



CERTIFIED PUBLIC ACCOUNTANTS

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

Financial Statements

June 30, 2013 and 2012

---

Member of



## Table of Contents

Management's Discussion and Analysis	1-15
Independent Auditors' Report	16-18
Financial Statements:	
Statements of Net Position	19-20
Statements of Revenues, Expenses and Changes in Net Position	21
Statements of Cash Flows	22-23
Notes to Financial Statements	24-59

## Management's Discussion and Analysis

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

Management's Discussion and Analysis

The following discussion and analysis of the Puerto Rico Medical Services Administration (the Administration) provides an overview of the Administration's financial performance during the years ended June 30, 2013 and 2012. Please read it in conjunction with the basic financial statements, which follow this section.

Financial Highlights

1. The Administration's net position as of June 30, 2013 and 2012 amounted to approximately (\$269) million and (\$228) million, respectively.
2. During the years ended June 30, 2013 and 2012 the Administration experienced operating losses of approximately \$77 million and \$56 million, respectively.
3. During the years ended June 30, 2013 and 2012, the Administration received approximately \$47 million and \$24 million, respectively, in contributions from governmental agencies, for payment of new recruitments, payroll contributions and other operating expenses.

Required Financial Statements

The required basic financial statements of the Administration consist of:

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

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

Management's Discussion and Analysis (Continued)

Statement of Net Position

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

	<u>2013</u>	<u>2012</u>	<u>Increase (Decrease)</u>	<u>%</u>
Current assets	\$ 51,780	\$ 61,329	\$ (9,549)	-16%
Non-current assets:				
Capital assets, net	52,634	54,730	(2,096)	-4%
Restricted cash	2,986	7,746	(4,760)	-61%
Other non-current assets	3,500	-	3,500	-
	<u>59,120</u>	<u>62,476</u>	<u>(3,356)</u>	<u>-5%</u>
	<u>\$ 110,900</u>	<u>\$ 123,805</u>	<u>\$ (12,905)</u>	<u>-10%</u>
Current liabilities	\$ 81,274	\$ 57,772	\$ 23,502	41%
Non-current liabilities	<u>298,691</u>	<u>293,769</u>	<u>4,922</u>	<u>2%</u>
	379,965	351,541	28,424	8%
Net position	<u>(269,065)</u>	<u>(227,736)</u>	<u>(41,329)</u>	<u>18%</u>
	<u>\$ 110,900</u>	<u>\$ 123,805</u>	<u>\$ (12,905)</u>	<u>-10%</u>
Net Position:				
Net investment in capital assets	\$ 52,634	\$ 54,649	\$ (2,015)	-4%
Unrestricted deficit	<u>(321,699)</u>	<u>(282,385)</u>	<u>(39,314)</u>	<u>14%</u>
	<u>\$ (269,065)</u>	<u>\$ (227,736)</u>	<u>\$ (41,329)</u>	<u>18%</u>

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

Management's Discussion and Analysis (Continued)

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

	<u>2012</u>	<u>2011</u>	Increase (Decrease)	%
Current assets	\$ 61,329	\$ 74,685	\$ (13,356)	-18%
Non-current assets:				
Capital assets, net	54,730	55,605	(875)	-2%
Restricted cash	<u>7,746</u>	<u>10,996</u>	<u>(3,250)</u>	-30%
	<u>62,476</u>	<u>66,601</u>	<u>(4,125)</u>	-6%
	<u>\$ 123,805</u>	<u>\$ 141,286</u>	<u>\$ (17,481)</u>	<u>-12%</u>
Current liabilities	\$ 57,772	\$ 118,517	\$ (60,745)	-51%
Non-current liabilities	<u>293,769</u>	<u>205,233</u>	<u>88,536</u>	43%
	351,541	323,750	27,791	9%
Net position	<u>(227,736)</u>	<u>(182,464)</u>	<u>(45,272)</u>	25%
	<u>\$ 123,805</u>	<u>\$ 141,286</u>	<u>\$ (17,481)</u>	<u>-12%</u>
Net Position:				
Net investment in capital assets	\$ 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>	18%
	<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 Position

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

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

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

	<u>2012</u>	<u>2011</u>	<u>Increase (Decrease)</u>	<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>

*This Space Is Intentionally Left In Blank*

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

Management's Discussion and Analysis (Continued)

Statement of Net Position – (continued)

The net decrease in accounts receivable from member institutions and private insurances, consisted of the following activity during the years ended June 30, 2013 and 2012 (in thousands):

As of June 30, 2013:

	Member Institutions	Private Insurance	Total
Gross services revenues	\$ 91,237	\$ 110,301	\$ 201,538
Revenue accounts reclassification	4,711	(3,717)	994
Contractual adjustments	-	(60,649)	(60,649)
Contractual adjustment reclassification	-	1,812	1,812
Non cash transactions	(6,156)	-	(6,156)
Provision for bad debt expense	(14,437)	(15,580)	(30,017)
Collections	(82,244)	(32,802)	(115,046)
Reclassification of receivable from Municipality of San Juan	(11,500)	-	(11,500)
	<u>\$ (18,389)</u>	<u>\$ (635)</u>	<u>\$ (19,024)</u>

As of June 30, 2012:

	Member Institutions	Private Insurance	Total
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	(83,834)	(28,448)	(112,282)
	<u>\$ (14,645)</u>	<u>\$ 3,110</u>	<u>\$ (11,535)</u>

During 2013 the Administration improved the billing process, continues a collection plan and renegotiated some commercial health insurance contracts. As a result, there was an increase of \$2,764 in collections. The increase \$17,028 in the provision of bad debt expense is principally due to the negotiation with the Municipality of San Juan.

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

Management's Discussion and Analysis (Continued)

Statement of Net Position – (continued)

Non-Current Assets - Capital Assets

As of June 30, 2013:

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

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
Capital assets, net	<u>\$ 55,605</u>	<u>\$ (607)</u>	<u>\$ (268)</u>	<u>\$ 54,730</u>

The decrease in capital assets during the year ended June 30, 2013 is mainly due to the fact that current year depreciation exceeded the current year acquisitions of equipment and the cost of building improvements.

*This Space Is Intentionally Left In Blank*

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

Management's Discussion and Analysis (Continued)

Statement of Net Position – (continued)

Liabilities

Current liabilities

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

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

The increase in accounts payable was mainly due to the deficiency of cash flow to pay debts in the Administration during the year ended June 30, 2013.

*This Space Is Intentionally Left In Blank*

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

Management's Discussion and Analysis (Continued)

Statement of Net Position – (continued)

Non-current liabilities

The increase in non-current liabilities as of June 30, 2013, consisted of (in thousands):

	<u>2013</u>	<u>2012</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	\$ 273,344	\$ 264,434	\$ 8,910	3%
Accrued pension costs, net of current portion	9,386	10,300	(914)	-9%
Compensatd absences, net of current portion	11,199	11,063	136	1%
Other post-employment benefit obligation	1,572	1,345	227	17%
Liabilities payable from restricted assets-Self insurance fund	<u>3,190</u>	<u>6,626</u>	<u>(3,436)</u>	<u>-52%</u>
	<u>\$ 298,691</u>	<u>\$ 293,768</u>	<u>\$ 4,923</u>	<u>2%</u>

The increase in the GDB line of credit was due to the \$6 million of interest expenses charged and payments made to the suppliers, net by the decrease in liabilities payable from restricted assets due to Actuarial Analysis of Unpaid Claim Liabilities and payments made for claims in the year ended June 30, 2013.

*This Space Is Intentionally Left In Blank*

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

Management's Discussion and Analysis (Continued)

Statement of Net Position – (continued)

Non-Current Liabilities

The following is the activity of long-term debts for the years ended June 30, 2013 and 2012 (in thousands):

As of June 30, 2013:

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

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
Compensated absences, net of current portion	11,061	2	-	11,063
Other post-employment benefit obligation	1,384	-	(39)	1,345
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>\$ 217,678</u>	<u>\$ 76,497</u>	<u>\$ (407)</u>	<u>\$ 293,768</u>

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

Management's Discussion and Analysis (Continued)

Revenues, Expenses and Changes in Net Position

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

	<u>2013</u>	<u>2012</u>	Increase (Decrease)	%
Net service revenues	\$ 110,872	\$ 122,571	\$ (11,699)	-10%
Operating costs and expenses:				
Cost of services	166,452	155,976	10,476	7%
General and administrative	16,558	14,975	1,583	11%
Depreciation and amortization	<u>4,516</u>	<u>7,126</u>	<u>(2,610)</u>	-37%
	<u>187,526</u>	<u>178,077</u>	<u>9,449</u>	<u>5%</u>
Operating loss	<u>(76,654)</u>	<u>(55,506)</u>	<u>(21,148)</u>	<u>38%</u>
Non-operating income (expenses):				
Contributions from the Commonwealth of Puerto Rico	47,370	23,892	23,478	98%
Other income	1,316	1,668	(352)	-21%
Decrease in self-insurance reserve	3,175	-	3,175	-
Interest expenses	(16,528)	(15,303)	(1,225)	8%
Gain on debt forgiveness	-	11	(11)	-100%
Loss on disposition of capital assets	<u>(8)</u>	<u>(34)</u>	<u>26</u>	<u>-76%</u>
	<u>35,325</u>	<u>10,234</u>	<u>25,091</u>	<u>245%</u>
Net change in net position	(41,329)	(45,272)	3,943	-9%
Net position, at beginning of year	<u>(227,736)</u>	<u>(182,464)</u>	<u>(45,272)</u>	<u>25%</u>
Net position, at end of year	<u>\$ (269,065)</u>	<u>\$ (227,736)</u>	<u>\$ (41,329)</u>	<u>18%</u>

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

Management's Discussion and Analysis (Continued)

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

	<u>2012</u>	<u>2011</u>	Increase (Decrease)	%
Net service revenues	\$ <u>122,571</u>	\$ <u>123,763</u>	\$ (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	<u>7,126</u>	<u>6,393</u>	<u>733</u>	<u>11%</u>
	<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	<u>(34)</u>	<u>(107)</u>	<u>73</u>	<u>-68%</u>
	<u>10,234</u>	<u>50,697</u>	<u>(40,463)</u>	<u>-80%</u>
Net change in net position	(45,272)	(522)	(44,750)	8573%
Net position, at beginning of year	<u>(182,464)</u>	<u>(181,942)</u>	<u>(522)</u>	<u>0%</u>
Net position, 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 Position – (continued)

Service revenues

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

	<u>2013</u>	<u>2012</u>	Increase (Decrease)	%
Member institutions	\$ 91,237	\$ 91,703	\$ (466)	-1%
Recovery prior year	-	879	(879)	-100%
Revenue accounts reclassification	-	(109)	109	-100%
Private and insurance	49,651	43,087	6,564	15%
Provision for bad debts	<u>(30,017)</u>	<u>(12,989)</u>	<u>(17,028)</u>	<u>131%</u>
	<u>\$110,871</u>	<u>\$122,571</u>	<u>\$ (11,700)</u>	<u>-10%</u>

Approximately over 66% of the Administration's service revenues are derived from services rendered to member institutions. The decrease in service revenue is principally caused by a reduction of member institution billing of decentralization services. The increase of \$17,028 in the provision of bad debt expense is principally due to the negotiation with the Municipality of San Juan.

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

	<u>2012</u>	<u>2011</u>	Increase (Decrease)	%
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 by a reduction of member institution billing of decentralization services. The decrease in doubtful accounts was caused by the control over billings and was an improvement of process.

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

Management's Discussion and Analysis (Continued)

Operating Costs and Expenses

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

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

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

	<u>2012</u>	<u>2011</u>	Increase (Decrease)	%
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 increase in non-operating income (expenses) for the year ended June 30, 2013 consist of (in thousands):

	<u>2013</u>	<u>2012</u>	Increase (Decrease)	%
Governmental contributions	\$47,370	\$23,892	\$ 23,478	98%
Other income	1,316	1,668	(352)	-21%
Decrease in self-insurance reserve	3,175	-	3,175	-
Gain from debt forgiveness	-	11	(11)	-100%
Interest expense	(16,528)	(15,303)	(1,225)	8%
Loss on disposition of capital assets	<u>(8)</u>	<u>(34)</u>	<u>26</u>	<u>-76%</u>
	<u>\$35,325</u>	<u>\$10,234</u>	<u>\$ 25,091</u>	<u>245%</u>

The governmental contributions consisted of the following activity during the year ended June 30, 2013:

- \$794 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.
- \$316 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.
- \$1.5 million received in connection with Joint Resolution No. 242 approved by the Commonwealth's Legislature Assembly on December 13, 2011, assigning to the Administration \$3.4 million for the acquisition of medical equipment.
- \$24.7 million received in connection with Joint Resolution No. 84 approved by the Commonwealth's Legislature Assembly on July 1, 2012, for payment of payroll and for the completion of the Trauma facilities in Mayaguez.
- \$5 million received from the Treasury Department on June 24, 2013 for payment of payroll.

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

Management's Discussion and Analysis (Continued)

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

- \$4 million received in connection with Law 161- approved by the Commonwealth's Legislature Assembly on August 8, 2012, for the San Juan Trauma facilities.
- \$11 million received in connection with Law 66 approved by the Commonwealth's Legislature Assembly on June 22, 1978, for the payment of principal and interest of the GDB line of credit.

Non-Operating Income (Expenses)

Interest expense during the year ended on June 30, 2013 consisted of approximately \$16.5 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

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the Puerto Rico Medical Services Administration (the Administration), a component unit of the Puerto Rico Department of Health (the Department), as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Administration's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

The Secretary of the Puerto Rico Department of Health  
and Board of Member Institutions of  
Puerto Rico Medical Services Administration  
Page 2

### Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Puerto Rico Medical Services Administration, as of June 30, 2013 and 2012, and the respective changes in net position, and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### Emphasis of Matter

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

As described in Note 13 to the financial statements, the financial condition of the Administration has been weakened by high operating costs and recurring operating losses, 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, 2013 and 2012, the Administration has a total deficit of \$269,065,190 and \$227,736,104, respectively, and a deficiency in working capital of \$29,494,165 in 2013. The Administration's operations will depend on obtaining additional contributions from the Secretary of the Puerto Rico Department of Health and the Commonwealth of Puerto Rico to partially subsidize existing and future operating losses, resulting from high operating costs and services provided to the medical indigent population not covered under any private health insurance or non-participating in the Health Reform Program Administered by the Puerto Rico Health Insurance Administration (ASES). The Administration has made formal requests to various Commonwealth's agencies, including the Office of Management and Budget, requesting additional funds to subsidize its operating deficit and improve its existing financial condition.

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

The Secretary of the Puerto Rico Department of Health  
and Board of Member Institutions of  
Puerto Rico Medical Services Administration  
Page 3

Other Matters

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis information on pages 1 and 15 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 13, 2013, on our consideration of the Administration's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Administration's internal control over financial reporting and compliance.



*FPV Galindez*

San Juan, Puerto Rico  
December 13, 2013

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

Statements of Net Position

June 30, 2013 and 2012

Assets	<u>2013</u>	<u>2012</u>
Current assets:		
Unrestricted cash	\$ 903,726	\$ 266,767
Accounts receivable:		
Member institutions, net of allowance for doubtful accounts of \$76,345,776 in 2013 and \$62,285,329 in 2012	19,414,885	37,803,758
Private insurance, net of allowance for doubtful accounts of \$112,732,336 in 2013 and \$98,964,813 in 2012	17,972,373	18,607,252
Note receivable from Municipality of San Juan	8,000,000	-
Other, net of allowance for doubtful accounts of \$192,879 in 2013 and 2012	<u>722,020</u>	<u>647,744</u>
	46,109,278	57,058,754
Inventories	3,274,764	2,805,964
Prepaid expenses	<u>1,492,504</u>	<u>1,197,221</u>
Total current assets	<u>51,780,272</u>	<u>61,328,706</u>
Non-current assets:		
Restricted cash	2,986,106	7,745,743
Note receivable from Municipality of San Juan	3,500,000	-
Capital assets, net	<u>52,634,049</u>	<u>54,730,068</u>
Total non-current assets	<u>59,120,155</u>	<u>62,475,811</u>
Total assets	<u>\$ 110,900,427</u>	<u>\$ 123,804,517</u>

(Continues)

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

Statements of Net Position (Continued)

June 30, 2013 and 2012

Liabilities and Net Position

	2013	2012
Current liabilities:		
Accounts payable	\$ 58,753,404	\$ 39,512,215
Accrued expenses	11,588,082	9,273,796
Current portion of accrued pension costs	8,907,242	6,251,520
Current portion of compensated absences	308,500	136,299
Liabilities payable from restricted assets - improvements to medical facilities and equipment purchased	1,717,209	2,598,006
Total current liabilities	81,274,437	57,771,836
Non-current liabilities:		
Line of credit	273,344,177	264,434,263
Accrued pension costs, net of current portion	9,385,559	10,299,651
Compensated absences, net of current portion	11,199,657	11,063,358
Other post-employment benefit obligation	1,571,982	1,345,480
Liabilities payable from restricted assets - Self-insurance fund	3,189,805	6,626,033
Total non-current liabilities	298,691,180	293,768,785
Total liabilities	379,965,617	351,540,621
Net position:		
Net invested in capital assets	52,634,049	54,648,659
Unrestricted deficit	(321,699,239)	(282,384,763)
Total net position	(269,065,190)	(227,736,104)
Total liabilities and net position	\$ 110,900,427	\$ 123,804,517

See notes to financial statements

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

Statements of Revenues, Expenses and Changes in Net Position

For the years ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Patient service revenue, net of contractual allowance	\$ 140,889,097	\$ 135,559,749
Provision for bad debts	<u>30,017,250</u>	<u>12,989,061</u>
Net patient service revenue	<u>110,871,847</u>	<u>122,570,688</u>
Operating costs and expenses:		
Cost of services	166,451,540	155,975,784
General and administrative	16,558,116	14,974,727
Depreciation and amortization	<u>4,516,367</u>	<u>7,125,922</u>
Total operating cost and expenses	<u>187,526,023</u>	<u>178,076,433</u>
Operating loss	<u>(76,654,176)</u>	<u>(55,505,745)</u>
Non-operating income (expenses):		
Contributions from the Commonwealth of Puerto Rico	47,370,262	23,892,054
Other income	1,316,530	1,667,766
Loss on disposition of capital assets	(8,204)	(34,098)
Gain (loss) on debt forgiveness	(360)	11,146
Decrease in self-insurance reserve	3,175,255	-
Interest expense	<u>(16,528,393)</u>	<u>(15,303,279)</u>
Total non-operating income, net	<u>35,325,090</u>	<u>10,233,589</u>
Net change in net position	(41,329,086)	(45,272,156)
Net position at beginning of year	<u>(227,736,104)</u>	<u>(182,463,948)</u>
Net position at end of year	<u>\$ (269,065,190)</u>	<u>\$ (227,736,104)</u>

See notes to financial statements

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

Statements of Cash Flows

For the years ended June 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Receipts from service revenues	\$ 93,872,039	\$ 113,934,546
Payments to suppliers for goods and services and, salaries and related benefits	<u>(135,616,280)</u>	<u>(137,784,068)</u>
Net cash used in operating activities	<u>(41,744,241)</u>	<u>(23,849,522)</u>
Cash flows from non capital and related financing activities:		
Intergovernmental contributions	38,732,000	22,912,336
Interest paid	<u>(10,572,456)</u>	<u>(946,075)</u>
Net cash provided by non capital and related financing activities	<u>28,159,544</u>	<u>21,966,261</u>
Cash flows from capital and related financing activities:		
Intergovernmental contributions	8,563,985	981,199
Acquisition of machinery and equipment	(1,990,326)	(3,482,274)
Improvements to emergency room and other facilities	(438,225)	(3,036,862)
Principal payments on line of credit	(1,078,439)	-
Principal payments on obligations under capital leases	(86,400)	(98,385)
Interest paid on capital lease obligations	<u>-</u>	<u>(3,315)</u>
Net cash provided by (used in) capital and related financing activities	<u>4,970,595</u>	<u>(5,639,637)</u>
Cash flows from investing activities:		
Change in restricted cash	4,759,637	3,250,699
Receipts from interest and other income	<u>4,491,424</u>	<u>1,667,766</u>
Net cash provided by investing activities	<u>9,251,061</u>	<u>4,918,465</u>
Net change in cash	636,959	(2,604,433)
Unrestricted cash, beginning of year	<u>266,767</u>	<u>2,871,200</u>
Unrestricted cash, end of year	<u>\$ 903,726</u>	<u>\$ 266,767</u>

(Continues)

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

Statements of Cash Flows (Continued)

For the years ended June 30, 2013 and 2012

	2013	2012
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (76,654,176)	\$ (55,505,745)
Adjustments to reconcile operating loss to net cash used in operating activities		
Depreciation and amortization	4,516,367	7,125,922
Provision for bad debts	30,017,250	12,989,061
Changes in assets and liabilities		
(Increase) decrease in:		
Accounts receivable	(47,017,058)	(21,625,202)
Inventories	(468,800)	(535,502)
Prepaid expenses	(295,283)	(306,806)
Increase (decrease) in:		
Accounts payable	47,797,168	22,564,831
Accrued expenses and other	360,291	11,443,919
	34,909,935	31,656,223
Net cash used in operating activities	\$ (41,744,241)	\$ (23,849,522)

Non-cash capital investing and financing activities

Retirement of capital assets	\$ 850,749	\$ 1,062,265
Payments to suppliers with proceeds from line of credit	\$ 4,032,418	\$ 37,775,696
Payments of accrued pension costs with proceeds from line of credit	\$ -	\$ 14,066,105
Non-cash interest expense charged from line of credit	\$ 6,000,000	\$ 14,353,889

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, 2013 and 2012

Note 1 - Organization and summary of significant accounting policies

Organization

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

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

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

Summary of significant policies

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

Basis of presentation

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

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

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

Basis of presentation – (continued)

These classifications are defined as follows:

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

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

Measurement focus and basis of accounting

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

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

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. During the year ended June 30, 2013, approximately \$76,346,000 and \$112,732,000, representing receivables from member institutions and private insurance, respectively, are not expected to be collected which are included as part of the allowance for doubtful accounts within accounts receivable in the accompanying statements of net position.

Valuation of accounts receivable

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

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

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

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

Fair value of financial instruments

The carrying amounts reported in the statement of net position for cash 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

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

Capital assets

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

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

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

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

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

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

Accounting for the impairment of capital assets

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

Compensated absences

The vacation and sick 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, 2013, 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, 2013 and 2012

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.

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

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

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.

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

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

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.

Insurance

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

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, 2013 and 2012

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

New Accounting Standards Adopted

The following new accounting standards were adopted by the Administration effective July 1, 2012:

- In December 2010, the GASB issued Statement No. 62, *Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The objective of this statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements: (1) FASB Statements and Interpretation; (2) Accounting Principles Board Opinions; and (3) Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure. There was no impact on the Administration's financial statement as a result of the implementation of GASB Statement No. 62.
- In June 2011, the GASB issued 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 these financial statement elements, which are distinct from assets and liabilities. There was no mayor impact on the Administration's financial statement as a result of the implementation of GASB Statement No. 63, except for the change in name of the Statement of Net Assets to Statement of Net Position.

*This Space Is Intentionally Left In Blank*

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

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

Recently issued accounting standards

The GASB has issued the following accounting pronouncements that have effective date after June 30, 2013:

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

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

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

Recently Issued Accounting Guidance – (continued)

- In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions Plans amendment of GASB Statement No. 27*. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements 27 and 50 remain applicable for pensions that are not covered by the scope of this Statement. The Statement is effective for fiscal years beginning after June 15, 2014.
- In January 2013, the GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*. This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term *government combinations* includes a variety of transactions referred to as mergers, acquisitions, and transfers of operations. The distinction between a government merger and a government acquisition is based upon whether an exchange of significant consideration is present within the combination transaction. Government mergers include combinations of legally separate entities without the exchange of significant consideration. This Statement requires the use of carrying values to measure the assets and liabilities in a government merger. Conversely, government acquisitions are transactions in which a government acquires another entity, or its operations, in exchange for significant consideration. This Statement requires measurements of assets acquired and liabilities assumed generally to be based upon their acquisition values. This Statement also provides guidance for transfers of operations that do not constitute entire legally separate entities and in which no significant consideration is exchanged. This Statement defines the term *operations* for purposes of determining the applicability of this Statement and requires the use of carrying values to measure the assets and liabilities in a transfer of operations. A disposal of a government's operations results in the removal of specific activities of a government. This Statement provides accounting and financial reporting guidance for disposals of government operations that have been transferred or sold. This Statement requires disclosures to be made about government combinations and disposals of government operations to enable financial

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

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

Recently Issued Accounting Guidance – (continued)

statement users to evaluate the nature and financial effects of those transactions. The requirements of this Statement are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013.

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

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

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 2 - Restricted cash

Restricted cash as of June 30, 2013 and 2012 consisted of:

Description	2013	2012
Cash-restricted for:		
Improvements to medical facilities and purchase of equipment	\$2,947,311	\$2,433,299
Self-insurance fund	32,395	5,268,335
Gamma Knife	444	652
Other	<u>5,956</u>	<u>43,457</u>
	<u>\$2,986,106</u>	<u>\$7,745,743</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 patient service revenue

Patient services revenue

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

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

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 3 - Net patient service revenue – (continued)

Patient services revenue – (continued)

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

The cost report for 2013 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 patient service revenue, net of contractual allowances and discounts, for the years ended June 30, 2013 and 2012 consisted of:

	2013	2012
Third-party payors	\$ 34,072,140	\$ 31,723,278
Third-party payors - member institutions	76,800,001	90,883,450
Self-pay patients	(294)	(36,040)
Patient service revenue (net of contractual allowances and discounts and provision for bad debts)	\$ 110,871,847	\$ 122,570,688

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 3 - Net patient service revenue – (continued)

Member institutions – (continued)

Changes in allowance for doubtful accounts on patient's account receivable for the year ended June 30, 2013 and 2012 consisted of:

	2013	2012
Balance, beginning of year	\$ 161,250,142	\$ 149,977,072
Provision for bad debts	30,017,250	12,989,061
Write-off of uncollectible accounts	(2,189,280)	(1,715,991)
Balance, end of year	\$ 189,078,112	\$ 161,250,142

Net patient service revenue from third-party payors is estimated fully collectible and it is recorded when the health care services are provided. Also, health care services provided to uninsured patients is recorded when the services are provided. Provision for bad debts related to receivables from third-party payors and uninsured patients and for patients for whom it was assessed the patient does not has the ability to pay is recorded as a deduction of net patient service revenue in the accompanying statements of revenues, expenses and changes in net position. At June 30, 2013 and 2012, 72% and 28% respectively, of the amounts reserved as uncollectible are related to third-party payors, and 41% and 59%, respectively, are related to self-pay patients, which includes deductibles and co-insurance which the Administration accounts for as patient balance.

*This Space Is Intentionally Left In Blank*

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 4 - Capital assets

Capital assets as of June 30, 2013 and 2012, and activity during the years then ended consisted of:

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

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 4 - Capital assets – (continued)

Description	Balance June 30, 2011	Acquisitions	Retirements	Reclassification	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>

Amortization expense of equipment under capital leases for the years ended June 30, 2013 and 2012 amounted to nil and \$59,860, respectively.

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 5 - Note receivable from the Municipality of San Juan

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

Note 6 - Self-insurance fund

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

The Administration maintains in the Fund cash of \$32,395 and \$5,268,335 as of June 30, 2013 and 2012, 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, 2013 and 2012, presented estimated liabilities of approximately \$3,189,805 and \$3,423,158, respectively, which were related with claims incurred during the years ended June 30, 1989 to June 30, 2013.

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, 2013 and 2012.

June 30, 2013:

<u>Description</u>	<u>Restricted Cash</u>	<u>Liabilities Payable</u>
Balances as of beginning of year	\$ 5,268,335	\$ 6,626,033
Funds received from operations	21,293,377	51,027
Claims paid and other disbursements	(26,529,317)	(312,000)
Decrease in self-insurance reserve	-	(3,175,255)
Balance as of end of year	<u>\$ 32,395</u>	<u>\$ 3,189,805</u>

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 6 - Self-insurance fund – (continued)

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>

Note 7 - Accrued pension costs

Accrued pension costs as of June 30, 2013 and 2012 consisted of:

June 30, 2013:

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

Accrued pension cost current portion presented in the accompanying statements of net position at June 30, 2013, consists of accrued pension costs current portion corresponding to fiscal year 2012-2013 amounting to \$5,839,118 and those related to fiscal year 2010-2011 under the below payment plan amounting to \$3,068,124.

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 7 - Accrued pension costs (continued)

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>

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

Future minimum payments for the next four (4) years are as follows:

<u>Year</u>	<u>Amount</u>
2014	\$ 3,068,124
2015	3,068,124
2016	3,068,124
2017	<u>1,022,707</u>
Total	<u>\$ 10,227,079</u>

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 8 - Employees' retirement plan

The Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (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.

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.

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 8 - Employees' retirement plan – (continued)

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 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, 2013, 2012 and 2011, are as follows:

<u>Description</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>
Traditional Plan-			
Employer	<u>\$3,498,773</u>	<u>\$3,257,139</u>	<u>\$3,063,550</u>
Employee	<u>\$2,523,483</u>	<u>\$2,576,671</u>	<u>\$2,681,952</u>
System 2000-			
Employer	<u>\$3,398,151</u>	<u>\$2,961,438</u>	<u>\$2,632,640</u>
Employee	<u>\$2,532,546</u>	<u>\$2,421,991</u>	<u>\$2,382,469</u>
Interest	<u>\$5,589,209</u>	<u>\$5,507,095</u>	<u>\$4,931,284</u>

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 8 - Employees' Retirement Plan – (continued)

Total employee and employers contributions paid by the Administration during the years ended June 30, 2013, 2012 and 2011 are as follows:

<u>Description</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>
Traditional Plan-			
Employer	<u>\$3,123,773</u>	<u>\$3,705,924</u>	<u>\$14,302,950</u>
Employee	<u>\$4,084,544</u>	<u>\$2,685,961</u>	<u>\$ 7,958,453</u>
System 2000-			
Employer	<u>\$2,945,264</u>	<u>\$3,155,506</u>	<u>\$ 9,397,254</u>
Employee	<u>\$3,751,256</u>	<u>\$2,762,470</u>	<u>\$ 5,318,483</u>

As of June 30, 2013 and 2012, the total unpaid employee and employer contributions, due to the System including interest, amounted to \$18,292,801 and \$16,551,171.

For the year ended June 30, 2013 and 2012, total covered payroll for employees was approximately \$61,174,292 and \$60,529,225, respectively. Covered payroll refers to all compensation paid by the Administration to employees covered by the System on which contributions to the pension are based.

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

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

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 8 - Employees' Retirement Plan – (continued)

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

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 9 - 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

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

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

are made about the future. The required schedule of funding progress as of June 30, 2013 and 2012, 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.

Description	2013	2012
Benefit obligation, beginning of year	<u>\$1,345,480</u>	<u>\$1,175,393</u>
Change in benefit obligation:		
Amortization of past service cost (\$4,676,400 in 2011 and \$4,010,699 in 2010)	299,494	286,908
Service cost	204,916	195,904
Adjustment to annual required contribution	(32,308)	(26,525)
Benefits paid	<u>(245,600)</u>	<u>(286,200)</u>
Annual postemployment cost	<u>226,502</u>	<u>170,087</u>
Benefit obligation accrued at end of year reflected in statement of net position	<u>\$1,571,982</u>	<u>\$1,345,480</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>5.90%</u>
Retirement age	<u>65 years</u>	<u>65 years</u>

*This Space Is Intentionally Left In Blank*

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

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

Required supplementary information

Schedule of Funding Progress

(\$ 000s)

Actuarial Valuation <u>Date</u>	Actuarial Value of Assets <u>(a)</u>	Accrued Liability <u>(b)</u>	Unfunded Accrued Liability (UAL) <u>(b-a)</u>	Funded Ratio <u>(a/b)</u>	Covered Payroll <u>(c)</u>	UAL as a Percentage of Covered Payroll <u>((b-a)/c)</u>
July 1, 2013	\$ -	\$4,771	\$4,771	0.0%	\$61,174	7.8%
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 <u>Ended</u>	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
June 30, 2013	\$472	52.0%	\$1,572
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  
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 10 - Commitments and contingencies

Commitments

Operating leases

The Administration leases certain equipment under various operational lease agreements expiring at various dates through year 2018. In addition, other commitments exist related to contracts for materials and maintenance. Total rental expense under operating leases amounted to approximately \$1,405,000 and \$1,099,000 for the years ended June 30, 2013 and 2012, respectively.

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

<u>Year ended June 30,</u>	<u>Amount</u>
2014	\$ 6,886,656
2015	5,683,643
2016	2,001,814
2017	764,842
2018	<u>143,578</u>
	<u>\$15,480,533</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  
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 10 - 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  
A Component Unit of the Puerto Rico Department of Health

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 10 - 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, 2013 and 2012, 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 \$3,189,805 and \$6,626,033 at June 30, 2013 and 2012, respectively.

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 10 - 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 statues and/or regulations by healthcare providers. Providers that are found to have violated these laws and regulations may be subjected to fines or penalties. While management of the Administration believes its policies, procedures and practices comply with governmental regulations, no assurance can be given that the Administration will not be subject to governmental inquires or actions.

Health Insurance Portability and Accountability Act

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

Implementation requirements of an Electronic Health Record System

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

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 10 - Commitments and contingencies – (continued)

Implementation requirements of an Electronic Health Record System – (continued)

The Centers for Medicare and Medicaid Services (CMS) manages and has implemented an incentive program for those hospitals that implement EHR and that also, comply with certain specific requirements. CMS EHR Incentive Programs provide incentive payments to eligible hospitals as they adopt, implement, upgrade or demonstrate meaningful use, as defined by CMS, of certified EHR technology. As of June 30, 2013, the Administration is under the implementation of its EHR system.

Note 11 - Services to member institutions and medical indigent population

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

*This Space Is Intentionally Left In Blank*

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 12 - Contributions from the Commonwealth of Puerto Rico

Governmental contributions during the years ended June 30, 2013 and 2012, consist of the following:

Description	2013	2012
Funds received in connection with Joint Resolution No. 4533 approved by the Commonwealth's Legislature on August 12, 2004, assigned \$40.5 million to the Administration for the construction of new Trauma facilities, the establishment of a Gamma Knife Center, a blood bank, improvement to the emergency room and purchase of equipment.	\$ 793,730	\$ 411,304
Funds received in connection with Joint Resolution No. 116 approved by the Commonwealth's Legislature on July 23, 2007, assigned \$2.9 million to the Administration for the acquisition of medical equipment.	316,404	419,895
Funds received in connection with Law No. 242 approved by the Commonwealth's Legislature on December 13, 2011, assigned \$3.4 million to the Administration for the acquisition of medical equipment.	1,528,128	150,000
Funds received in connection with Joint Resolution No. 59 approved by the Commonwealth's Legislature on July 1, 2011, to reimburse the Administration for the payment of recruitment, payroll contributions and operating expenses made during the years ended June 30, 2012 and 2011.	-	22,910,000
Funds received in connection with Joint Resolution No. 84 approved by the Commonwealth's Legislature on July 1, 2012, for the payment of payroll and for the completion of the Trauma facilities in Mayagüez.	24,710,000	-
Government appropriation from the General Fund granted on June 24, 2013 for the payment of payroll.	5,000,000	-

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

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

Description	2013	2012
Funds received in connection with Law 161-2012 approved by the Commonwealth's Legislature on August 8, 2012 for the San Juan Trauma facilities.	4,000,000	-
Funds received in connection with Law 66 approved by the Commonwealth's Legislature on June 22, 1978, for the payment of principal and interest on the GDB line of credit.	11,022,000	-
Donated equipment by the Treasury Department	-	855
	<u>\$47,370,262</u>	<u>\$23,892,054</u>

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

The financial condition of the Administration has been weakened by high operating costs and recurring operating losses, which have affected its ability to pay its suppliers, governmental agencies and other creditors on a regular basis. In addition, the Administration has been affected by the delay in the collection of billings for services rendered to member institutions due to the lack of cash flow amongst said institutions. As of June 30, 2013 and 2012, the Administration has total deficit of \$269,065,190 and \$227,736,104, respectively. The Administration's operations will depend on the following critical factors to partially subsidize existing and future operating losses:

1. Implementation of a new Administration Management Platform under the Program "*Hacia la Reconceptualización del Centro Médico*"; focused on definitions and measurements of core business processes, results based on core measurements, corrective actions, ongoing training, and overall continuous improvement.
2. Increase of actual contracted rates among existing government insurers as a function of incurred Administration costs, frequency, severity of medical services, and risk distribution throughout the insurance provider network. The insured patients under the government insured population represents 67% of the Administration's patient mix.

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

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

3. Implementation of an insurance coverage system for the medical indigent population through the Health Reform Program Administered by the Puerto Rico Health Insurance Administration (ASES). Medical Coverage is not provided for these patients under any private health insurer.
4. Redefinition of contractual agreements with government and commercial insurers.
5. Improvement of billing effectiveness and efficiency by technologically integrating the databases of the Administration's patients and ASES's insured's; which represent 42% of the Administration's insured patient mix. Billing for non – commercial and commercial insured's will also improve throughout innovative management platforms, continuous training and process re-engineering initiatives.
6. Redefinition and/or amendments of contractual agreements with mayor suppliers based on actual needs.
7. Formal requests 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. Governor Executive Order OE-2013-0150 which orders requirements to comply with the integration and consolidation of ASEM and the University District Hospital (UDH). This order highlights the following recommendations:
  - a. To obtain more relevant information of all the Medical Center Components, in addition to the information included in the report, to determine necessary changes and to establish the feasibility criteria for a reconceptualization 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.

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

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

- d. The implementation of Project of Law 607 to harmonize the Act 66 of June 22, 1978, (the creator of the ASEM), with Act 72 (September 7, 1993), which establishes the increase in contracted rates provided under the Health Reform by the Puerto Rico Health Insurance Administration (ASES) as a function of incurred Administration costs, frequency, severity of medical services, and risk distribution.
  - 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.
2. The establishment of revised chart of rates for services rendered to member institutions, medical insurance companies and others, to cover the actual costs.
  3. 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.
  4. Enforce the insurance company or providers to comply with Law No. 65 Art. 5 (July 19, 2013), 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.
  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.

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

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

7. The Administration improved the actual 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. Participation Agreement with MedAssets in order to enter into an affiliation agreement with Puerto Rico Purchasing Alliance, LLC. Member accesses MedAsset's portfolio of vendor contracts (Group Purchasing Program) for the procurement of supplies, services, and equipment (collectively, "Products"). Development of comprehensive work plan to achieve a trauma hospital level 1 accreditation.

Note 14 - Reclassifications

Certain reclassifications have been made to the 2012 financial statement figures to conform them to current year presentation.

Note 15 - 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.

*This Space Is Intentionally Left In Blank*

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

Notes to Financial Statements (Continued)

June 30, 2013 and 2012

Note 15 - Concentration of credit – patients' accounts receivable – (continued)

The mix of receivables from patients and third-party payors at June 30 2013 and 2012, is as follows:

	2013	2012
ACAA	6%	10%
Humana Insurance	2%	7%
Private	72%	42%
Triple S	5%	5%
MCS	4%	14%
Medicare	2%	5%
Others	<u>9%</u>	<u>17%</u>
	<u>100%</u>	<u>100%</u>

Note 16- Functional expenses

The Administration provides general health care services. Expenses, related to providing these services for the year ended June 30 2013 and 2012, are as follow:

	2013	2012
Health care services	\$166,451,540	\$155,975,784
General and administrative	<u>21,074,483</u>	<u>22,100,649</u>
	<u>\$187,526,023</u>	<u>\$178,076,433</u>

Note 17- Subsequent events

The Administration evaluated subsequent events through December 13, 2013 which is the date the financial statements were available to be issued. No events have occurred subsequent to the statement of net assets date that would require additional adjustment to, or disclosure in the financial statements, except for the following:

- On November 14, 2013 the execution of the agreement between the Municipality of San Juan and the Administration as mentioned in note 5.
- On November 20, 2013 the execution of the new Collective Bargain Agreement.