

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

Financial Statements

June 30, 2012 and 2011

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

Management's Discussion and Analysis

The following discussion and analysis of the Puerto Rico Medical Services Administration (the Administration) provides an overview of the Administration's financial performance during the years ended June 30, 2012 and 2011. Please read it in conjunction with the basic financial statements, which follow this section.

Financial Highlights

1. The Administration's deficit as of June 30, 2012 and 2011 amounted to approximately \$228 million and \$183 million, respectively.
2. During the years ended June 30, 2012 and 2011 the Administration experienced operating losses of approximately \$56 million and \$51 million, respectively.
3. During the years ended June 30, 2012 and 2011, the Administration received approximately \$24 million and \$19 million, respectively, in contributions from governmental agencies, for payment of new recruitments, payroll contributions and other operating expenses.

Required Financial Statements

The required basic financial statements of the Administration consist of:

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

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

Management's Discussion and Analysis (Continued)

Statement of Net Assets (Deficit)

The Administration's statements of net assets (deficit) as of June 30, 2012 and 2011, consisted of (in thousands):

	<u>2012</u>	<u>2011</u>	<u>Increase (Decrease)</u>	<u>%</u>
Current assets	\$ 61,329	\$ 74,685	\$ (13,356)	-18%
Non-current assets:				
Capital assets, net	54,730	55,605	(875)	-2%
Restricted cash	7,746	10,996	(3,250)	-30%
	<u>62,476</u>	<u>66,601</u>	<u>(4,125)</u>	<u>-6%</u>
	<u>\$ 123,805</u>	<u>\$ 141,286</u>	<u>\$ (17,481)</u>	<u>-12%</u>
Current liabilities	\$ 70,181	\$ 118,517	\$ (48,336)	-41%
Non-current liabilities	<u>281,360</u>	<u>205,233</u>	<u>76,127</u>	<u>37%</u>
	351,541	323,750	27,791	9%
Net asset (deficit)	<u>(227,736)</u>	<u>(182,464)</u>	<u>(45,272)</u>	<u>25%</u>
	<u>\$ 123,805</u>	<u>\$ 141,286</u>	<u>\$ (17,481)</u>	<u>-12%</u>
Net asset (deficit):				
Investment in capital asset, net of related debt	\$ 54,649	\$ 55,425	\$ (776)	-1%
Restricted	-	1,323	(1,323)	-100%
Unrestricted deficit	<u>(282,385)</u>	<u>(239,212)</u>	<u>(43,173)</u>	<u>18%</u>
	<u>\$ (227,736)</u>	<u>\$ (182,464)</u>	<u>\$ (45,272)</u>	<u>25%</u>

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

Management's Discussion and Analysis (Continued)

Statement of Net Assets (Deficit)

The decrease in current assets as of June 30, 2012, consisted of (in thousands):

	<u>2012</u>	<u>2011</u>	Increase (Decrease)	<u>%</u>
Unrestricted cash	\$ 267	\$ 2,871	\$ (2,604)	-91%
Receivable from member institutions and private insurances	56,411	67,946	(11,535)	-17%
Accounts receivable from Government Development Bank of Puerto Rico (GDB)	-	1	(1)	-100%
Accounts receivable others	648	706	(58)	-8%
Inventories	2,806	2,271	535	24%
Prepaid expenses	<u>1,197</u>	<u>890</u>	<u>307</u>	<u>34%</u>
	<u>\$61,329</u>	<u>\$74,685</u>	<u>\$ (13,356)</u>	<u>-18%</u>

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

Statement of Net Assets (Deficit) – (continued)

The net (decrease) in accounts receivable from member institutions and private insurance, consisted of the following activity during the years ended June 30, 2012 and 2011 (in thousands):

As of June 30, 2012:

	<u>Member Institutions</u>	<u>Private Insurance</u>	<u>Total</u>
Gross services revenues	\$ 91,703	\$ 112,363	\$204,066
Recovery prior years	879	-	879
Revenue accounts reclassification	(109)	2	(107)
Contractual adjustments	-	(66,152)	(66,152)
Contractual adjustment reclassification	-	(3,126)	(3,126)
Non cash transactions	(21,695)	(129)	(21,824)
Provision for bad debt expense	(1,589)	(11,400)	(12,989)
Collections	<u>(83,834)</u>	<u>(28,448)</u>	<u>(112,282)</u>
	<u>\$ (14,645)</u>	<u>\$ 3,110</u>	<u>\$ (11,535)</u>

As of June 30, 2011:

	<u>Member Institutions</u>	<u>Private Insurance</u>	<u>Total</u>
Gross services revenues	\$ 95,764	\$ 107,672	\$203,436
Recoveries prior years	6,993	-	6,993
Revenue accounts reclassification	1,963	(4,047)	(2,084)
Contractual adjustments	-	(65,405)	(65,405)
Contractual adjustment reclassification	-	4,853	4,853
Non cash transactions	16,776	8,685	25,461
Provision for bad debt expense	(6,537)	(17,493)	(24,030)
Collections	<u>(86,507)</u>	<u>(21,432)</u>	<u>(107,939)</u>
	<u>\$ 28,452</u>	<u>\$ 12,833</u>	<u>\$ 41,285</u>

During 2012 the Administration improved the billing process, established a collection plan and renegotiated some of commercial health insurance contracts. As a result, there was an increase of \$4,343 in collections, a decrease of \$11,041 in the provision of bad debt expense and a decrease in contractual adjustment percent. The decrease in contractual allowance applicable to commercials health insurance amounted to 58% and 60% at June 30, 2012 and 2011, respectively.

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

Statement of Net Assets (Deficit) – (continued)

Non-Current Assets - Capital Assets

As of June 30, 2012:

Description	Balance June 30, 2011	Increase	Decrease	Balance June 30, 2012
Capital assets not being depreciated	\$ 6,872	\$ -	\$ -	\$ 6,872
Capital assets being depreciated	160,451	6,519	(1,062)	165,908
Accumulated depreciation	(111,718)	(7,126)	794	(118,050)
Capital assets being depreciated, net	48,733	(607)	(268)	47,858
	<u>\$ 55,605</u>	<u>\$ (607)</u>	<u>\$ (268)</u>	<u>\$ 54,730</u>

As of June 30, 2011:

Description	Balance June 30, 2010	Increase	Decrease	Balance June 30, 2011
Capital assets not being depreciated	\$ 28,872	\$ -	\$ (22,000)	\$ 6,872
Capital assets being depreciated	138,761	23,271	(1,581)	160,451
Accumulated depreciation	(106,686)	(6,393)	1,361	(111,718)
Capital assets being depreciated, net	32,075	16,878	(220)	48,733
	<u>\$ 60,947</u>	<u>\$ 16,878</u>	<u>\$ (22,220)</u>	<u>\$ 55,605</u>

The decrease in capital assets during the year ended June 30, 2012 is mainly due to the fact that current year depreciation exceeded the current year acquisitions of equipment and the cost of building improvements.

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

Management's Discussion and Analysis (Continued)

Statement of Net Assets (Deficit) – (continued)

Liabilities

Current Liabilities

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

	<u>2012</u>	<u>2011</u>	<u>Increase (Decrease)</u>	<u>%</u>
Accounts payable	\$ 39,512	\$ 67,604	\$ (28,092)	-42%
Accrued expenses	21,738	19,018	2,720	14%
Accrued pension costs	6,252	29,036	(22,784)	-78%
Current portion of obligations under capital leases	81	180	(99)	-55%
Liabilities payable from restricted assets	<u>2,598</u>	<u>2,679</u>	<u>(81)</u>	<u>-3%</u>
	<u>\$ 70,181</u>	<u>\$ 118,517</u>	<u>\$ (48,336)</u>	<u>-41%</u>

The decrease in accounts payable is mainly due to payments made by the Administration during the year ended June 30, 2012, from proceeds of loan provided by the GDB to the Administration.

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

Management's Discussion and Analysis (Continued)

Statement of Net Assets (Deficit) – (continued)

Non-Current Liabilities

The increase in non-current liabilities as of June 30, 2012, consisted of (in thousands):

	<u>2012</u>	<u>2011</u>	<u>Increase (Decrease)</u>	<u>%</u>
Government Development Bank of Puerto Rico line of credit in connection with Law #66 of June 22, 1978, as amended	\$ 264,434	\$ 198,238	\$ 66,196	33%
Accrued pension costs, net of current portion	10,300	-	10,300	100%
Liabilities payable from restricted assets-Self Insurance Fund	<u>6,626</u>	<u>6,995</u>	<u>(369)</u>	<u>-5%</u>
	<u>\$ 281,360</u>	<u>\$ 205,233</u>	<u>\$ 76,127</u>	<u>27%</u>

The decrease in liabilities payable from restricted assets was caused by the fact that claims for malpractice were paid during the year ended June 30, 2012. During the year ended June 30, 2012, no provision was made to cover additional claims under the Administration's self insurance fund since the amount of the estimated accrued liability of \$7 million was considered adequate. The increase in notes payable, was caused by the loan provided by the GDB.

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

Statement of Net Assets (Deficit) – (continued)

Non-Current Liabilities

The following is the activity of long-term debts for the years ended June 30, 2012 and 2011 (in thousands):

As of June 30, 2012:

Description	Balance June 30, 2011	Increase	Decrease	Balance June 30, 2012
Self-insurance fund	\$ 6,994	\$ -	\$ (368)	\$ 6,626
Accrued pension costs, net of current portion	-	10,300	-	10,300
Government Development Bank of Puerto Rico line of credit in connection with Law #66 of June 22, 1978 as amended	<u>198,239</u>	<u>66,195</u>	<u>-</u>	<u>264,434</u>
	<u>\$ 205,233</u>	<u>\$ 76,495</u>	<u>\$ (368)</u>	<u>\$ 281,360</u>

As of June 30, 2011:

Description	Balance June 30, 2010	Increase	Decrease	Balance June 30, 2011
Self-insurance fund	\$ 7,405	\$ -	\$ (411)	\$ 6,994
Government Development Bank of Puerto Rico line of credit in connection with Law #66 of June 22, 1978 as amended	<u>-</u>	<u>198,239</u>	<u>-</u>	<u>198,239</u>
	<u>\$ 7,405</u>	<u>\$ 198,239</u>	<u>\$ (411)</u>	<u>\$ 205,233</u>

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

Management's Discussion and Analysis (Continued)

Revenues, Expenses and Changes in Net Assets (Deficit)

The Administration's statements of revenue, expenses, and changes in net assets (deficit) for the years ended June 30, 2012 and 2011, consisted of (in thousands):

	2012	2011	Increase (Decrease)	%
Net service revenues	\$ 122,571	\$ 123,763	\$ (1,192)	-1%
Operating costs and expenses:				
Cost of services	155,976	158,105	(2,129)	-1%
General and administrative	14,975	10,484	4,491	43%
Depreciation and amortization	7,126	6,393	733	11%
	<u>178,077</u>	<u>174,982</u>	<u>3,095</u>	<u>2%</u>
Operating loss	<u>(55,506)</u>	<u>(51,219)</u>	<u>(4,287)</u>	<u>8%</u>
Non-operating income (expenses):				
Contributions from the Commonwealth of Puerto Rico	23,892	18,566	5,326	29%
Interest income and other	1,668	783	885	113%
Interest expenses	(15,303)	(11,375)	(3,928)	35%
Gain on debt forgiveness	11	42,830	(42,819)	-100%
Loss on disposition of capital assets	(34)	(107)	73	-68%
	<u>10,234</u>	<u>50,697</u>	<u>(40,463)</u>	<u>-80%</u>
Net change (deficit)	(45,272)	(522)	(44,750)	8573%
Deficit, at beginning of year	<u>(182,464)</u>	<u>(181,942)</u>	<u>(522)</u>	<u>0%</u>
Deficit, at end of year	<u>\$ (227,736)</u>	<u>\$ (182,464)</u>	<u>\$ (45,272)</u>	<u>25%</u>

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

Management's Discussion and Analysis (Continued)

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

Service Revenues

The decrease in service revenues for the year ended June 30, 2012, consisted of (in thousands):

	<u>2012</u>	<u>2011</u>	<u>Increase (Decrease)</u>	<u>%</u>
Member institutions	\$ 91,703	\$ 95,764	\$ (4,061)	-4%
Recovery prior year	879	6,993	(6,114)	-87%
Revenue accounts reclassification	(109)	1,963	(2,072)	-106%
Private and insurance	43,087	43,073	14	0%
Provision for bad debts	<u>(12,989)</u>	<u>(24,030)</u>	<u>11,041</u>	<u>-46%</u>
	<u>\$ 122,571</u>	<u>\$ 123,763</u>	<u>\$ (1,192)</u>	<u>-1%</u>

Approximately over 67% of the Administration's service revenues are derived from services rendered to member institutions. The decrease in service revenue is principally caused for a reduction of member institution billing of decentralization services. The decrease in doubtful accounts was caused by the control over the billings and was an improvement of process.

Operating Costs and Expenses

Increase in operating costs and expenses for the year ended June 30, 2012, consisted of (in thousands):

	<u>2012</u>	<u>2011</u>	<u>Increase (Decrease)</u>	<u>%</u>
Salaries payroll taxes and fringe benefits	\$ 98,724	\$ 103,048	\$ (4,324)	-4%
General and administrative	14,975	10,484	4,491	43%
Costs of materials and services	47,002	44,917	2,085	5%
Depreciation and amortization	7,126	6,393	733	11%
Utilities	<u>10,250</u>	<u>10,140</u>	<u>110</u>	<u>1%</u>
	<u>\$ 178,077</u>	<u>\$ 174,982</u>	<u>\$ 3,095</u>	<u>2%</u>

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

Management's Discussion and Analysis (Continued)

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

Non-Operating Income (Expenses)

The decrease in non-operating income (expenses) for the year ended June 30, 2012, consist of (in thousands):

	2012	2011	Increase (Decrease)	%
Governmental contributions	\$ 23,892	\$ 18,566	\$ 5,326	29%
Interest income and other	1,668	783	885	113%
Gain from debt forgiveness	11	42,830	(42,819)	-100%
Interest expense	(15,303)	(11,375)	(3,928)	35%
Loss on disposition of capital assets	(34)	(107)	73	-68%
	<u>\$ 10,234</u>	<u>\$ 50,697</u>	<u>\$ (40,463)</u>	<u>-80%</u>

The governmental contributions consisted of the following activity during the year ended June 30, 2012:

- \$411 thousand received in connection with Joint Resolution No. 4533 approved by the Commonwealth's Legislature Assembly on August 12, 2004, assigning \$40.5 million to the Administration for the construction of new Trauma facilities, the establishment of Gamma Knife Center, a Flood Fort, improvement to the Emergency Room and purchase of equipment.
- \$420 thousand received in connection with Joint Resolution No. 116 approved by the Commonwealth's Legislature Assembly on July 23, 2007, assigning \$2.9 million to the Administration for the acquisition of medical equipment.
- \$150 thousand received in connection with Joint Resolution No. 242 approved by the Commonwealth's Legislature Assembly on December 13, 2011, assigning to the Administration \$3,400,000 for the acquisition of medical equipment.
- \$22.9 million received in connection with Joint Resolution No. 68 approved by the Commonwealth's Legislature Assembly on July 2, 2010, for payment of the new recruitments, payroll contributions and operating expenses made during year ended June 30, 2012.

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

Management's Discussion and Analysis (Continued)

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

Non-Operating Income (Expenses)

Interest expense during the year ended on June 30, 2012 consisted of approximately \$15 million billed by the Government Development Bank of Puerto Rico.

Contacting the Administration's Financial Management

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

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of Puerto Rico Medical Services Administration (the Administration), a component unit of the Puerto Rico Department of Health (the Department), as of June 30, 2012 and 2011, which collectively comprise the Administration's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Administration's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Administration's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to in the first paragraph presents fairly, in all material respects, the financial position of Puerto Rico Medical Services Administration as of June 30, 2012 and 2011, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued a separated report dated November 30, 2012 on our consideration of the Administration's internal control over financial reporting and our test of its compliance with certain provisions of laws, regulations, contracts, grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financing reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

As described in Note 10, the Administration derives a substantial portion of its revenues from services rendered to member institutions. In addition, the Administration provides services to the medical indigent population, some of them uninsured, which do not have formal means of repayment. Amounts due from member institutions and medical indigent population may be subject to periodic revisions and/or adjustments, based on the availability of funds from the member institutions and/or the entities adhered to the Commonwealth of Puerto Rico.

As described in Note 13, the financial condition of the Administration has been weakened by high operating costs and recurring operating losses, which has affected its ability to pay its suppliers, governmental agencies and other creditors on a regular basis. In addition, the Administration has been affected by the delay in the collection of billings for services rendered to member institutions. As of June 30, 2012 and 2011, the Administration has a total deficit of \$227,736,104 and \$182,463,948, respectively, and a deficiency in working capital of \$8,851,968 and \$43,832,250, respectively. The Administration's operations will depend on obtaining additional contributions from the Secretary of the Puerto Rico Department of Health and the Commonwealth of Puerto Rico to partially subsidize existing and future operating losses, resulting from high operating costs and services provided to the medical indigent population not covered under any private health insurance or non-participating in the Health Reform Program Administered by the Puerto Rico Health Insurance Administration (ASES). The Administration has made formal requests to various Commonwealth's agencies, including the Office of Management and Budget, requesting additional funds to subsidize its operating deficit and improve its existing financial condition.

As explained in Note 14, the accompanying financial statements as of June 30, 2012 and 2011 include accounts receivable aggregating \$36,115,963 and \$34,724,459, respectively, from the Hospital of the Municipality of San Juan, related to medical services rendered by the Administration to the Municipality of San Juan (the Municipality), covering inpatient and outpatient services, laboratory, pharmacy, general services and other ancillary services billed to the Municipality. The ultimate collectability of this account receivable is dependent upon future review and acceptance between the Administration and the Municipality, and as such, cannot be determined as this time. A provision to cover approximately 40% of the uncollectability of this receivable has been made in the accompanying financial statements.

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

Board of Member Institutions of  
Puerto Rico Medical Services Administration  
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Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 1 through 12 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 to 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 information and knowledge that 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.



*FPV Galindez*

San Juan, Puerto Rico  
November 30, 2012

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

Statements of Net Assets (Deficit)

June 30, 2012 and 2011

Assets	<u>2012</u>	<u>2011</u>
Current assets:		
Unrestricted cash	\$ 266,767	\$ 2,871,200
Accounts receivable:		
Member institutions, net of allowance for doubtful accounts of \$62,285,329 in 2012 and \$60,652,996 in 2011	37,803,758	52,448,716
Private insurance, net of allowance for doubtful accounts of \$98,964,813 in 2012 and \$89,324,076 in 2011	18,607,252	15,496,358
Government Development Bank of Puerto Rico in connection with Joint Resolution 4533	-	1,481
Other, net of allowance for doubtful accounts of \$192,879 in 2012 and in 2011	<u>647,744</u>	<u>706,133</u>
	57,325,521	71,523,888
Prepaid expenses	1,197,221	890,415
Inventories	<u>2,805,964</u>	<u>2,270,462</u>
	<u>61,328,706</u>	<u>74,684,765</u>
Non-current assets:		
Restricted cash	7,745,743	10,996,442
Capital assets, net	<u>54,730,068</u>	<u>55,605,053</u>
	<u>62,475,811</u>	<u>66,601,495</u>
	<u>\$ 123,804,517</u>	<u>\$ 141,286,260</u>

(Continue)

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

Statements of Net Assets (Deficit) (Continued)

June 30, 2012 and 2011

Liabilities and Net Assets (Deficit)

	2012	2011
Current liabilities:		
Accounts payable	\$ 39,512,215	\$ 67,603,882
Accrued expenses	21,737,524	19,018,300
Current portion accrued pension costs	6,251,520	29,035,813
Current portion of obligations under capital leases	81,409	179,794
Liabilities payable from restricted assets - improvements to medical facilities and equipment purchase	2,598,006	2,679,226
	70,180,674	118,517,015
Non-current liabilities:		
Line of credit	264,434,263	198,238,573
Accrued pension costs, net of current portion	10,299,651	-
Liabilities payable from restricted assets - Self-Insurance Fund	6,626,033	6,994,620
	281,359,947	205,233,193
Total liabilities	351,540,621	323,750,208
Net assets (deficit):		
Invested in capital assets, net of related debt	54,648,659	55,425,259
Restricted	-	1,322,596
Unrestricted deficit	(282,384,763)	(239,211,803)
Deficit	(227,736,104)	(182,463,948)
	\$ 123,804,517	\$ 141,286,260

See notes to financial statements

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

Statements of Revenues, Expenses and Changes in Net Assets (Deficit)

For the years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Net service revenues	\$ <u>122,570,688</u>	\$ <u>123,762,949</u>
Operating costs and expenses:		
Cost of services	155,975,784	158,105,055
General and administrative	14,974,727	10,484,119
Depreciation and amortization	<u>7,125,922</u>	<u>6,393,070</u>
	<u>178,076,433</u>	<u>174,982,244</u>
Operating loss	<u>(55,505,745)</u>	<u>(51,219,295)</u>
Non-operating income (expenses):		
Contributions from the Commonwealth of Puerto Rico	23,892,054	18,566,075
Interest income and other	1,667,766	782,963
Loss on disposition of capital assets	(34,098)	(106,967)
Gain on debt forgiveness	11,146	42,830,577
Interest expense	<u>(15,303,279)</u>	<u>(11,375,381)</u>
	<u>10,233,589</u>	<u>50,697,267</u>
Changes in net assets (deficit)	(45,272,156)	(522,028)
Deficit at beginning of year	<u>(182,463,948)</u>	<u>(181,941,920)</u>
Deficit at end of year	<u>\$ (227,736,104)</u>	<u>\$ (182,463,948)</u>

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

Statements of Cash Flows

For the years ended June 30, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Receipts from service revenues	\$ 113,934,546	\$ 82,478,425
Payments to suppliers for goods and services and, salaries and related benefits	(137,784,068)	(83,283,795)
Net cash used in operating activities	(23,849,522)	(805,370)
Cash flows from non capital and related financing activities:		
Intergovernmental contributions	22,912,336	20,168,504
Bank overdraft	-	(1,952,606)
Interest paid	(946,075)	(5,827,630)
Net cash provided by non capital and related financing activities	21,966,261	12,388,268
Cash flows from capital and related financing activities:		
Intergovernmental contributions	981,199	399,083
Acquisition of machinery and equipment	(3,482,274)	(1,122,541)
Improvements to emergency room and other facilities	(3,036,862)	(148,079)
Principal payments on obligations under capital leases	(98,385)	(79,856)
Interest paid on capital lease obligations	(3,315)	(9,107)
Net cash used in capital and related financing activities	(5,639,637)	(960,500)
Cash flows from investing activities:		
Increase (decrease) in restricted cash	3,250,699	(8,546,863)
Cash received on disposal of assets	-	5,252
Receipts from interest and other income	1,667,766	782,963
Net cash provided by (used in) investing activities	4,918,465	(7,758,648)
Net change in cash	(2,604,433)	2,863,750
Unrestricted cash, beginning of year	2,871,200	7,450
Unrestricted cash, end of year	\$ 266,767	\$ 2,871,200

(Continue)

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

Statements of Cash Flows (Continued)

For the years ended June 30, 2012 and 2011

	2012	2011
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (55,505,745)	\$ (51,219,295)
Adjustments to reconcile operating loss to net cash used in operating activities		
Depreciation and amortization	7,125,922	6,393,070
Provision for doubtful accounts	12,989,061	24,029,861
Changes in assets and liabilities		
(Increase) decrease in:		
Accounts receivable	(21,625,202)	(65,314,385)
Inventories	(535,502)	13,455
Prepaid expenses	(306,806)	138,050
Increase (decrease) in:		
Accounts payable	22,564,831	107,322,645
Accrued expenses and other	11,443,919	(22,168,771)
	31,656,223	50,413,925
Net cash used in operating activities	\$ (23,849,522)	\$ (805,370)

Non-cash capital investing and financing activities

Retirement of capital assets	\$ 1,062,265	\$ 1,473,898
Payments to suppliers with proceeds of line of credit	\$ 37,775,696	\$ 126,552,928
Payments of accrued pension costs with proceeds of line of credit	\$ 14,066,105	\$ 66,147,000
Non-cash interest expense charged to line of credit	\$ 14,353,889	\$ 4,975,610

See notes to financial statements

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

Notes to Financial Statements

June 30, 2012 and 2011

Note 1 - Organization and summary of significant accounting policies

Organization

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

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

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

Summary of significant policies

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

Basis of presentation

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

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

Notes to Financial Statements (Continued)

June 30, 2012 and 2011

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

Basis of presentation – (continued)

These classifications are defined as follows:

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

If there are significant unspent related debt proceeds at year end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt; rather, that portion of the debt is included in the same net assets component as the unspent proceeds. As of June 30, 2012, net assets invested in capital assets, net of related debt consisted of the balance of capital assets less obligation under capital leases.

- Restricted – This component of net assets consists of constraints placed on net assets use through external constraints imposed by creditors (such as through debt covenants), contributions, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation. As of June 30, 2012, net assets restricted consisted mainly of cash available from governmental contributions received for improvements to the Administration's facilities and other capital additions.
- Unrestricted deficit – This component of net assets consist of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt".

Measurement focus and basis of accounting

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

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

Notes to Financial Statements (Continued)

June 30, 2012 and 2011

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

Use of estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, including estimated uncollectable for accounts receivable for services to patients, and liabilities, including estimated malpractice liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amount of revenue and expenses incurred during the reporting period. The reserve for doubtful accounts, and the estimated malpractice liabilities, among other accounts, requires the significant use of estimates. Actual results could differ from those estimates.

Accounts receivable

Accounts receivable from member institution are presented net of advances received by the Administration from these institutions. These advances are received on a quarterly basis and are applied to the accounts receivable as services are rendered. Approximately \$62,285,000 and \$98,965,000 million, representing receivables from member institutions and private insurance, respectively, are not expected to be collected during the year ending June 30, 2013, which are included as part of the allowance for doubtful accounts within accounts receivable in the accompanying statements of net assets (deficit).

Valuation of accounts receivable

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

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

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

Notes to Financial Statements (Continued)

June 30, 2012 and 2011

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

Fair value of financial instruments

The carrying amounts reported in the statement of net assets (deficit) for cash and receivables, approximate their fair value due to their short-term duration. The carrying amount of obligation under capital leases equals its fair value.

Inventories

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

Capital assets

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

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

<u>Description</u>	<u>Useful Life</u>
Land improvements	40 years
Building	40 years
Building improvements	5 years
Machinery and equipment	3-20 years
Equipment under capital leases	Lease term

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

Notes to Financial Statements (Continued)

June 30, 2012 and 2011

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

Capital assets - (continued)

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

Accounting for the impairment of capital assets

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

Compensated absences

The vacation and sick leave policy of the Administration provides for the accumulation of thirty (30) days of vacation and eighteen (18) days of sick leave annually. Vacation time is fully vested to the employees from the first day of work. An employee is reimbursed for accumulated vacation days up to the maximum allowed of sixty (60) days.

Under the collective bargain agreement, which went into effect on January 1, 2006, employees are entitled to the payment of the excess of fifteen (15) days in accumulated sick leave up to a maximum of eighteen (18) days.

As per Law No. 156 of August 20, 1996, for fiscal years beginning after July 1, 1997, the employees have the right to accumulate the excess of 60 and 90 days in vacation and sick leaves, respectively, until December 31<sup>st</sup> of each year. The excess should be paid to the employees before March 31<sup>st</sup> of the following year.

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

Notes to Financial Statements (Continued)

June 30, 2012 and 2011

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

Net patient service revenue

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

Post-employment benefits other than pension benefits

The Administration adopted the provisions of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*. The Administration provides post-retirement benefits to all employees who meet certain age and years of services requirements. Such benefits consist principally of health care benefits and a post-employment payment. Healthcare benefits are provided for a period of six (6) months after retirement. A lump-sum payment is made for post-employment bonus after retirement.

Revenues

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

Operating revenues and expenses

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

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

Notes to Financial Statements (Continued)

June 30, 2012 and 2011

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

Insurance

The Administration carries commercial insurance to cover for casualty, theft, claims and other losses. The Commonwealth negotiates the commercial insurance coverage, and the cost is paid by the Administration. The Administration is self-insured for medical malpractice claims and judgments, as discussed in Note 5. The Administration also pays for workers' compensation insurance to another component unit of the Commonwealth.

Non-exchange transactions

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

Deposits and investment risks

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

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

Notes to Financial Statements (Continued)

June 30, 2012 and 2011

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

Recently issued accounting standards

- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*

This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Concepts Statement No. 4 *Elements of financial Statements*, introduced and defined those elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities.

The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2011. Earlier application is encouraged.

- GASB Statement No. 64, *Application of Hedge Accounting Termination Provisions – an amendment of GASB Statement No. 53*

The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. This Statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied.

The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2011. Earlier application is encouraged.

- GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*

This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

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

Notes to Financial Statements (Continued)

June 30, 2012 and 2011

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

Recently issued accounting standards – (continued)

- GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* – (continued)

The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. Earlier application is encouraged.

- GASB Statement No. 66, *Technical Correction -2012 an amendment of GASB Statement No. 62*

The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 1989 FASB and AICPA Pronouncements*.

This Statement amends, Statement 62 by modifying the specific guidance on accounting for (1) operating lease payments that vary from a straight-line basis, (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. These changes clarify how to apply Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*, and result in guidance that is consistent with the requirements in Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, respectively.

The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. Earlier application is encouraged.

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

Notes to Financial Statements (Continued)

June 30, 2012 and 2011

Note 2 - Restricted cash

Restricted cash as of June 30, 2012 and 2011 consisted of:

Description	2012	2011
Cash-restricted for:		
Improvements to medical facilities and purchase of equipment	\$ 2,433,299	\$ 2,488,698
Self-insurance fund	5,268,335	8,402,715
Gamma Knife	652	101,646
Other	<u>43,457</u>	<u>3,383</u>
	<u>\$ 7,745,743</u>	<u>\$ 10,996,442</u>

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

Note 3 - Net service revenue

Patient services revenue

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

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

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

Notes to Financial Statements (Continued)

June 30, 2012 and 2011

Note 3 - Net service revenue – (continued)

Patient services revenue – (continued)

The Administration's Medicare cost reports have been reviewed by the Medicare fiscal intermediary through 2011.

The cost report for 2012 is subject to the Medicare fiscal intermediary examination. Laws and regulations governing the Medicare program are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change in the near term.

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

Member institutions

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

A summary of gross and net patient service revenue for the years ended June 30, 2012 and 2011 follows:

Year ended June 30, 2012:

	<u>Net Patient Service Revenue</u>	<u>Members Institutions</u>	<u>Total</u>
Gross patient service revenue	\$112,365,066	\$ 92,472,942	\$204,838,008
Less:			
Contractual adjustments under third party	(69,278,259)	-	(69,278,259)
Provision for bad debts	<u>(11,399,569)</u>	<u>(1,589,492)</u>	<u>(12,989,061)</u>
Net service revenue	<u>\$ 31,687,238</u>	<u>\$90,883,450</u>	<u>\$122,570,688</u>

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

Notes to Financial Statements (Continued)

June 30, 2012 and 2011

Note 3 - Net service revenue – (continued)

Year ended June 30, 2011:

	<u>Net Patient Service Revenue</u>	<u>Members Institutions</u>	<u>Total</u>
Gross patient service revenue	\$103,624,991	\$104,719,972	\$208,344,963
Less:			
Contractual adjustments under third party	(60,552,153)	-	(60,552,153)
Provision for bad debts	<u>(17,493,242)</u>	<u>(6,536,619)</u>	<u>(24,029,861)</u>
Net service revenue	<u>\$ 25,579,596</u>	<u>\$ 98,183,353</u>	<u>\$123,762,949</u>

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

Notes to Financial Statements (Continued)

June 30, 2012 and 2011

Note 4 - Capital assets

Capital assets as of June 30, 2012 and 2011, and activity during the years then ended is as follow:

Description	Balance June 30, 2011	Acquisitions	Retirements	Reclasification	Balance June 30, 2012
Capital assets not being depreciated:					
Land	\$ 6,871,955	\$ -	\$ -	\$ -	\$ 6,871,955
Capital assets being depreciated:					
Land improvements	11,867,399	-	-	-	11,867,399
Building and improvements	79,954,716	3,036,862	-	-	82,991,578
Machinery and equipment	48,118,431	3,482,274	(750,842)	-	50,849,863
Equipment under capital leases	20,510,520	-	(311,423)	-	20,199,097
	<u>160,451,066</u>	<u>6,519,136</u>	<u>(1,062,265)</u>	<u>-</u>	<u>165,907,937</u>
Accumulated depreciation and amortization:					
Land improvements	11,742,823	72,685	-	-	11,815,508
Building and improvements	46,211,208	2,109,730	-	-	48,320,938
Machinery and equipment	33,313,276	4,883,647	(482,643)	-	37,714,280
Equipment under capital leases	20,450,661	59,860	(311,423)	-	20,199,098
	<u>111,717,968</u>	<u>7,125,922</u>	<u>(794,066)</u>	<u>-</u>	<u>118,049,824</u>
Capital assets being depreciated, net	<u>48,733,098</u>	<u>(606,786)</u>	<u>(268,199)</u>	<u>-</u>	<u>47,858,113</u>
Capital assets, net	<u>\$ 55,605,053</u>	<u>\$ (606,786)</u>	<u>\$ (268,199)</u>	<u>\$ -</u>	<u>\$ 54,730,068</u>

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

Notes to Financial Statements (Continued)

June 30, 2012 and 2011

Note 4 - Capital assets – (continued)

Description	Balance June 30, 2010	Acquisitions	Retirements	Reclasification	Balance June 30, 2011
Capital assets not being depreciated:					
Land	\$ 6,871,955	\$ -	\$ -	\$ -	\$ 6,871,955
Construction in progress	<u>22,000,000</u>	<u>-</u>	<u>-</u>	<u>(22,000,000)</u>	<u>-</u>
	<u>28,871,955</u>	<u>-</u>	<u>-</u>	<u>(22,000,000)</u>	<u>6,871,955</u>
Capital assets being depreciated:					
Land improvements	11,867,399	-	-	-	11,867,399
Building and improvements	57,806,637	148,079	-	22,000,000	79,954,716
Machinery and equipment	48,502,312	1,122,541	(1,506,422)	-	48,118,431
Equipment under capital leases	<u>20,584,964</u>	<u>-</u>	<u>(74,444)</u>	<u>-</u>	<u>20,510,520</u>
	<u>138,761,312</u>	<u>1,270,620</u>	<u>(1,580,866)</u>	<u>22,000,000</u>	<u>160,451,066</u>
Accumulated depreciation and amortization:					
Land improvements	11,654,870	87,953	-	-	11,742,823
Building and improvements	44,320,382	1,890,826	-	-	46,211,208
Machinery and equipment	30,250,664	4,349,848	(1,287,236)	-	33,313,276
Equipment under capital leases	<u>20,460,662</u>	<u>64,443</u>	<u>(74,444)</u>	<u>-</u>	<u>20,450,661</u>
	<u>106,686,578</u>	<u>6,393,070</u>	<u>(1,361,680)</u>	<u>-</u>	<u>111,717,968</u>
Capital assets being depreciated, net	<u>32,074,734</u>	<u>(5,122,450)</u>	<u>(219,186)</u>	<u>22,000,000</u>	<u>48,733,098</u>
Capital assets, net	<u>\$ 60,946,689</u>	<u>\$ (5,122,450)</u>	<u>\$ (219,186)</u>	<u>\$ -</u>	<u>\$ 55,605,053</u>

Amortization expense of equipment under capital leases for the year ended June 30, 2012 and 2011 amounted to \$59,860 and \$64,443, respectively.

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

Notes to Financial Statements (Continued)

June 30, 2012 and 2011

Note 5 - Self-insurance fund

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

The Administration maintains in the Fund cash of \$5,268,335 and \$8,402,715 as of June 30, 2012 and 2011, respectively, to provide for the payment of possible claims. Funding requirements are determined based on actuarial report and the Administration's Internal Council Office. The most recent actuarial reports as of June 30, 2012 and 2011, presented estimated liabilities of approximately \$3,423,158 and \$4,239,500, respectively, which were related with claims incurred during the years ended June 30, 1989 to June 30, 2012.

The following is the activity of the restricted cash available and liabilities payable from restricted assets under the Self-Insurance Fund for the years ended June 30, 2012 and 2011.

June 30, 2012:

Description	Restricted cash	Liabilities Payable
Balances as of beginning of year	\$8,402,715	\$6,994,620
Funds received from operations	6,677,426	200
Claims paid and other disbursements	<u>(9,811,806)</u>	<u>(368,787)</u>
Balance as of end of year	<u>\$5,268,335</u>	<u>\$6,626,033</u>

June 30, 2011:

Description	Restricted cash	Liabilities Payable
Balances as of beginning of year	\$ 2,265	\$7,405,510
Funds received from operations	9,088,998	400
Claims paid and other disbursements	<u>(688,548)</u>	<u>(411,290)</u>
Balance as of end of year	<u>\$8,402,715</u>	<u>\$6,994,620</u>

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

Notes to Financial Statements (Continued)

June 30, 2012 and 2011

Note 6 - Accrued pension costs

Accrued pension costs as of June 30, 2012 and 2011 consisted of:

June 30, 2012:

Description	Amount
Employer's contributions	\$ 2,292,720
Employee's contributions	2,178,327
Employee's and employer's contributions under System 2000	4,200,130
Withholdings of employees' loans	157,322
Interest and other	<u>7,722,672</u>
	16,551,171
Less: Current portion	<u>(6,251,520)</u>
Accrued pension cost, net of current portion	<u>\$10,299,651</u>

Accrued pension cost current portion presented in the accompanying statements of net assets (deficit) at June 30, 2012, consists of accrued pension costs current portion corresponding to fiscal year 2011-2012 amounting to \$3,183,396 and those related to fiscal year 2010-2011 under the below payment plan amounting to \$3,068,124.

June 30, 2011:

Description	Amount
Employer's contributions	\$ 2,741,390
Employee's contributions	2,403,208
Employee's and employer's contributions under System 2000	4,590,431
Withholdings of employees' loans	74,534
Interest and other	<u>19,226,250</u>
	<u>\$29,035,813</u>

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

June 30, 2012 and 2011

Note 6 - Accrued pension costs (continued)

On November 1, 2011, the Administration entered into a payment plan agreement (the Agreement) with the Administration of the Retirement Systems of the Employees of the Government and the Judicature of Puerto Rico (Retiro) for repayment of debt amounting to \$15,340,619, at such date, corresponding to fiscal year 2010-2011. Beginning on November 15, 2011, the agreement calls for sixty (60) monthly installments of \$255,677 bearing no interest. Default payments of less than one year in default, will bear interest at 9%, and 12% for those in excess of one year.

Future minimum payments for the next five (5) years are as follows:

<u>Year</u>	<u>Amount</u>
2013	\$ 3,068,124
2014	3,068,124
2015	3,068,124
2016	3,068,124
2017	<u>1,025,279</u>
Total	<u>\$13,297,775</u>

Note 7 - Employees' retirement plan

The Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (the System) is a cost sharing multiple-employer defined-benefit pension plan sponsored by, and reported as a component unit of the Commonwealth.

The System was created under Act. No 447 (the Act), approved on May 15, 1951, as amended, and became effective on January 1, 1952. All regular appointed and temporary employees of the Administration under age of fifty-five (55) at the date of employment became plan participants of the System.

The System provides retirement, death, and disability benefits. Retirement benefits depend upon age retirement and number of years of credited service. Benefits generally vest after ten (10) years of plan participation.

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

June 30, 2012 and 2011

Note 7 - Employees' retirement plan (continued)

Retirement benefits are determined by the application of stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest thirty-six (36) months of compensation recognized by the System. The annuity, for which a plan member is eligible, is limited to a minimum of \$200 per month and a maximum of 75 percent of the average compensation.

Contribution requirements, which are established by Law and are not actuarially determined, are as follows:

Commonwealth	10.275% of applicable payroll
Employees:	
Hired on or before March 31, 1990	5.775% of monthly gross salary up to \$550
	8.275% of monthly gross salary over \$550
Hired on or after April 1, 1990	8.275% of monthly gross salary

On September 24, 1999, an amendment to Act, which created the System, was enacted with the purpose of establishing a defined contribution plan known as System 2000.

System 2000 became effective on January 1, 2000. Employees participating in the defined-benefit plan (the "traditional plan") at December 31, 1999, had the option to either stay in the traditional plan or transfer to System 2000. Persons employed on or after January 1, 2000, are only allowed to become members of System 2000.

System 2000 is a hybrid defined-contribution plan, also known as a cash balance plan. Under this new plan, there is a pool of pension assets, which are invested by the System, together with those of System 2000 benefit plan. The Commonwealth does not guarantee benefits at retirement age. The annuity is based on a formula which assumes that each year the participants' contribution (with a minimum of 5.275% of the participants' salary up to a maximum of 10%) will be invested as instructed by the participant in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Notes, (2) earn a rate equal to 75% of the return of the return of the System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants receive periodic account statements similar to those of a defined contribution plans showing their accrued balances. Disability pensions are not granted under

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

June 30, 2012 and 2011

Note 7 - Employees' retirement plan - (continued)

System 2000. The employers' contributions (10.275% of the employee's salary) are used to fund the defined benefit plan.

System 2000 reduces the retirement age from sixty-five (65) years to sixty (60) years for those employees who joined the current plan on or after January 1, 2000.

Total employee and employer required contributions for the years ended June 30, 2012, 2011 and 2010, are as follows:

<u>Description</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>
Traditional Plan-			
Employer	<u>\$3,257,139</u>	<u>\$ 3,063,550</u>	<u>\$ 3,107,405</u>
Employee	<u>\$2,576,671</u>	<u>\$ 2,681,952</u>	<u>\$ 2,740,949</u>
System 2000-			
Employer	<u>\$2,961,438</u>	<u>\$ 2,632,640</u>	<u>\$ 2,635,002</u>
Employee	<u>\$2,421,991</u>	<u>\$ 2,382,469</u>	<u>\$ 2,384,653</u>
Interest	<u>\$5,507,095</u>	<u>\$ 4,931,284</u>	<u>\$ 6,797,048</u>

Total employee and employers contributions paid by the Administration during the years ended June 30, 2012, 2011 and 2010 are as follows:

<u>Description</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>
Traditional Plan-			
Employer	<u>\$3,705,924</u>	<u>\$14,302,950</u>	<u>\$ 767,557</u>
Employee	<u>\$2,685,961</u>	<u>\$ 7,958,453</u>	<u>\$ 890,119</u>
System 2000-			
Employer	<u>\$3,155,506</u>	<u>\$ 9,397,254</u>	<u>\$ 534,092</u>
Employee	<u>\$2,762,470</u>	<u>\$ 5,318,483</u>	<u>\$ 681,770</u>

As of June 30, 2012 and 2011, the total unpaid employee and employer contributions, due to the System including interest, amounted to \$16,551,171 and \$29,035,813.

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Notes to Financial Statements (Continued)

June 30, 2012 and 2011

Note 7 - Employees' Retirement Plan - (continued)

For the year ended June 30, 2012 and 2011, total covered payroll for employees was approximately \$60,529,225 and \$61,468,860, respectively. Covered payroll refers to all compensation paid by the Administration to employees covered by the ERS on which contributions to the pension are based.

The System issues, publicly available financial reports that include their basic financial statements and required supplementary information. Those reports may be obtained by writing to the System's administrator at 437 Ponce de León, Hato Rey, Puerto Rico 00918, Telephone Number (787) 756-4410.

Note 8 - Post-employment benefits - other than pensions

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

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

The calculation was based on the types of benefits provided under the terms of employees' collective bargain agreements. The calculation involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and such determined amounts are subject to continual revision as actual results compared to past experience and new estimates are made about the future. The required schedule of funding progress as of June 30, 2012 and 2011, presented as required supplementary information provides multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

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

June 30, 2012 and 2011

Note 8 - Post-employment benefits other than pensions – (continued)

Description	2012	2011
Benefit obligation, beginning of year	<u>\$1,175,393</u>	<u>\$ 981,935</u>
Change in benefit obligation:		
Amortization of past service cost (\$4,676,400 in 2011 and \$4,010,699 in 2010)	286,908	240,840
Service cost	195,904	182,273
Adjustment to annual required contribution	(26,525)	(20,855)
Benefits paid	<u>(286,200)</u>	<u>(208,800)</u>
Annual postemployment cost	<u>170,087</u>	<u>193,458</u>
Benefit obligation accrued at end of year reflected in balance sheet	<u>\$1,345,480</u>	<u>\$1,175,393</u>
Assumptions:		
Discount rate	<u>4.0%</u>	<u>4.0%</u>
Expected long-term rate of return on plan assets	<u>0.00%</u>	<u>0.00%</u>
Health care cost trend rate	<u>5.90%</u>	<u>6.50%</u>
Retirement age	<u>65 years</u>	<u>65 years</u>

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

June 30, 2012 and 2011

Note 8 - Post-employment benefits other than pensions – (continued)

Required supplementary information

Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Accrued Liability (b)	(\$ 000s)			UAL as a Percentage of Covered Payroll ((b-a)/c)
			Unfunded Accrued Liability (UAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	
July 1, 2011	\$ -	\$4,676	\$4,676	0.0%	\$67,639	6.9%
July 1, 2009	\$ -	\$3,869	\$3,869	0.0%	\$72,395	5.3%
July 7, 2007	\$ -	\$1,059	\$1,059	0.0%	\$58,711	1.8%

Schedule of Employer Contributions

(\$ 000s)

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
June 30, 2012	\$456	62.7%	\$1,345
June 30, 2011	\$402	51.9%	\$1,175
June 30, 2010	\$387	48.5%	\$982
June 30, 2009	\$639	16.9%	\$783
June 30, 2008	\$302	16.5%	\$252

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

June 30, 2012 and 2011

Note 9 - Commitments and contingencies

Commitments

Capital leases

The Administration leases certain equipment under various capital lease agreements expiring in various dates through the year 2013. The future minimum lease obligations and the net present value of the minimum lease payments as of June 30, 2012, under existing capital lease agreements are as follows:

<u>Year ending June 30,</u>	<u>Amount</u>
2013	<u>\$81,409</u>

Activity of long-term debt for the years ended June 30, 2012 and 2011 are as follows:

As of June 30, 2012:

<u>Description</u>	<u>Balance June 30, 2011</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance June 30, 2012</u>	<u>Current Portion</u>
Capital lease obligations	<u>\$179,794</u>	<u>\$ -</u>	<u>\$ 98,385</u>	<u>\$ 81,409</u>	<u>\$ 81,409</u>

As of June 30, 2011:

<u>Description</u>	<u>Balance June 30, 2010</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance June 30, 2011</u>	<u>Current Portion</u>
Capital lease obligations	<u>\$259,650</u>	<u>\$ -</u>	<u>\$ 79,856</u>	<u>\$179,794</u>	<u>\$179,794</u>

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

June 30, 2012 and 2011

Note 9 - Commitments and contingencies – (continued)

Commitments – (continued)

Operating leases

The Administration leases certain equipment under various operational lease agreements expiring at various dates through year 2017. In addition, other commitments exist related to contracts for materials and maintenance. Total rental expense under operating leases amounted to approximately \$1,099,000 and \$1,261,000 for the years ended June 30, 2012 and 2011, respectively.

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

<u>Years ending June 30,</u>	<u>Amount</u>
2013	\$ 6,578,482
2014	4,499,341
2015	1,194,108
2016	234,409
2017	<u>32,569</u>
	<u>\$12,538,909</u>

Government Development Bank Line of Credit

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

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

- a. payment of debts to suppliers, agencies, institutions, reserve fund for the self-insurance (professional responsibility and inter-fund debt) of the Administration; and

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

June 30, 2012 and 2011

Note 9 - Commitments and contingencies – (continued)

Commitments – (continued)

Government Development Bank Line of Credit – (continued)

- b. to provide operational liquidity to ease their fiscal situation, as determined by the agreement with the GDB.

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

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

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

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

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

June 30, 2012 and 2011

Note 9 - Commitments and contingencies – (continued)

Commitments – (continued)

Government Development Bank Line of Credit – (continued)

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

Contingencies

The Administration is a party in certain legal actions and claims related to medical malpractice arising in the ordinary conduct of its business. Although the Administration appears as a defendant in the claims, many of them involve medical personnel of the member institutions, and in effect, these claims are against said institutions. As a result of the deficiency as of June 30, 2012 and 2011, of funds available in the Self-Insurance Fund, any unfavorable outcome may have a significant effect on the financial condition of the Administration.

Based on a review of current facts and circumstances management has provided for what is believed to be a reasonable estimate of the exposure to loss associated to litigation. The Administration has established an accrual reserve for claim losses in the amount of \$6,626,033 and \$6,994,620 at June 30, 2012 and 2011, respectively.

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Notes to Financial Statements (Continued)

June 30, 2012 and 2011

Note 9 - Commitments and contingencies – (continued)

Contingencies – (continued)

Regulatory issues

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

Health Insurance Portability and Accountability Act

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

Note 10 - Services to member institutions and medical indigent population

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

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Notes to Financial Statements (Continued)

June 30, 2012 and 2011

Note 11 - Contributions from the Commonwealth of Puerto Rico

Governmental contributions during the years ended June 30, 2012 and 2011, consist of the following:

Description	2012	2011
Funds received in connection with Joint Resolution No. 4533 approved by the Commonwealth's Legislature on August 12, 2004, assigned \$40.5 million to the Administration for the construction of a new Trauma facilities, the establishment of a Gamma Knife Center, a blood bank, improvement to the emergency room and purchase of equipment.	\$ 411,304	\$ 386,995
Funds received in connection with Joint Resolution No. 116 approved by the Commonwealth's Legislative Assembly on July 23, 2007, assigning \$2.9 million to the Administration for the acquisition of medical equipment.	419,895	19,080
Funds received in connection with Joint Resolution No. 242 approved by the Commonwealth's Legislature on December 13, 2011, assigning to the Administration \$3,400,000 for the acquisition of medical equipment.	150,000	-
Funds received in connection with Joint Resolution No. 68 approved by the Commonwealth's Legislature on July 2, 2010, to reimburse the Administration for the payment of recruitment, payroll contributions and operating expenses made during year ended June 30, 2012 and 2011.	<u>22,910,855</u>	<u>18,160,000</u>
	<u>\$23,892,054</u>	<u>\$18,566,075</u>

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

June 30, 2012 and 2011

Note 12 - Gain on debt forgiveness

As fully disclosed in note 9 above, during 2011 the Administration obtained a line of credit from the Puerto Rico Governmental Development Bank (GDB) that was used to settle certain amounts due to suppliers, agencies and institutions. From the savings generated as a result of the debt renegotiations, the Administration recorded a gain on debt forgiveness amounting to \$11,146 and \$42,830,577 for the years ended June 30, 2012 and 2011, respectively, included as non-operating income in the accompanying statement of revenues, expenses and changes in net assets (deficit).

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

The financial condition of the Administration has been weakened by high operating costs and recurring operating losses, which has affected its ability to pay its suppliers, governmental agencies and other creditors on a regular basis. In addition, the Administration has been affected by the delay in the collection of billings for services rendered to member institutions. As of June 30, 2012 and 2011, the Administration has total deficit of \$227,736,104 and \$182,463,948, respectively. The Administration's operations will depend on obtaining additional contributions from the Commonwealth of Puerto Rico to partially subsidize existing and future operating losses, resulting from high operating costs and services provided to the medical indigent population not covered under any private health insurance or non-participating in the Health Reform Program Administered by the Puerto Rico Health Insurance Administration (ASES).

The Administration has made formal request to various Commonwealth's agencies, including the Office of Management and Budget, petitioning additional funds to subsidize its operating deficit.

The following initiatives have been established:

1. On September 7, 2005, Act 112 was approved to amend Article 15 of Act 66 of June 22, 1978. The last-mentioned Act requires, from the Secretary of Health and the ASEM's Executive Director (CEO), the compilation and submission to the Governor and to Legislative Assembly of Puerto Rico, a reorganization plan for the integration and consolidation of administrative functionalities and programs of all the components of the Puerto Rico Medical Center to achieve operational efficiency and reduction of costs.
2. In connection with the requirements of Act 112, and to comply with the foresaid integration and consolidation, on January 31, 2007, the Secretary of Health and the ASEM's CEO submitted to the Governor of the Commonwealth of Puerto Rico an action plan for the improvement of the Puerto Rico Medical Center. This plan included the Administration (ASEM), the University District Hospital (UDH) and the Pediatric University Hospital

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Notes to Financial Statements (Continued)

June 30, 2012 and 2011

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

(PUH). Similar recommendations were included in a 2008 report, by the Health System Evaluation Committee appointed by the Governor in reference to the operation of the Medical Center. The report highlights the following recommendations:

- a. To obtain more relevant information of all the Medical Center Components, in addition to the information included in the report, to determine necessary changes and to establish the feasibility criteria for a reorganization of the Medical Center.
  - b. The implementation of a new integrated information system to be shared with the member institutions. This system is already in place and fully operational.
  - c. The reevaluation of the relationship of all Member Institutions with the Medical Services Administration itself to promote the efficiency utilization and quality of services. Presently there are several agreements in process with the Medical Sciences Campus and other Institutions as well.
  - d. The establishment of a Project of Law to harmonize the Act 66 of June 22, 1978, (the creator of the ASEM), with Act 72 (September 7, 1993), which implement the Health Reform by the Puerto Rico Health Insurance Administration (ASES).
  - e. The establishment of recurrent financing sources by the Government of Puerto Rico's Office of Management and Budget (OGP) to subsidize ASEM's costly operation and, therefore, to be able to keep providing the complex medical services, the use of highly technological equipment and to subsidize the clinical treatment to the medical indigent and economical disadvantaged population not covered otherwise.
3. The establishment of revised chart of rates for services rendered to member institutions, medical insurance companies and others, to cover the actual cost.
  4. Enforce the member institutions to comply with Article No. 13 of Act 6 (June 2, 1978), as amended. It requires the settlement of past due amounts owed to the Administration at the end of each fiscal year, documented with periodic billings submitted for goods and services provided in excess of periodic cash advances received.

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Notes to Financial Statements (Continued)

June 30, 2012 and 2011

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

5. Requesting that all past unpaid debts incurred by the member institutions with the Administration be settled immediately. Presently, ASEM is developing a collections plan as applicable as discussed below.
6. Establishing a subsidiary of accounts receivable for Member Institutions to achieve and enhance the recovery of delinquent accounts. This was established at the beginning of this fiscal year.
7. The Administration acquired a system for the billing of the health insurance companies. It also contains bookkeeping and administrative tools to improve management and control of the accounts receivables. The Administration expects a billing and recovery improvement in this area. This system is in place, working properly and under continuous development.
8. Furthermore, self-motivated, with the rebuilding of the Pharmacy facilities, along with a Cardinal Health's Pyxis system, we will improve our medications delivery efficiency and reduce the drugs wasting. This also provides mechanisms to the correct invoicing of medications to the patients and insurances as well. There will also be new tasks created with this project. These can also generate direct income by selling the service of the recombination of intravenous medications to other hospitals in the area. The law provides that this can only be performed by licensed pharmacists in a licensed facility, being ASEM's the only one in the Medical Center with such characteristics.
9. Another initiative gestated by the Office of ASEM's CEO was the contracting the expertise of Vixen Technology Services, LLC, to improve all administrative process leading to the patients involving: admissions, pre-certification, claims and billing, among others. According to the 2010-000042 contracts, Vixen will help the ASEM to recover a substantial amount of money.
10. Purchasing of medicines supplies through "Group Purchasing Organization" (GPO) and "340B Drug Pricing Program" to obtain purchase discounts ranging from 20% to 60%.
11. Establishment of a community outpatient pharmacy, to capture patients receiving services in the Puerto Rico Medical Center area.
12. Development of comprehensive work plan to achieve a trauma hospital level 1 accreditation.
13. Promote and expand actual services provided to member institutions to private sectors.

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

June 30, 2012 and 2011

Note 14 - Uncertainties

The Administration has net accounts receivable aggregating \$21,844,158 and \$18,617,323 from the Hospital of the Municipality of San Juan, related to medical services rendered by the Administration to the municipality of San Juan covering inpatient and outpatient services, laboratory, pharmacy, general services and other ancillary services billed to the Municipality in accordance with the provision of Law No. 66 of June 22, 1978, which created the Administration, to operate and administer the centralized health services, provided in support of the member institution and consumers of the complex known as "Puerto Rico Medical Center". The Administration demands that these amounts are due related to services rendered covering the period from June 30, 2005 to June 30, 2012; however, certain amounts are still unpaid.

The Administration filed a claim at the Puerto Rico Department of Justice and at the Commission for the Resolution of Controversies for Over Payment and Debts between Governmental Agencies (the Commission), demanding the resolution of this matter.

On June 29, 2009, the Commission designated the Puerto Rico Office of Management and Budget (OMB) to serve as a mediator in this claim. As of the date of the accompanying financial statements, no resolution or recommendation has been made by OMB in connection with this controversy.

Note 15 - Reclassifications

Certain reclassifications have been made to the 2011 financial statement figures to conform them to current year presentation.

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

June 30, 2012 and 2011

Note 16 - Concentration of credit – patients' accounts receivable

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

The mix of receivables from patients and third-party payors at June 30 2012 and 2011, is as follows:

	2012	2011
ACAA	10%	9%
Humana Insurance	7%	8%
Private	42%	37%
Triple S	5%	7%
MCS	14%	22%
Medicare	5%	6%
Others	17%	11%
	100%	100%

Note 17- Functional expenses

The Administration provides general health care services. Expenses, related to providing these services for the year ended June 30 2012 and 2011, are as follow:

	2012	2011
Health care services	\$155,975,784	\$158,105,055
General and administrative	22,100,649	16,877,189
	\$178,076,433	\$174,982,244

Note 18 - Subsequent event

The Administration evaluated subsequent events through November 30, 2012 which is the date the financial statements were available to be issued. No events have occurred subsequent to the statement of net assets date and to the financial statements were available to be issued, that would require additional adjustment to, or disclosure in the financial statements.