition, there was a reduction in interest income and reimbursement of PCD administrative expenses.

Operating expenses increased by \$125.6 million or 7.24% mostly as a result of the increase of expenses related to medical insurance premiums of \$148 million, a decrease on other health care cost of \$23 million, an increase on general and administrative expenses of approximately \$699 thousand, mostly composed of an increase on administrative fees of the direct contracting program. This was offset by \$88 thousand due to a decrease in depreciation and amortization expenses.

***Capital Assets***

The Administration's investment in capital assets as of June 30, 2010 and 2009 amounted to \$210,419 and \$208,854, respectively, net of accumulated depreciation. Capital assets include equipment, furniture, and vehicles.

During the years ended June 30, 2010, and 2009, the Administration invested approximately \$74,046 and \$69,950 in capital assets, respectively.

Depreciation and amortization expense for the years ended June 30, 2010 and 2009 amounted to \$72,481 and \$246,069, respectively.

***Debt Administration***

At June 30, 2010 and 2009, the Administration had approximately \$483 and \$358 million respectively, in outstanding premiums, claims payables and accrued expenses. The increase was mainly because due to the deficit, the invoices for the months of May and June could not be paid.

***Direct Contracting Project***

On July 1<sup>st</sup>, 2003 the Administration began the direct contracting project in the southeast region with 23,300 covered lives. On March 2004, it was expanded to the northeast region with an additional 9,400 covered lives. On October 2005, the project was further expanded to include approximately 4,000 more lives from the Municipality of Vieques.

# ***Puerto Rico Health Insurance Administration***

## ***(A Component Unit of the Commonwealth of Puerto Rico)***

*Management's Discussion and Analysis*

*June 30, 2010*

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The project differs from the traditional model and allows the Administration to share medical insurance risks with health providers (Independent Practice Association or IPA). While the health provider bears the risk of the basic coverage, the Administration bears the risk of the special coverage, which includes catastrophic conditions, dental coverage and reinsurance. For the Vieques project, the Government assumes all the risk. A third party administrator (TPA), Cooperativa de Seguros de Vida (COSVI), handles all the administrative work related to the operation such as payments of claims, some actuarial work, contracting service providers and general administration of the project.

Financial arrangements for this project begin each month with the transfer of funds from one account to another within the Administration. According to the designated PMPM (per member per month) premium, money is transferred from the premiums account to the project account based on the actual number of subscribers enrolled as of the first day of the month. From this account, a capitation amount is paid to the IPAs contracted. The remaining funds are maintained in the account for the payment of claims and are managed by the TPA.

When the project was being planned, a population of 125,000 was estimated to give trustworthy results from which to draw conclusions and make decisions. Final population, as mentioned, stayed above 32,000. A lesser risk distribution implies a bigger financial burden. The direct contracting PMPM expenditures are higher than the managed care organization PMPM expenditures in the southeast and northeast regions.

Beginning on November 1, 2006, the Government decided to expand the concept of the project to a whole region. The metro north region was selected and Humana Health Plans of PR (Humana) was awarded the TPA contract for a period of two years. Since November 1, 2008, Triple C, Inc. was selected for the new TPA contract until June 30, 2010. Approximately 190,000 lives are covered under this project.

Effective October 1, 2010, in compliance with our government plan, we developed a new integrated health model named MI SALUD 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 provider.
4. Extended hours for health providers of basic services.
5. Tele-emergency services available 24 hours.
6. Integration of the physical health and mental health in one place.
7. The risk of the primary health provider in relation to medicines, emergency and preventive health test was decreased and was transferred to the health 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 insurance companies.

***Puerto Rico Health Insurance Administration***  
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*June 30, 2010*

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***Contract with the Municipality of Guaynabo***

On October 2007, the Administration entered in a contract with the Municipality of Guaynabo with 13,592 covered lives. Under this contract, the municipality of Guaynabo bears the risk of the basic and special coverage. Humana handles all the administrative work related to the payment of claims of services provided outside the municipality's facilities. As a result of this arrangement, the Administration no longer receives the municipality contribution.

***Projections for fiscal year 2010-2011***

For fiscal year 2010-2011, a deficit of \$53 million is projected. On the other hand, the projected budget for fiscal year 2010-2011 is \$1,871,762,000; which represents an increase of \$186,833,000 in comparison with the approved budget from fiscal year 2009-2010. This raise was based on an increase in federal funds of \$186,611,000, a decrease in legislative appropriation of \$2,379,000 and an increase in other sources of \$3,337,000.

The budget for fiscal year 2010-2011 considers the following amounts:

- \$1,122,550,000 from the legislative appropriation
- \$566,698,000 from federal funds
- \$178,704,000 from other sources
- \$856,000 for operational expenses of the Administration
- \$2,954,000 from the stabilization fund

***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***  
***(A Component Unit of the Commonwealth of Puerto Rico)***

*Balance Sheet*  
*June 30, 2010*

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**Assets**

Current assets:	
Cash and cash equivalents	\$ 202,808,849
Accounts receivable - net of allowance for doubtful accounts of \$27,067,562	4,725,361
Accounts receivable Municipalities - net of allowance for doubtful accounts of \$28,754,711	25,983,768
Accounts receivable pharmacy rebates	<u>11,824,459</u>
Total current assets	245,342,437
Capital assets - net	<u>210,419</u>
Total assets	<u><u>\$ 245,552,856</u></u>

**Liabilities and Deficit**

Current liabilities:	
Premiums and pharmacy rebates payable	\$ 376,968,589
Claims payable	59,452,794
Due to other governmental agencies	7,239,104
Due to agency fund	2,278,534
Accounts payable and accrued expenses	46,242,150
Accrued compensated absences	<u>522,838</u>
Total current liabilities	492,704,009
Non current liabilities:	
Accrued compensated absences	<u>348,558</u>
Total liabilities	<u>493,052,567</u>
Commitments and contingencies	
Net deficit:	
Invested in capital assets, net of related debt	210,419
Deficit	<u>(247,710,130)</u>
Total deficit	<u>(247,499,711)</u>
Total liabilities and deficit	<u><u>\$ 245,552,856</u></u>

See accompanying notes to financial statements.

***Puerto Rico Health Insurance Administration***  
***(A Component Unit of the Commonwealth of Puerto Rico)***  
*Statement of Revenues, Expenses and Changes in Net Deficit*  
*Year Ended June 30, 2010*

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Operating revenues:	
Contributions from:	
Department of Health of Puerto Rico	\$ 437,699,036
Municipalities	191,147,357
Employers	19,246,968
Pharmacy rebate program - net	<u>73,770,840</u>
Total operating revenues	<u>721,864,201</u>
Operating expenses:	
Medical insurance premiums	1,554,435,330
Claims incurred and health care costs	324,269,231
General and administrative	83,775,439
Depreciation and amortization	<u>72,481</u>
Total operating expenses	<u>1,962,552,481</u>
Loss from operations	<u>(1,240,688,280)</u>
Non operating revenues:	
Transfers from the Commonwealth of Puerto Rico	1,169,143,000
Interest income and other	<u>1,439,718</u>
Total non operating revenue	<u>1,170,582,718</u>
Increase in net deficit	(70,105,562)
Net deficit at beginning of year	<u>(177,394,149)</u>
Net deficit at end of year	<u>\$ (247,499,711)</u>

See accompanying notes to financial statements.

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

*Statement of Cash Flows*  
*Year Ended June 30, 2010*

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Cash flows from operating activities:	
Collections of contributions	\$ 705,649,778
Collections from pharmacy rebate program	75,084,500
Payments of premiums	(1,447,562,521)
Payments to employees	(4,054,022)
Payments to vendors for goods and services	(90,470,317)
Payments to health care organizations and third party administrator	<u>(287,753,780)</u>
Net cash used in operating activities	<u>(1,049,106,362)</u>
Cash flows from non-capital and related financing activities:	
Transfers from the Commonwealth of Puerto Rico	1,169,143,000
Collections of other income	<u>702,504</u>
Net cash provided by non-capital and related financing activities	<u>1,169,845,504</u>
Purchase of capital assets and net cash used in capital and related financing activities	<u>(74,046)</u>
Interest collected and net cash provided by investing activities	<u>737,214</u>
Net increase in cash and cash equivalents	121,402,310
Cash and cash equivalents, at beginning of year	<u>81,406,539</u>
Cash and cash equivalents, at end of year	<u>\$ 202,808,849</u>

See accompanying notes to financial statements.

***Puerto Rico Health Insurance Administration***  
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*Statement of Cash Flows*  
*Year Ended June 30, 2010*

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Reconciliation of operating loss to net cash used in operating activities:

Loss from operations	\$ (1,240,688,280)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation and amortization	72,481
Bad debt expense	29,036,571
Changes in operating assets and liabilities:	
Decrease in:	
Accounts receivable	29,785,291
Due from agency fund	48,215
Prepaid expenses	38,069
Increase (decrease) in:	
Premiums and pharmacy rebates payable	106,872,809
Claims payable	36,515,451
Accounts payable and accrued expenses	(11,044,970)
Accrued compensated absences	258,001
	<hr/>
Net cash used in operating activities	\$ <u>(1,049,106,362)</u>

See accompanying notes to financial statements.

***Puerto Rico Health Insurance Administration***  
***(A Component Unit of the Commonwealth of Puerto Rico)***  
*Statement of Assets and Liabilities – Agency Fund*  
*June 30, 2010*

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**Assets**

Accounts receivable	\$ 547,081
Due from proprietary fund	<u>2,278,534</u>
Total asset	<u>\$ 2,825,615</u>

**Liabilities**

Accounts payable	\$ 1,896,704
Accrued expenses	<u>928,911</u>
Total liabilities	<u>\$ 2,825,615</u>

See accompanying notes to financial statements.

# ***Puerto Rico Health Insurance Administration***

*Notes to Basic Financial Statements*

*Year Ended June 30, 2010*

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## **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. The Administration is a public corporation with full autonomy.

The Administration is responsible for implementing, administering and negotiating a health insurance system, through contracts with insurance underwriters, to provide quality medical and hospital care to the Commonwealth residents regardless of their financial condition and capacity to pay. 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, that amends Act No. 72 of 1993, the Administration was authorized to negotiate directly with health providers under a pilot program. The Single State Medicaid Agency is the Department of Health. Within the Department, the Officer of economic aid to the medically indigent has responsibility for the Medicaid Program.

On July 1, 2003 the Administration began the first demonstrative pilot project of directly contracted providers. This project serves approximately 32,000 lives from the San Juan, northeast and southeast regions. On November 1, 2006 the Administration began a second project of directly contracted providers that serves approximately 190,000 lives from the metro-north region.

Effective October 1, 2010, in compliance with our government plan, we developed a new integrated health model named MI SALUD 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 provider.
4. Extended hours for health providers of basic services.
5. Tele-emergency services available 24 hours.
6. Integration of the physical health and mental health in one place.
7. The risk of the primary health provider in relation to medicines, emergency and preventive health test was decreased and was transferred to the health 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 insurance companies.

# ***Puerto Rico Health Insurance Administration***

*Notes to Basic Financial Statements*

*Year Ended June 30, 2010*

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## **2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### ***(a) 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.

### ***(b) 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 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 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 20, the Administration applied all Statements and Interpretations of the Financial Accounting Standards Board, 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.

### ***(c) Cash and Cash Equivalents***

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

### ***(d) 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.

### ***(e) Transfers from the Commonwealth of Puerto Rico***

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

# ***Puerto Rico Health Insurance Administration***

*Notes to Basic Financial Statements*

*Year Ended June 30, 2010*

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## ***(f) Contributions from the Department of Health of Puerto Rico***

Contributions received from Department of Health represent reimbursement for Medicaid benefits received by Department of Health on behalf of the Puerto Rico Government related to beneficiaries also covered by the premiums of the Administration.

## ***(g) Contributions from Municipalities***

Contributions from Municipalities represent charges made by the Administration based on established percentages applied to the corresponding Municipality's operational budget for the preceding fiscal year. These contributions are withheld by the Municipality Revenue Collection Center from money assigned to the municipalities and remitted monthly to the Administration.

## ***(h) 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:

### ***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.

## ***(i) 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.

## ***(j) Revenue Recognition***

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

# ***Puerto Rico Health Insurance Administration***

*Notes to Basic Financial Statements*

*Year Ended June 30, 2010*

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## ***(k) 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.

## ***(l) 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. Property and equipment under capital leases are amortized using the straight-line method over the shorter of the lease term or the estimated useful life of the assets. Such amortization is included in the depreciation and amortization expense in the financial statements.

## ***(m) 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.

As per the Administration personnel protocol, the employee has the right to accumulate the excess of sixty (60) days in vacation and ninety (90) days and 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.

## ***(n) 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.

## ***(o) Statement of Cash Flows***

The accompanying statement of cash flows is 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***

*Notes to Basic Financial Statements*

*Year Ended June 30, 2010*

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## ***(p) Pharmacy Rebate Program***

During the year 2002, the Administration established a governmental pharmacy program which allows contracting rebates and discounts with drug manufacturers.

The Administration contracted a private corporation for the implementation and management of this rebate program.

During fiscal year 2009, the income derived from this program (net of management fees) was distributed 75% to the health care provider and 25% is retained by the Administration. During the fiscal year 2010, the Administration retained 100% based on a Department of Justice Ruling.

## ***(q) Accounting for Pension Costs***

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

The SGAS 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.

## ***(r) Claims Payable***

Claims payable represents the estimated amount to be paid to providers based on experience and accumulated statistical data under one of the direct contracting pilot project. The estimates of medical claims incurred but not reported and other medical expense payments is developed using actuarial methods and assumptions based upon payment patterns, inflation of medical costs, historical developments and other relevant factors. The Administration agrees with health care organizations certain medical care services provided to the beneficiaries. Health care providers are compensated on a capitation basis.

The above liabilities are necessarily based on estimates and while management believes that the amounts are adequate, the ultimate liability maybe 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.

## ***(s) Medical Cost Recognition***

Medical costs include claim payments, capitation payments, and various other costs incurred to provide medical care to beneficiaries as well as estimates of future payments for medical 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 medical care to members. The estimates of future medical claims and

# ***Puerto Rico Health Insurance Administration***

*Notes to Basic Financial Statements*

*Year Ended June 30, 2010*

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other expense payments are developed using actuarial methods and assumptions based upon payment patterns, medical inflation, historical development and other relevant factors. Estimates of future payments relating to services incurred in the current and prior periods are continually reviewed by management and adjusted as necessary. Risks related to catastrophic diseases are assumed by the Administration.

## ***(t) Subsequent Events***

In preparing these financial statements, the Administration has evaluated events and transactions for potential recognition or disclosure through December 23, 2010, the date the financial statements were available to be issued.

## ***(u) Future Adoption of Accounting Pronouncements***

The GASB has issued the following statement, which the Administration has not yet adopted:

GASB Statement No. 54, *Fund Balance Reporting and Government Fund Type Definitions* for periods beginning after June 15, 2010. The objective of this Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

Management has concluded that the possible impact of the adoption of this statement in the Administration's basic financial statements cannot be determined at this moment.

## **3. MANAGEMENT PLANS**

As reflected in the accompanying basic financial statements, the Administration has a deficit of approximately \$248 million and incurred an increase in net deficit of approximately \$70 million during the year ended June 30, 2010. Effective November 23, 2010, the Act No 72 of the Legislature of the Commonwealth was amended to authorize the Administration to incur obligations up to \$187 million in order to pay outstanding debts incurred prior to July 1, 2010. The obligation will be paid directly by the Office of Management and Budget. In addition, the budget for fiscal year 2010-2011 increased by approximately \$188 million mainly due to the increase in federal funds.

## **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. 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.

# ***Puerto Rico Health Insurance Administration***

*Notes to Basic Financial Statements*

*Year Ended June 30, 2010*

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For the year ended June 30, 2010, the custodial risk of the administration amounted to \$191.5 million, which is the bank balance of cash and cash equivalents deposited at the Government Development Bank for Puerto Rico and the Economic Development Bank for Puerto Rico. These deposits are exempt from the collateral requirement established by the Commonwealth.

## **5. ACCOUNTS RECEIVABLE**

Accounts receivable and the allowance for doubtful accounts as of June 30, 2010 consist of the following:

Governmental agencies	\$ 28,843,485
Municipalities	54,738,479
Pharmacy rebate program	11,824,459
Other	2,949,438
	<u>98,355,861</u>
Allowance for doubtful accounts	<u>(55,822,273)</u>
Account receivable, net	<u>\$ 42,533,588</u>

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 \$27 million. The second section of the reserve is related to municipalities based on a retroactive receivable amounting to approximately \$29 million. The third one represents mainly uncollected premiums amounting to \$31 thousand.

## **6. CAPITAL ASSETS**

The activities of the capital assets accounts of the Administration for the fiscal year ended June 30, 2010 was as follows:

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Retirements</b>	<b>Ending Balance</b>
Equipment, computer and software	\$ 1,171,763	67,586	(17,730)	1,221,619
Vehicles	78,459	—	—	78,459
Leasehold improvements	118,850	2,695	—	121,545
Furniture and others	238,343	3,765	—	242,108
	<u>1,607,415</u>	<u>74,046</u>	<u>(17,730)</u>	<u>1,663,731</u>
Accumulated depreciation	<u>(1,398,561)</u>	<u>(72,481)</u>	<u>17,730</u>	<u>(1,453,312)</u>
Capital assets, net	<u>\$ 208,854</u>	<u>1,565</u>	<u>—</u>	<u>210,419</u>

# ***Puerto Rico Health Insurance Administration***

*Notes to Basic Financial Statements*

*Year Ended June 30, 2010*

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## **7. RETIREMENT SYSTEM**

### **Defined Benefit Pension Plan**

The Employees' Retirement System of the Commonwealth and its instrumentalities (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, under 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.

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 9.275% 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***

*Notes to Basic Financial Statements*

*Year Ended June 30, 2010*

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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 9.2750% 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, 2010 amounted to approximately \$253,278.

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2010, a copy of which can be obtained from the Retirement System Administration, P.O. Box 42003, San Juan, Puerto Rico, 00949.

## **8. COMMITMENTS AND CONTINGENCIES**

### **Commitments**

The Administration conducts its operations in a leased facility under a long-term operating lease agreement expiring during 2012. Rent expense for the year ended June 30, 2010 amounted to \$403,899.

Minimum future rental payments under the non-cancellable operating lease as of June 30, 2010 are as follows:

<b>Year Ending June 30,</b>	<b>Amount</b>
2011	369,765
2012	215,696
Total	<u>\$ 585,461</u>

### **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, excluding the litigation mentioned in the above paragraph, the Administration, in consultation with

# ***Puerto Rico Health Insurance Administration***

*Notes to Basic Financial Statements*

*Year Ended June 30, 2010*

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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 is co-defendant in a case involving a claim of approximately \$14,000,000 by a provider of information technology services. The Administration's legal counsel believes that at this stage an estimate can be made as to the financial effect of \$1,500,000 to this litigation and cannot offer any evaluation of the likelihood of a favorable or unfavorable outcome.

The Administration has been requested to repay the Puerto Rico Treasury Department approximately \$103,000,000 representing additional transfers of money from the central government during the fiscal years 2001-2003. After consultation with internal 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 financial assistance from the federal government passed through the Department of Health of Puerto Rico. 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.

## **9. SUBSEQUENT EVENT**

Effective October 1, 2010, in compliance with our government plan, we developed a new integrated health model named MI SALUD with the following changes:

- a. Set up a standard premium per region as established by the Administration.
- b. Eliminate the referrals when the beneficiary needs the service of a specialist.
- c. Better access to prescribed medicines without the authorization of the primary health provider.
- d. Extended hours for health providers of basic services.
- e. Tele-emergency services available 24 hours.
- f. Integration of the physical health and mental health in one place.
- g. The risk of the primary health provider in relation to medicines, emergency and preventive health test was decreased and was transferred to the health insurance companies.
- h. Increase the coverage to include the middle class working force.
- i. Set up a ceiling in relation to administrative expenses and gains of the health insurance companies.

# ***Puerto Rico Health Insurance Administration***

*Notes to Basic Financial Statements*

*Year Ended June 30, 2010*

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Effective November 23, 2010, the Act No 72 of the Legislature of the Commonwealth was amended to include a new Section 2A to the Article IV. The same authorized the Administration to incur in obligations up to \$187 million in order to pay outstanding debts incurred prior to July 1, 2010.

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