*Financial Statements*

**AUTOMOBILE ACCIDENTS**

**COMPENSATIONS ADMINISTRATION**

FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2011 AND 2010

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# INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Automobile Accidents Compensations Administration
San Juan, Puerto Rico

We have audited the accompanying financial statements of Automobile Accidents Compensations Administration, a component unit of the Commonwealth of Puerto Rico, as of and for the years ended June 30, 2011 and June 30, 2010, as listed in the table of contents. These financial statements are the responsibility of the Automobile Accidents Compensations Administration's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Automobile Accidents Compensations Administration as of June 30, 2011 and June 30, 2010, and the respective changes in its financial position, and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standard*, we have also issued our report dated September 27, 2011, on our consideration of the Automobile Accidents Compensations Administration's internal control over financial reporting and 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 results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

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Accounting principles generally accepted in the United States of America require that the management's discussion on pages 3 through 18 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.

September 27, 2011

Aquino, De Córdova, Alfaro & Co., LLP

by

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has been affixed to the
original report

# MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the financial report of the Automobile Accidents Compensations Administration ("hereinafter referred to as the Administration") represents a narrative overview and analysis of the financial performance and activities for the fiscal years ended June 30, 2011, 2010 and 2009. The information presented herein should be read in conjunction with the attached Financial Statements, including the notes thereto.

Summarized financial statement information, relevant financial and operational indicators, operational budgets and other management tools were used for purpose of this analysis.

***FINANCIAL HIGHLIGHTS***

- The loss from insurance operations decreased $9.5 million, 90.3% less than the previous year ($1 million in 2011 vs. $10.5 million in 2010). This is mainly due to a decrease on the benefits expenses as well as the benefit we continue to receive from the fees negotiated with the medical providers. This also represents a decrease of $51.6 million or 83.1% less than 2009 ($62.1 million in 2009) mainly due to an increase of $51.2 million in the Reserve for Future Benefits in 2009, because of a change from a discounted reserve to an undiscounted method as recommended by our actuary.
- The total operating expenses decrease by $10.8 million, 12% less when compared with prior year total expenses incurred ($79.4 million in 2011 vs. $90.3 million in 2010). The operating expenses in 2010 decreased $55.3 million, 38% less than 2009 ($145.6 million in 2009).
- General and administrative expenses (including depreciation and amortization) are $4.2 million more than previous year ($20.6 million in 2011 vs. $16.4 million in 2010). This is mainly due to an increase in the allowance for uncollectible accounts. Between 2010 and 2009 there are $1.6 million less ($18 million in 2009); partially due to the implementation of a Reduction in Force (RIF) in March 2010.
- Gross insurance premiums earned decreased by $1.2 million, 1.5%, when compared with prior fiscal year ($81.5 million in 2011 vs. $82.7 million in 2010). Gross insurance premiums earned are $3.8 million, 4% less than 2009 ($86.5 millions in 2009).
- Total assets decreased by $24 million ($169.2 million in 2011 vs. $193.3 million in 2010), and increased in 2010 by $11.9 million ($181.4 million in 2009).
- The Administration's liabilities exceeded assets by $47 million as of June 30, 2011 and $67.6 million as of June 30, 2010. Total net deficit decreased $20.5 million when compared with the end of prior fiscal year (-$47.1 million in 2011 vs. -$67.6 million in 2010). In 2010 the net deficit decreased $366,372 when compared with the end of 2009 (-$67.9 million in 2009).
- Total liabilities decreased $44.6 million ($216.3 million in 2011 vs. $260.9 million in 2010), and increased $11.6 million in 2010 in comparison with 2009 ($249.3 million in 2009).

### *FINANCIAL HIGHLIGHTS - CONTINUED*

- Collateral received under the securities lending program decreased $43.2 million (100%), because the Administration withdrew from the securities lending program no longer having this obligation. In 2010 the investments and the collateral received under the securities lending program increased $14.5 million when compared with 2009 (50%).
- The investments portfolio experienced a realized loss of $1.5 during the year ended June 30, 2011 and a realized gain of $1.8 million during the year ended June 30, 2010, and an unrealized gain of $19.6 million during the year ended June 30, 2011 and $5.1 during the year ended June 30, 2010.

### *OVERVIEW OF THE FINANCIAL REPORT*

The Administration is a component unit of the Commonwealth of Puerto Rico (hereinafter referred to as the "Commonwealth") and is presented in the Commonwealth's government-wide financial statements as an enterprise fund.

The Administration's financial statements are presented, attached to this document, and represent the financial position and results of operation of the Administration as of June 30, 2011 and 2010, and for the fiscal years then ended.

The financial statements include a Balance Sheet, Statement of revenues, expenses and changes in net (deficit) assets, cash flows, and the notes to such financial statements.

### *BALANCE SHEETS*

The Balance Sheets presents the Administration's statement of position as of June 30, 2011 and 2010, showing information that includes all of the Administration's assets and liabilities, as well as the net deficit. An evaluation of the overall financial health of the Administration would extend to other external factors, such as the quality of the portfolio of investments and their related market conditions, the experience of gains and losses that may be affected by demographic variables, and the inflationary increase of medical costs.

### *STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (DEFICIT)*

The statement of revenues, expenses and changes in net assets (deficit) shows how the Administration's net assets changed during the fiscal year. All current fiscal year revenues and expenses are included regardless of when the cash is received or paid. An important purpose of the design of this statement is to show the financial reliance of the Administration's functions on premium revenues earned.

### *STATEMENTS OF CASH FLOWS*

The statement of cash flows presents the sources and uses of cash flows divided in categories: operating activities, non-capital financing activities, capital and related financing activities, and investing activities. The statement reconciles net cash and cash equivalents at the beginning and end of the year and reconciles the net operating loss with the cash provided by (used in) operating activities to provide an explanation of cash and non-cash activities within the statement of revenues, expenses and changes in net assets (deficit).

### *NOTES TO FINANCIAL STATEMENTS*

The notes to the financial statements provide information required and necessary to the understanding of material information of the Administration financial statements. The notes present information about the Administration's significant accounting policies, significant account balances and activities, risk management, obligations, commitments and contingencies.

## *DETAILED FINANCIAL ANALYSIS*

The Administration was created in 1968 by virtue of Law 138 as a public corporation of the Government of Puerto Rico. It operates a system of compulsory insurance for vehicles licensed for the use within the Commonwealth of Puerto Rico. The insurance covers bodily injuries caused by automobile accidents and has an annual premium, which was established back in 1968, of $35 per motor vehicle. The Administration, therefore, is responsible for managing the risks of insurance established in the Law and provides adequate resources for insured beneficiaries by managing premiums, claims and expenses.

The financial position of the Administration as of June 30, 2011, changed with respect to that of the prior years as follows:

| | | | Variance | | | Variance | |
|---|---|---|---|---|---|---|---|
| | 2011 | 2010 | Dollars | Percent | 2009 | Dollars | Percent |
| Cash and cash equivalents | $ 10,998,054 | $ 5,993,647 | $ 5,004,407 | 83.50% | $ 6,409,787 | $ (416,140) | -6.49% |
| Collateral received under securities lending program | - | 43,222,484 | (43,222,484) | -100.00% | 28,723,099 | 14,499,385 | 50.48% |
| Investments, at fair value | 147,513,643 | 131,258,866 | 16,254,777 | 12.38% | 119,429,306 | 11,829,560 | 9.91% |
| Accounts receivable | 3,117,916 | 3,920,874 | (802,958) | -20.48% | 17,564,085 | (13,643,211) | -77.68% |
| Capital assets | 7,587,851 | 8,895,346 | (1,307,495) | -14.70% | 9,218,892 | (323,546) | -3.51% |
| Other assets | 31,106 | 31,106 | - | 0.00% | 26,064 | 5,042 | 19.34% |
| **Total Assets** | $ 169,248,570 | $ 193,322,323 | $ (24,073,753) | -12.45% | $ 181,371,233 | $ 11,951,090 | 6.59% |
| Reserves for future benefits | $ 166,595,917 | $ 165,926,782 | $ 669,135 | 0.40% | $ 166,351,764 | $ (424,982) | -0.26% |
| Deferred premiums reserve | 39,477,916 | 37,770,335 | 1,707,581 | 4.52% | 39,106,307 | (1,335,972) | -3.42% |
| Obligation to return collateral under securities lending program | - | 43,222,484 | (43,222,484) | -100.00% | 28,723,099 | 14,499,385 | 50.48% |
| Payable for acquisition of investments | 724,591 | 357,913 | 366,678 | 102.45% | 4,699,213 | (4,341,300) | -92.38% |
| Accounts payable, including insurance premiums in advance (2010) | 5,470,862 | 9,563,647 | (4,092,785) | -42.80% | 5,362,821 | 4,200,826 | 78.33% |
| Accrued liabilities | 4,057,686 | 4,052,524 | 5,162 | 0.13% | 5,065,763 | (1,013,239) | -20.00% |
| **Total liabilities** | 216,326,972 | 260,893,685 | (44,566,713) | -17.08% | 249,308,967 | 11,584,718 | 4.65% |
| Net assets invested in capital assests | 7,587,851 | 8,895,346 | (1,307,495) | -14.70% | 9,218,892 | (323,546) | -3.51% |
| Unrestricted net assets | (54,666,253) | (76,466,708) | 21,800,455 | -28.51% | (77,156,626) | 689,918 | -0.89% |
| **Net deficit** | (47,078,402) | (67,571,362) | 20,492,960 | -30.33% | (67,937,734) | 366,372 | -0.54% |
| **Total Liabilities and Net Deficit** | $ 169,248,570 | $ 193,322,323 | $ (24,073,753) | -12.45% | $ 181,371,233 | $ 11,951,090 | 6.59% |

***TOTAL ASSETS***

Total assets decreased $24 million or 12.4% due to the net effect of the following:

***CASH AND CASH EQUIVALENTS***

Cash and cash equivalents increased $5 million for the year ended June 30, 2011 mainly for Short Term investments acquired by the Administration. It should be noted that the net cash provided from operating activities amounted to $337 thousand during the fiscal year 2011 vs. $1.1 million provided the year before. The decrease of $744 thousand in the net cash provided by operating activities was due to a decrease of $8.9 million in cash received from insured and a reduction of $9.6 million in cash paid for benefits and expenses and to employees for services ($78.1 million in 2011 vs. $87.7 million in 2010), as well as a reduction of $1.4 million in other operating receipts which had a significant impact in the decrease of the cash provided by operating activities.

Cash and cash equivalents, when compared with 2009, decreased $416 thousand for the year ended June 30, 2010. It should be noted that the net cash provided from operating activities amounted to $1.1 million during the fiscal year 2010 vs. $8.4 million used the year before. The increase of $9.6 million in the net cash provided by operating activities was due to an increase of $3.3 million in cash received from insured and a reduction of $4.9 million in payments for benefits and expenses and employees for service ($87.7 million in 2010 vs. $92.6 million in 2009) which had a significant impact in the reduction of the cash used in operating activities. Management performed a strict strategic and financial planning of withdrawals needed for operating activities. During the fiscal year ended June 30, 2010 no withdrawals were made from the investment portfolio to finance operating activities.

***INVESTMENTS***

During the last twenty years, the premium income received has been insufficient to cover the operating expenses of the Administration. As a result, withdrawals from the investment portfolio were frequently made to cover operating funding needs. During the last two years, no withdrawals were made from the portfolio compared to 2009 when $15.8 million were withdrawn.

During 2011, the Administration experienced an increase of the fair value of its investments amounted to $16.3 million when compare with 2010. The decrease of $43.2 million in collateral received under the securities lending program is offset by the corresponding obligation to return it (see liabilities), and is due to the Administration's withdrawal of the program in order to reduce the risk of the portfolio.

### *INVESTMENTS - CONTINUED*

The following are the rationales for the increase of $16.2 million in the fair market value of the investments portfolio:

- Realized losses in the sales of investments were $1.5 million in 2011 vs. $1.8 million of realized gains last year, a decrease of $3.3 million or 183%. In 2009, the portfolio experienced realized losses of $13 million (an increase of $14.8 million or 114% when compared with 2010).

- Unrealized gains on investments amounted to $19.6 million, while last year experienced an unrealized gains of $5.1 million. This represents a net change of $14.5 million, or 284%. In 2009 the portfolio experienced realized gains of $12.6 million. This represents a net change of $17.7 million, or 140% when compare with 2010.

In 2010, the Administration experienced an increase of the fair value of its investments amounted to $11.8 million and an increase of $14.5 million in collateral received under the securities lending program when compare with 2009.

### *INVESTMENT MARKET CONDITIONS*

The market conditions were favorable, leading to a net increase of $16.2 million in the investments portfolio at fair market value. Like every investor, the Administration is subject to the market risk, which consists of changes in market rates and prices that may adversely affect the financial condition or the results of operations.

Favorable market conditions for Fiscal Year 2010-2011 were experienced as a result of a market stabilization. There were some indicators that confirm and give support to our argument:

- There has been an improvement in consumer consumption.
- Even though the Growth Domestic Price decreased 1%, population also grew at 1% per year, this translates to "no growth" per capita.
- Government spending shrunk slightly.

There were also favorable market conditions for investment Fiscal Year 2009-2010 as a result of market stabilization. There were some indicators that confirm and give support to this argument:

- The United States Government has passed a regulatory reform bill in order to ameliorate the effect of the financial crisis, as well as various stimulus packages.
- Growth Domestic Price (GDP) Index and Employment have started to rise.
- Commodities' prices have started to recover.

### *INVESTMENT MARKET CONDITIONS - CONTINUED*

In the third quarter of Fiscal Year 2010, the Administration changed two of its money managers, one of which held the largest part of the portfolio. In order to reduce the pre existing risk of asset management concentration, the Administration hired three new investment portfolio managers.

The Administration will continue to evaluate very closely the performance of the investments' money managers in fiscal year 2011-2012.

### *ACCOUNTS RECEIVABLE*

The decrease in accounts receivable of $803 thousand was mainly caused by fluctuations in the premiums due from the Treasury Department at year end. Premiums receivable are estimated based on information provided by the Puerto Rico Treasury Department and are subject to change if new information is provided. In addition, the allowance for doubtful accounts experienced an increase based upon historic collection experience and current economic condition. In 2010, when compare with 2009, there was a decrease in accounts receivable of $13.6 million, for the information provided by the Puerto Rico Treasury Department.

### *CAPITAL ASSETS*

The decrease shown in the net capital assets was $1.3 million ($7.6 million in 2011 vs. $8.9 million in 2010), and was related to the net effect of acquisitions, and depreciation charges during the fiscal year. The few property acquisitions made by the Administration during the year were made to maximize the services and enhance the efficiency of operations. The Administration has been working on new software and technology developments designed to help speed up the claim processing area, as well as control the disbursement procedures in the years to come.

In November 2005, the Administration entered into a agreement with a third party to obtain and implement a cost effective information system infrastructure to automate the administration and payment of medical services providers and claimants. For the fiscal year ended June 30, 2011, the Administration recognized an impairment loss for approximately $963,000 associated with the significantly and unexpectedly decline in service utility of some modules of the system. The provision for impairment represents the difference between the net carrying cost and the estimated fair market value. The write-down is included in operating expenses in the Administration's statement of revenues, expenses and change in net (deficit) assets.

In 2010, a decrease in the net capital assets was $324 thousand was experienced ($9.2 millions in 2009) due to the same reasons.

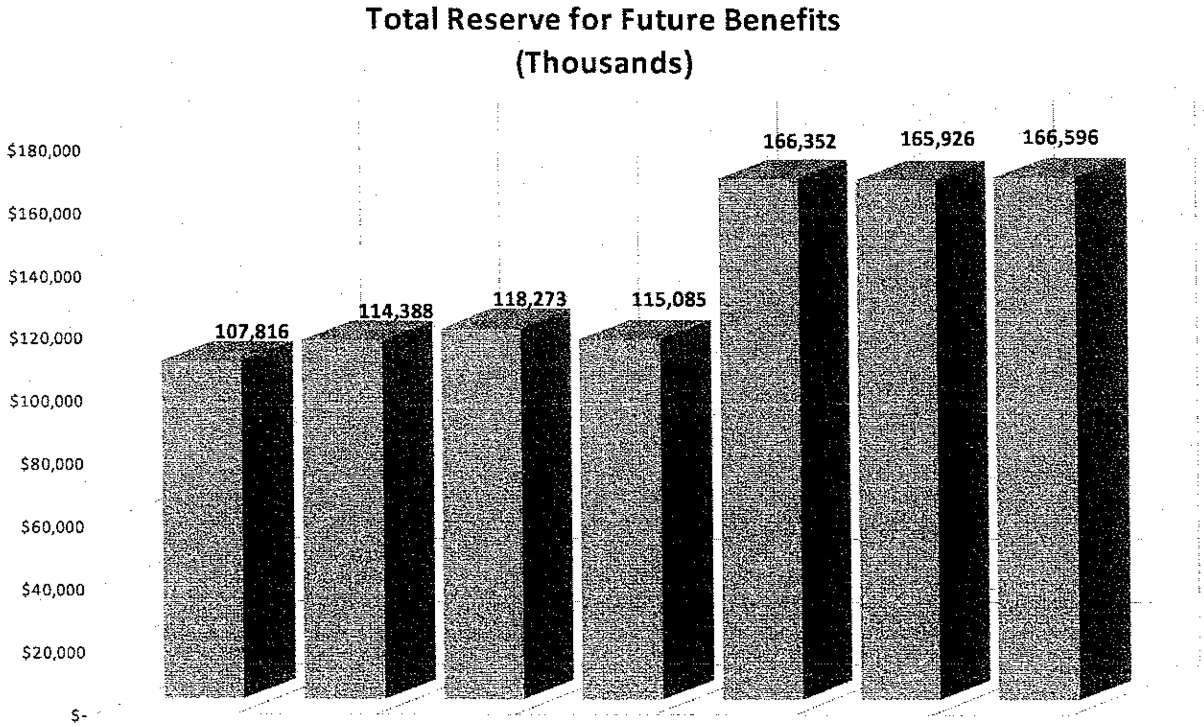
## *LIABILITIES AND NET DEFICIT*

Below is a general discussion of the liabilities and net assets section of the Administration's financial position.

## *RESERVES FOR FUTURE BENEFITS*

The composition of the reserves for future benefits as of the end of the last six fiscal years was as follows:

| Description | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|
| Death | $ 13,171 | $ 12,424 | $ 13,249 | $ 17,988 | $ 16,488 | $ 14,419 |
| Funeral | 816 | 409 | 362 | 360 | 369 | 237 |
| Disability | 5,942 | 5,310 | 6,337 | 5,548 | 5,791 | 3,945 |
| Medical hospital: | | | | | | |
| Basic | 41,265 | 44,671 | 35,788 | 42,124 | 44,515 | 46,421 |
| Extended Benefit | 52,903 | 55,132 | 59,024 | 99,944 | 98,371 | 101,257 |
| Dismemberment | 291 | 327 | 325 | 388 | 392 | 317 |
| Total | $ 114,388 | $ 118,273 | $ 115,085 | $ 166,352 | $ 165,926 | $ 166,596 |



### *INCREASE IN RESERVES FOR FUTURE BENEFITS*

A reserve for future benefits is an estimate of unpaid benefits on any given date. The estimate of the reserve for future benefits is an actuarial function involving the current financial evaluation of future contingent events. The total reserve figure for Fiscal Year ended June 30, 2011 shows an increase of $669 thousand or 0.40% ($166.6 million in 2011 vs. $165.9 million in 2010). In 2010 the estimate of the reserve decreased $425 thousand or 0.26% ($166.3 million in 2009). According to the actuarial report, the Reserve for Future Benefits is segregated into six major areas: benefits for Death, Funeral, Disability, Dismemberment and Medical Hospital Benefits, basic and extended. Each major area is evaluated separately and a reserve is estimated for each of them.

During the last three fiscal years the estimate of the reserve for future benefits has been close to $166 million with little variance due to the actuary's conservatism.

It should be noted that most payments for Funeral and Dismemberment benefits are settled within two years, while the Disability benefits may perhaps run for two years. Other benefits settlements may depend on the composition and age distribution of the beneficiaries. Up to 2008, the Reserve for Future Benefits were discounted. Effective in 2009, the Reserve were undiscounted as recommended by our actuary.

### *OBLIGATION TO RETURN COLLATERAL UNDER THE SECURITIES LENDING PROGRAM*

The decrease of $43.2 million or 100% in the obligation of collateral to be returned under the securities lending program was due to the same reasons as explained above for the collateral received (contra-account). In 2010 the obligation of collateral to be returned under the securities lending program increased $14.5 million or 50% when compare with 2009.

### *PAYABLE FOR ACQUISITION OF INVESTMENT*

Payable for the acquisition of investments increased by $366 thousand when compared to prior year ($724 thousand on 2011 vs. $358 thousand on 2010). In 2010 the payable decreased by $4.3 million ($4.7 million in 2009). The reason for this variation depends on the transactions pending settlements in the investment portfolio.

### *ACCOUNTS PAYABLE*

Accounts payable (excluding insurance premiums in advances) decreased by $3.5 million or 41.5% when compared to prior year ($5 million on 2011 vs. $8.5 million on 2010). The main reason for this is a reduction in the pending invoices corresponding to vendors of medical services and expenses for the beneficiaries of the Administration. In 2010 the accounts payable increased by $3.6 million or 75% when compared with 2009 ($4.9 million in 2009). The main reason for this increment is the accrual of pending invoices corresponding to vendors of medical services and expenses for the beneficiaries of the Administration. In 2009, the pending invoices not recorded were considered as part of the Reserve for Future Benefits.

### *ACCRUED LIABILITIES*

Accrued liabilities in 2011 practically remained the same as the previous year only increasing by $5 thousand or 0.13% when compared to prior year. The main reason for this stabilization has been the pressure placed by management on employees to use their excess accrued vacation time and the reduction in payroll expenses.

In 2010, the accrued liabilities decreased by $1 million or 20% ($5.1 million in 2009). This reduction was do by to employee's use of their excess accrued vacation time, the reduction in payroll expenses and as well as a reduction of approximately 90 employees to the total Administration's headcount due to a RIF and retirements.

### *NET DEFICIT AT END OF YEAR*

The net deficit for the Fiscal Year ended June 30, 2011 decreased by $20.5 million. This decrease in net deficit was related to all management actions here in before stated.

It should be noted that, as required by the Law that created the Administration, the excess of revenues collected during any fiscal year over the payment of benefits and operational expenses must be kept by the Administration to cover all unanticipated claims. Also, if in any year the receipts and the reserves accrued are not sufficient to cover the losses and the expenses incurred, the Secretary of the Treasury shall provide, as an advance to the Administration, the sums required to remediate the deficiency. Such advance would be obtained from any funds available in the general Government fund.

## *STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (DEFICIT)*

The following statement presents a detail of the Administration's revenues, expenses and change in net deficit (000's omitted):

| | | | Variance | | | Variance | |
|---|---|---|---|---|---|---|---|
| | 2011 | 2010 | Dollars | Percent | 2009 | Dollars | Percent |
| Net insurance premiums earned | $ 77,549 | $ 78,609 | $ (1,060) | -1.35% | $ 82,730 | $ (4,121) | -4.98% |
| Benefits incurred | 37,737 | 49,631 | (11,894) | -23.96% | 102,928 | (53,297) | -51.78% |
| Beneficiaries' services | 21,088 | 24,247 | (3,159) | -13.03% | 24,624 | (377) | -1.53% |
| General and administrative expenses | 20,618 | 16,377 | 4,241 | 25.90% | 18,022 | (1,645) | -9.13% |
| Total operating expenses | 79,443 | 90,255 | (10,812) | -11.98% | 145,574 | (55,319) | -38.00% |
| Other (expenses) income, net | 877 | 1,175 | (298) | -25.36% | 814 | 361 | 44.35% |
| Loss from insurance operations | (1,017) | (10,471) | 9,454 | -90.29% | (62,030) | 51,559 | -83.12% |
| Interests and dividends, net | 3,414 | 3,922 | (508) | -12.95% | 4,504 | (582) | -12.92% |
| (Loss) gain on sales of investments | (1,545) | 1,816 | (3,361) | -185.08% | (12,994) | 14,810 | -113.98% |
| Unrealized gain (loss) on investments | 19,641 | 5,099 | 14,542 | 285.19% | (12,584) | 17,683 | -140.52% |
| Change in Net Assets | $ 20,493 | $ 366 | $ 20,127 | 5499.18% | $ (83,104) | $ 83,470 | -100.44% |

## *REVENUES FROM INSURANCE PREMIUMS*

The premiums are earned ratably over the one-year term of coverage, and it is anticipated to remain in-line with the prior year if no significant change in premiums collected is established. The insurance premium rate per vehicle per year is $35 and has remained the same for over 40 years. Net revenues from insurance premiums experienced a decrease of $1.1 million or 1.4% over last year ($77.5 million in 2011 vs. $78.6 million in 2010). The decrease resulted from estimates based on information provided by the Puerto Rico Treasury Department, which is subject to future changes based on new information that may be provided. In 2010, Net revenues from insurance premiums experienced a decrease of $4.1 million or 5% over the previous year ($82.7 million in 2009).

### *SERVICE FEES*

Law No. 233 was enacted during the Fiscal Year ended June 30, 2004. This Law allows the Puerto Rico Treasury Department to charge a fee of 5% over all revenues collected by the Puerto Rico Treasury Department for collection expense purposes. On a full year basis, this charge reached an amount of $3.9 million for the Fiscal Year 2010-11, in comparison to $4.1 million for Fiscal Year 2009-10. This amount is also estimated from information provided by the Puerto Rico Treasury Department, which is subject to future changes based on new information that may be provided. In the fiscal year 2008-09 the services fees amounted to $3.8 million.

### *BENEFITS EXPENSES INCURRED*

During Fiscal Year ended June 30, 2011, the benefits incurred experienced a combined 23.9% decrease or $11.8 million ($37.7 million in 2011 vs. $49.6 in 2010). This decrease was mainly caused by aggressive cost reduction plan implemented by the Administration, including instructional letters and sound approval procedures. In addition, a change in the Prescription Benefit Manager and the implementation of new pharmacy policies contributed to a reduction of the actual benefits paid without considering the reserve adjustment.

During Fiscal Year ended June 30, 2010, the benefits incurred experienced a combined 51.2% decrease or $53.3 million ($49.6 million in 2010 vs. $102.9 million in 2009). This was mainly due to an increase of $51.2 million in the Reserve for Future Benefits in 2009 because of a change from a discounted reserve to an undiscounted method as recommended by our actuary.

### *BENEFICIARIES' SERVICES*

The beneficiaries' services expense experienced a decrease of $3.1 million or 12.8% ($21.1 million in 2011 vs. $24.2 million in 2010). In 2010 the beneficiaries' services expenses decreased $377 thousand or 1.5% ($24.6 million in 2009). This is mainly due to the invoice payment process which includes a new Review and Utilization Program for hospital claims.

### *GENERAL AND ADMINISTRATIVE EXPENSES*

The general and administrative expenses (including depreciation and amortization) experienced an increase of $4.2 million when compared with the previous year ($20.6 million in 2011 vs. $16.4 million in 2010). The main cause for this increase was an in increase in the allowance for uncollectible accounts and the recognition of impairment loss of capital asset. During 2010 the Administration experienced a decrease of $1.6 million with the previous year ($18.0 million in 2009) because of the RIF plan that was implemented this Fiscal Year; as well as the retirement of employees.

## *DISTRIBUTION OF TOTAL OPERATING EXPENSES*

In summary, as previously explained, the Total Operating Expenses (including transfers to another governmental agency) incurred during the year ended June 30, 2011 decreased $10.2 million when compared with the prior year ($81.1 million in 2011 vs. $91.3 million in 2010). In 2010 the Total Operating Expenses incurred during the year ended June 30, 2010 decreased by $55.3 million when compared with 2009 ($146.6 million). The composition of the Administration's Total Operating Expenses (including transfer to another governmental agency) as compared with the previous five fiscal years is as follows:

| | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|
| Death & funeral benefits | $ 2,230 | $ 4,087 | $ 7,907 | $ 1,310 | $ 288 |
| Disability benefits | 4,150 | 5,061 | 2,778 | 2,891 | 175 |
| Accident & health benefits | 56,426 | 45,352 | 92,243 | 45,430 | 37,275 |
| G & A | 19,889 | 17,638 | 18,022 | 16,377 | 20,617 |
| Beneficiaries' services | 22,180 | 24,028 | 25,664 | 25,323 | 22,768 |
| Total Expenses | $ 104,875 | $ 96,166 | $ 146,614 | $ 91,331 | $ 81,123 |

In order to reduce benefits expenses, the Administration has negotiated with private entities that in turn will rent space and establish a radiology center, orthopedist and physical therapy facilities at the Administration's main office premises. These private entities provide various services such as X-ray, MRI, CT-Scan, orthopedist and physical therapy to beneficiaries, as well as to private patients. In return of the Administration providing the volume of patients, the private entities reduced the actual pricing rates for those services by 30%. These initiatives generate savings approximately between $2 and $2.5 million and generate an annual rental income of approximately $120 thousand.

## *STATEMENTS OF CASH FLOWS*

The Administration's cash flow for the year resulted in a net increase in cash and cash equivalents of $5 million, as shown below (000's omitted):

| | | | Variance | | | Variance | |
|---|---|---|---|---|---|---|---|
| | 2011 | 2010 | Dollars | Percent | 2009 | Dollars | Percent |
| Cash flows provided by (used in) operating activities: | | | | | | | |
| Cash received from insured | $ 77,993 | $ 86,868 | $ (8,875) | -10.22% | $ 83,571 | $ 3,297 | 3.95% |
| Cash paid for benefits and expenses | (48,104) | (53,353) | 5,249 | -9.84% | (59,199) | 5,846 | -9.88% |
| Cash paid to employees for services and accumulated benefits | (30,024) | (34,354) | 4,330 | -12.60% | (33,419) | (935) | 2.80% |
| Other operating receipts | 472 | 1,920 | (1,448) | -75.42% | 554 | 1,366 | 246.57% |
| Net cash provided by (used in) operating activities | 337 | 1,081 | (744) | -68.83% | (8,493) | 9,574 | -112.73% |
| Cash flows from non-capital financing activities: | | | | | | | |
| (Decrease) increase in securities lending obligations | (43,222) | 14,499 | (57,721) | -398.10% | (18,320) | 32,819 | -179.14% |
| | (43,222) | 14,499 | (57,721) | -398.10% | (18,320) | 32,819 | -179.14% |
| Cash flows used in capital and related financing activities - capital expenditures | (348) | (402) | 54 | -13.43% | (784) | 382 | -48.72% |
| Cash flows from investing activities: | | | | | | | |
| Proceeds from sale of investments | 106,459 | 115,535 | (9,076) | -7.86% | 164,245 | (48,710) | -29.66% |
| Purchase of investments | (102,752) | (119,165) | 16,413 | -13.77% | (152,742) | 33,577 | -21.98% |
| Contributions on investments in real estate, net of gross income | (2,076) | (1,300) | (776) | 59.69% | (3,207) | 1,907 | -59.46% |
| Purchase of securities, net of collections of interest dividend income, and non-cash collateral received on securities lending transactions | 46,607 | (10,664) | 57,271 | -537.05% | 22,980 | (33,644) | -146.41% |
| Net cash provided by (used in) investing activities | 48,238 | (15,594) | 63,832 | -409.34% | 31,276 | (46,870) | -149.86% |
| Net increase (decrease) in cash and cash equivalents | $ 5,005 | $ (416) | $ 5,421 | -1303.13% | $ 3,679 | $ (4,095) | -111.31% |

### *CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES*

The cash received from insurance premiums during the fiscal year decreased by $8.9 million or 10.2% over the same period last year ($78 million in 2011 vs. $86.9 million in 2010). In 2010 the cash received from insurance premiums increased by $3.3 million or 3.9% over the same period the previous year ($83.6 million in 2009).

We must remember that, on the other hand, in 2004 the collections were reduced by 5.0% due to the implementation of Law No. 233, which resulted in a service charge by the Puerto Rico Treasury Department for the collection of the premiums. The fees charged amounted to $3.9 in 2011, $4.1 million in 2010, $3.8 million in 2009, $4.3 million in 2008, $4.2 million in 2007, $4 million in 2006, and $3.9 million in 2005, and $965 thousand in 2004.

Other areas affecting the cash from operating activities included payments for benefits and expenses. During the year, a decrease of $9.6 million or 10.9% was experienced in the payments for benefits and expenses and to employees for services and accumulated benefits ($78.1 million in 2011 vs. $87.7 million in 2010). On the other hand, the other operating receipts experienced a decrease of $1.4 million ($472 thousand in 2011 vs. $1.9 million in 2010) due to the net effect of other collections and the change in other accounts receivable. In 2010 the other operating receipts increased by $1.4 million ($1.9 million in 2010 vs. $554 thousand in 2009) due to the efforts in collections and the net effect with the change in other accounts receivable.

### *CONTACTING THE ADMINISTRATION'S FINANCIAL MANAGEMENT*

This financial analysis (including the financial statements and notes thereto) is designed to provide a general overview of the Administration's finances and to comply with the financial reporting guidelines established by the Commonwealth of Puerto Rico, as well as to demonstrate the Administration's commitment to public accountability. For questions regarding this analysis and/or to request additional information, contact the Administration's Finance Department at Chardon Ave. #249, Arterial Hostos Square, Hato Rey, PR, 00918 or by calling 787-753-8495.

# AUDITED FINANCIAL STATEMENTS

**AUTOMOBILE ACCIDENTS COMPENSATIONS ADMINISTRATION**
BALANCE SHEETS
JUNE 30, 2011 AND 2010

| | 2011 | 2010 |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents | $ 10,998,054 | $ 5,993,647 |
| Collateral received under securities lending program | - | 43,222,484 |
| Investments, at fair value | 147,513,643 | 131,258,866 |
| Accounts receivable: | | |
| Premiums | 666,088 | - |
| Accrued interest and dividends | 782,405 | 753,272 |
| Receivable from sale of investments | 916,273 | 338,644 |
| Other, net | 753,150 | 2,828,958 |
| | 3,117,916 | 3,920,874 |
| | 161,629,613 | 184,395,871 |
| **CAPITAL ASSETS** | | |
| Being depreciated, net | 4,510,718 | 4,854,966 |
| Not being depreciated | 3,077,133 | 4,040,380 |
| | 7,587,851 | 8,895,346 |
| Other assets | 31,106 | 31,106 |
| | $ 169,248,570 | $ 193,322,323 |

See accompanying notes to financial statements.

| | 2011 | 2010 |
|---|---|---|
| **LIABILITIES AND NET ASSETS (DEFICIT)** | | |
| **LIABILITIES** | | |
| Reserves for future benefits: | | |
| Accident and health | $ 147,677,944 | $ 142,885,882 |
| Death and funeral | 14,656,128 | 16,857,337 |
| Disability | 4,261,845 | 6,183,563 |
| | 166,595,917 | 165,926,782 |
| Deferred premiums reserve | 39,477,916 | 37,770,335 |
| Obligation to return collateral under securities lending program | - | 43,222,484 |
| Payable for acquisition of investments | 724,591 | 357,913 |
| Accounts payable | 5,020,130 | 8,587,950 |
| Insurance premiums advance from Puerto Rico Treasury Department | - | 597,078 |
| Due to Puerto Rico Traffic Safety Commission | 450,732 | 378,619 |
| Accrued liabilities | 4,057,686 | 4,052,524 |
| **TOTAL LIABILITIES** | 216,326,972 | 260,893,685 |
| **COMMITMENTS AND CONTIGENCIES** | | |
| **NET ASSETS (DEFICIT)** | | |
| Invested in capital assets | 7,587,851 | 8,895,346 |
| Unrestricted | (54,666,253) | (76,466,708) |
| | (47,078,402) | (67,571,362) |
| | $ 169,248,570 | $ 193,322,323 |

See accompany notes to financial statements.

**AUTOMOBILE ACCIDENTS COMPENSATIONS ADMINISTRATION**
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS (DEFICIT)
YEARS ENDED JUNE 30, 2011 AND 2010

| | 2011 | 2010 |
|---|---|---|
| **PREMIUMS** | | |
| Gross insurance premiums earned | $ 81,512,490 | $ 82,752,675 |
| Less services fee | (3,963,158) | (4,143,630) |
| **NET INSURANCE PREMIUMS EARNED** | 77,549,332 | 78,609,045 |
| **BENEFITS AND EXPENSES** | | |
| Death and funeral benefits | 287,820 | 1,309,792 |
| Disability benefits | 175,555 | 2,890,694 |
| Accident and health benefits | 37,273,891 | 45,430,378 |
| Beneficiaries services | 21,088,036 | 24,247,435 |
| General and administrative expenses | 19,925,741 | 15,651,112 |
| Depreciation and amortization expense | 691,808 | 725,430 |
| **TOTAL OPERATING EXPENSES** | 79,442,851 | 90,254,841 |
| **OTHER OPERATING INCOME (EXPENSES)** | | |
| Other income, mainly recoveries of benefits | 2,557,246 | 2,251,024 |
| Transfers to other Governmental Agency | (1,680,365) | (1,076,115) |
| **LOSS FROM INSURANCE OPERATIONS** | (1,016,638) | (10,470,887) |
| **NON OPERATING REVENUES (EXPENSES)** | | |
| Interest and dividends, net of administration costs | 3,383,197 | 3,860,770 |
| Interest - securities lending | 91,324 | 116,101 |
| Interest, fees and other expenses of securities lending | (60,784) | (54,495) |
| Realized (losses) gains on sales of investments | (1,545,177) | 1,816,219 |
| Unrealized gains on investments | 19,641,038 | 5,098,664 |
| **TOTAL NON-OPERATING REVENUES** | 21,509,598 | 10,837,259 |
| **CHANGE IN NET ASSETS** | 20,492,960 | 366,372 |
| **NET DEFICIT AT BEGINNING OF YEAR** | (67,571,362) | (67,937,734) |
| **NET DEFICIT AT END OF YEAR** | $ (47,078,402) | $ (67,571,362) |

See accompanying notes to financial statements.

**AUTOMOBILE ACCIDENTS COMPENSATIONS ADMINISTRATION**
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2011 AND 2010

| | 2011 | 2010 |
|---|---|---|
| **CASH FLOWS PROVIDED BY OPERATING ACTIVITIES** | | |
| Cash received from insured | $ 77,993,747 | $ 86,868,342 |
| Cash paid for benefits and expenses | (48,104,481) | (53,352,638) |
| Cash paid to employees for services and accumulated benefits | (30,023,693) | (34,354,648) |
| Other operating receipts | 471,657 | 1,919,694 |
| **NET CASH PROVIDED BY OPERATING ACTIVITIES** | 337,230 | 1,080,750 |
| **CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES** | | |
| (Decrease) increase in securities lending obligations | (43,222,484) | 14,499,385 |
| **CASH FLOWS USED IN CAPITAL AND RELATED FINANCING ACTIVITIES** | | |
| Capital expenditures | (347,560) | (401,884) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Proceeds from sales of investments | 106,458,783 | 115,535,357 |
| Purchases of investments | (102,752,445) | (119,165,053) |
| Contributions on investments in real estate, net of gross income | (2,076,205) | (1,299,975) |
| Purchase of securities, net of collections of interest dividend income, and non-cash collateral received on securities lending transactions | 46,607,088 | (10,664,720) |
| **NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES** | 48,237,221 | (15,594,391) |
| **NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | 5,004,407 | (416,140) |
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR** | 5,993,647 | 6,409,787 |
| **CASH AND CASH EQUIVALENTS AT END OF YEAR** | $ 10,998,054 | $ 5,993,647 |

See accompanying notes to financial statements.

**AUTOMOBILE ACCIDENTS COMPENSATIONS ADMINISTRATION**
STATEMENTS OF CASH FLOWS - CONTINUED
YEARS ENDED JUNE 30, 2011 AND 2010

| | 2011 | 2010 |
|---|---|---|
| **RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES** | | |
| Loss from insurance operations | $ (1,016,638) | $ (10,470,887) |
| Adjustment to reconcile operating loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 691,808 | 725,430 |
| Provision for doubtful accounts | 4,161,397 | 737,755 |
| Loss from impairment of capital assets | 963,247 | - |
| Changes in assets and liabilities: | | |
| Premiums receivable | (666,088) | 8,998,191 |
| Other accounts receivable | (2,085,589) | (331,330) |
| Other assets | - | (5,042) |
| Reserve for future benefits | 669,135 | (424,982) |
| Deferred premium reserve | 1,707,581 | (1,335,972) |
| Accounts payable | (3,567,820) | 3,686,693 |
| Accrued liabilities | 5,162 | (1,013,239) |
| Insurance premiums advance from Puerto Rico Treasury Department | (597,078) | 597,078 |
| Due to Puerto Rico Traffic Safety Commission | 72,113 | (82,945) |
| **NET CASH PROVIDED BY OPERATING ACTIVITIES** | $ 337,230 | $ 1,080,750 |

**SUPPLEMENTAL DISCLOSURES OF NON CASH AND RELATED FINANCING ACTIVITIES:**

| | 2011 | 2010 |
|---|---|---|
| Account receivable written-off | $ - | $ 904,680 |
| Securities sold, but not yet delivered | $ 577,629 | $ 4,210,019 |
| Securities purchased, but not yet received | $ 366,678 | $ 4,225,013 |

See accompanying notes to financial statements.

## NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

***Organization and Summary of Significant Accounting Policies***

The Automobile Accidents Compensations Administration (the "Administration") is a public corporation and a component unit of the Commonwealth of Puerto Rico, created by Law No.138 of June 26, 1968 (as amended). The Administration operates a system of compulsory insurance for vehicles licensed to be used on public roads and highways in Puerto Rico. This insurance covers bodily injuries and compensation for beneficiaries (and their dependants) caused by automobile accidents. The annual premium is $35 per motor vehicle.

As a public corporation, the Administration is exempt from the payment of taxes, except on payroll.

A summary of the Administration's significant accounting policies used in the preparation of the accompanying financial statements follows:

***Basis of Accounting***

The Administration reports follows the provisions of GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting,* as amended by GASB Statement No. 34, which requires proprietary activities to apply all applicable GASB pronouncements as well as all Financial Accounting Standards Board (FASB) Statements and Interpretations, and Accounting Principles Board Opinions and Accounting Research Bulletins issued on or before November 30, 1989, unless the pronouncements conflict or contradict GASB pronouncements.

This pronouncement permits the adoption of all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict or contradict GASB pronouncements. The Administration, as allowed by GASB, has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that are not in conflict with GASB pronouncements.

***Insurance Premiums***

Insurance premiums are collected in advance by the Treasury Department and recognized ratably as income during the policy year. As per Law No. 233 of September 2, 2003, the Puerto Rico Treasury Department of the Commonwealth of Puerto Rico charges a 5% service fee overall revenue collected by the Treasury Department. The service charges during the years ended June 30, 2011 and 2010, amounted to approximately $3,960,000 and $4,144,000, respectively. The portion of premiums that will be earned in the future is deferred and reported as Deferred Premiums Reserve.

## NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

### *Cash and Cash Equivalents*

For financial statement purposes, the Administration considers all highly liquid instruments purchased with a maturity of three months or less to be cash equivalents. Cash equivalents as of June 30, 2011 and 2010, consist of funds invested in short term bills, notes and investments funds.

### *Investments*

The Administration invest in marketable securities in order to shift the risks to uncertainty of the possible liabilities regarding claims.

Investments are recorded at their fair market value in conformity with GASB Statement No. 31, *"Accounting and Financial Reporting for Investments and for External Investment Pools."* The fair value is based on quotations obtained from national securities exchanges. When securities are not listed in national securities exchanges, quotations are obtained from brokerage firms. Changes in fair value are reported in the Statements of Revenues, Expenses and Changes in Net Assets.

The Administration follows the provisions of GASB Statement No. 28, *"Accounting and Financial Reporting for Securities Lending Transactions."* This statement establishes standards of accounting and financial reporting for securities lending transactions in which governmental entities (lenders) transfer their securities to broker-dealers and other entities (borrowers) for collateral and simultaneously agree to return the collateral for the same securities in the future. Cash collateral of securities received for which the Administration has the ability to invest and pledge forward at their discretion is recorded as an asset and a liability. Letters of credit and securities that cannot be pledged are not recorded as assets and liabilities in the Administration's books of accounts.

### *Receivables or Payables Resulting from the Sale or Acquisition of Investments*

Investment transactions at or close to June 30, 2011 and 2010, for which the settlement date occurs after the fiscal year ends, are recorded separately for financial statement purposes.

### *Accounts Receivable*

Receivables from premiums collected are estimates based on the amounts reported by the Puerto Rico Treasury Department which could be subject to change. Any change is recorded when it is identified.

Receivables are unsecured and presented net of estimated allowances for uncollectible accounts. Such allowances are determined based upon past collection experience and current economic conditions.

Accrued interest and dividends represents uncollected income earned on investments.

## NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

### *Capital Assets*

Capital assets are recorded at cost less accumulated depreciation and amortization. Depreciation and amortization is provided using the straight-line method over the estimated useful life of the assets. Leasehold improvements are amortized over the respective lease terms or the estimated useful life of the improvements, whichever is shorter. Expenditures for maintenance and repairs that do not extend the life of the assets are charged to operations, while those for renewals and improvements are capitalized. Capital assets are defined by the Administration as assets which have a cost of $250 or more at the date of acquisition and have an expected useful life of one or more years.

Estimated useful life is as follow:

| | |
|---|---|
| Building | 45 years |
| Equipment | 10-20 years |
| Computer and software | 5-7 years |
| Vehicles | 4 years |
| Office furniture and fixtures | 5-10 years |

### *Accounting for the Impairment of Capital Assets*

The Administration accounts for asset impairment under the provision 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 impairments of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. 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 or change in circumstance is outside the normal life cycle of the capital asset. Impaired capital assets that will no longer be used by the Administration should be reported at the lower of carrying value or fair value.

### *Benefits Expenses*

Benefits expenses are recorded when claims are incurred. In addition, management has established reserves to cover for the estimated cost of all future benefits related to claims incurred but not reported during the year. These reserves are adjusted annually following the advice of an independent actuary. Management believes that these reserves are reasonable and reflective of anticipated ultimate experience. Since the reserves are based on estimates, the net amounts that will ultimately be paid to settle the liability may change from the estimated amounts provided for.

## NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

### *Benefits Expenses - continued*

The Law that created the Administration limits medical hospitalization benefits to a maximum of two years after an accident, except in severe trauma cases. The Law allows a Medical Committee to extend payment of medical benefits beyond the two-year period as deemed necessary.

In addition, the Law that created the Administration requires that the excess of revenues collected during any fiscal year over the payment of benefits and operational expenses must be kept by the Administration to cover all unanticipated claims. Also, if in any year the receipts and the reserves accrued are not sufficient to cover the losses and the expenses incurred, the Secretary of the Treasury of Puerto Rico shall provide, as an advance to the Administration the sums required to remedy the deficiency. Such advance would be obtained from any funds available in the General Fund of the Commonwealth of Puerto Rico.

### *Compensated Absences*

The Administration accounts for compensated absences in accordance with the provisions of GASB Statement No. 16, "Accounting for Compensated Absences". GASB Statement No. 16 requires accrual of the cost of the benefits through the years that employees provide services until the date of full eligibility for such benefits.

The vacation policy of the Administration generally provides for the annual accumulation of thirty (30) days of vacation and eighteen (18) days of sick leave. Vacation time and sick leave are fully vested to the employees from the first day of work. The excess of accumulated vacation over thirty (30) days and over three (3) days of sick leave is paid periodically to those employees as provided in the collective bargaining agreement. For administrative employees, any excess over fifteen (15) days of sick leave is also paid periodically. In addition, all employees with over ten (10) years of service are entitled upon retirement to a lump-sum payment equal to $130 for each year of service.

### *Pension Cost*

Pension cost is accounted for in accordance with the provisions of GASB Statement No. 27 "Accounting for Pensions by State and Local Governmental Employers". This statement establishes standards of accounting and financial reporting for pension expenditures/expenses and related pension liabilities, pension assets, note disclosures, and required supplementary information in the financial statements of state and local governmental employers.

This Statement defines that pension expense is equal to the statutory required contribution to the employee retirement system. A pension liability or asset is reported equal to the cumulative differences between statutory required contributions and actual contributions up to June 30, 2011 and 2010.

## NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

### *Termination Benefits*

The Administration accounts for termination benefits in accordance with the provision of GASB Statement No. 47, "Accounting for Termination Benefits". This Statement establishes accounting standards for termination benefits. Pursuant to this Statement, the Administration should recognize a liability and expense for voluntary termination benefits (for example, early-retirement incentives) when the offer is accepted and the amount can be estimated. At June 30, 2011 and 2010, no formal voluntary termination benefits were incurred.

### *Risk Management*

The Administration is exposed to the risk of loss from torts, theft, damages to, and destruction of assets, errors and omissions, employee injuries and illnesses, natural disasters, environmental and other losses. Commercial insurance coverage is obtained for claims that may arise from such matters. The commercial insurance coverage is negotiated by the Treasury Department of the Commonwealth of Puerto Rico, and the cost is paid by the Administration. No additional payments were made after the annual insurance costs were determined.

### *Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from estimated amounts. The accounts requiring the use of significant estimates include certain receivables, reserve for future benefits, deferred premiums reserve, and useful lives of property and equipment.

### *Reclassification*

Certain amounts in the 2010 financial statements were reclassified to conform to the 2011 presentation.

## NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

***Fair Value of Financial Instruments***

Financial instruments consist of cash, accounts receivable, accounts payable and debt. The carrying amount of all significant financial instruments approximates fair value, principally due to length of maturity.

## NOTE B - CASH AND CASH EQUIVALENTS

As of June 30, 2011 and 2010, cash and cash equivalents mainly consist of deposits in banks and short term investments categorized as follows:

| Category | Description |
|---|---|
| 1 | Cash Deposits in local banks collateralized or insured by the Federal Deposit Insurance Corporation. |
| 2 | Uncollateralized Deposits. |

A summary of the Administration's cash and cash equivalents by category of risk as of June 30, 2011 and 2010, are shown below:

**2011**

| | Credit Risk Category 1 | Credit Risk Category 2 | Bank Balance | Carrying Amount |
|---|---|---|---|---|
| Unrestricted cash | $ 4,506,453 | $ - | $ 4,506,453 | $ 2,163,168 |
| Restricted cash | 633,708 | - | 633,708 | 12,411 |
| Short Term Investments | - | 8,822,475 | 8,822,475 | 8,822,475 |
| | $ 5,140,161 | $ 8,822,475 | $ 13,962,636 | $ 10,998,054 |

**2010**

| | Credit Risk Category 1 | Credit Risk Category 2 | Bank Balance | Carrying Amount |
|---|---|---|---|---|
| Unrestricted cash | $ 4,997,291 | $ - | $ 4,997,291 | $ 2,501,979 |
| Restricted cash | 1,398,408 | - | 1,398,408 | 378,619 |
| Short Term Investments | - | 3,113,049 | 3,113,049 | 3,113,049 |
| | $ 6,395,699 | $ 3,113,049 | $ 9,508,748 | $ 5,993,647 |

## NOTE B - CASH AND CASH EQUIVALENTS - CONTINUED

Deposits held in custody by financial institutions are either insured by the Federal Depository Insurance Corporation (FDIC) up to $250,000, or collateralized with various financial instruments held by a trustee of the Treasury Department of the Commonwealth of Puerto Rico. Based on these provisions, insured or collateralized deposits are not considered to be subject to custodial risk, which is the risk that in the event of a bank's failure, the Administration's deposits may not be returned.

The restricted cash represents funds of Puerto Rico Traffic Safety Commission held in custody the Administration (see Note J).

## NOTE C - INVESTMENTS

The Administration invests in stocks, bonds, real estate, United States obligations, and cash equivalents as described more fully in its investment policy. Also, it can invest in international securities. As of June 30, 2011 and 2010, the credit quality rating for the investment securities portfolio was comprised of the following:

| | 2011 | | | | |
|---|---|---|---|---|---|
| | Credit Risk Rating | | | | |
| Investment Type: | AAA to A | BBB + to B | CCC | Not Rated | Total |
| Corporate bonds | $ 8,601,587 | $ 7,120,281 | $ - | $ 7,315,603 | $ 23,037,471 |
| U.S. sponsored agencies notes: | | | | | |
| Federal Home Loan Bank (FHLB) | 737,772 | - | - | 1,108,626 | 1,846,398 |
| Federal Home Mortgage Corporation (FHLMC) | - | 2,632,540 | - | - | 2,632,540 |
| Federal National Mortgage Association (FNMA) | 5,361,104 | - | - | 77,215 | 5,438,319 |
| U.S. Government bonds | 30,795,530 | - | - | - | 30,795,530 |
| Mortgage and assets-backed securities: | | | | | |
| FNMA | 2,948,627 | - | - | 455,736 | 3,404,363 |
| FHLMC | - | 300,606 | - | - | 300,606 |
| Asset Backed Securities | - | - | - | 161,880 | 161,880 |
| Commercial Mortgage - Backed | - | 426,929 | 158,483 | 2,226,427 | 2,811,839 |
| Municipal/provincial bonds | - | - | - | 1,653,082 | 1,653,082 |
| U.S. corporate stocks | 26,636,782 | 6,982,704 | - | 13,301,928 | 46,921,414 |
| Non U.S. corporate stocks | 3,172,339 | 2,415,920 | - | 12,485,336 | 18,073,595 |
| Real Estate | - | - | - | 10,436,606 | 10,436,606 |
| Total investments | $ 78,253,741 | $ 19,878,980 | $ 158,483 | $ 49,222,439 | $ 147,513,643 |

## NOTE C – INVESTMENTS - CONTINUED

| | 2010 | | | | |
|---|---|---|---|---|---|
| | Credit Risk Rating | | | | |
| Investment Type: | AAA to A | BBB + to B | CCC | Not Rated | Total |
| Corporate bonds | $ 17,011,470 | $ 7,034,564 | $ - | $ 4,062,029 | $ 28,108,063 |
| U.S. sponsored agencies notes: | | | | | |
| Federal Home Loan Bank (FHLB) | 2,379,515 | - | - | 1,355,027 | 3,734,542 |
| Federal National Mortgage Association (FNMA) | 2,974,081 | - | - | - | 2,974,081 |
| Federal Farm Credit Bank (FFCB) | 1,542,291 | - | - | - | 1,542,291 |
| U.S. Government bonds | 26,123,127 | - | - | - | 26,123,127 |
| Mortgage and assets-backed securities: | | | | | |
| FNMA | - | - | - | 2,705,249 | 2,705,249 |
| FHLMC | - | - | - | 1,699,547 | 1,699,547 |
| Other fixed income | - | - | - | 12,588 | 12,588 |
| Asset Backed Securities | 555,334 | 75,111 | 1,796 | - | 632,241 |
| Commercial Mortgage - Backed | 3,142,059 | 76,250 | - | 497,642 | 3,715,951 |
| Municipal/provincial bonds | 2,341,060 | - | - | - | 2,341,060 |
| U.S. corporate stocks | - | - | - | 38,802,060 | 38,802,060 |
| Non U.S. corporate stocks | - | - | - | 13,276,714 | 13,276,714 |
| Real Estate | - | - | - | 5,591,352 | 5,591,352 |
| Total investments | $ 56,068,937 | $ 7,185,925 | $ 1,796 | $ 68,002,208 | $ 131,258,866 |

The custody of these investments is held by a custodial bank in the name of the Administration. The investments portfolio is managed by six asset management firms and external consultants, and internal cash position is managed by the Assistant Executive Director for Finance, Planning and Budgeting.

## NOTE C - INVESTMENTS - CONTINUED

The Administration's investment policy taken as a whole, requires money managers to maintain, with certain limitations, the following composition of the assets: not more than 72% in 2011 and 62% in 2010, and not less than 30% in 2011 and 33% in 2010, in fixed income securities; not more than 57.5% in 2011 and 62.5% in 2010, and not less than 24% in 2011 and 2010 in equity securities. The equity securities position in the portfolio, no more than 12.5% in 2011 and 17.5% in 2010 may be invested in international markets. Investments in real estate should not exceed 7% of the total investment portfolio.

Equity investments will not be considered speculative in nature and will be those traded on the major national and international securities exchanges. Equity investments may only be acquired with a market capitalization of more than $200 million (at the time of purchase) and will not be unduly concentrated in any one industry or economic sector, with the exception of Puerto Rico Stocks.

Except for instruments issued by the Commonwealth of Puerto Rico and its instrumentalities, fixed income securities may only be acquired if they are rated, at the time of purchase, within the four highest classifications designated by one of the major rating services, i.e., Standard and Poor's or Moody's Investor Services. Not more than 5% of any single debt issue may be purchased as an investment, with the exception of the US Government or its agencies' paper. Not more than 10% of the assets of the fund at market value may be invested in the securities of a single issuer, with the exception of the US Government or its agencies. The bonds portfolio average duration shall not exceed seven years.

The Administration's investment in real estate consists of contributions to the Invesco Real Estate Fund I and II, LP, which are a funds organized to invest in diversified real estate assets. The total commitment to Fund I and II requires contributions that will amount to $10,000,000 for each fund. Total contributions to the Fund I and II at June 30, 2011, amounted to $9,248,390 and $6,000,331, respectively, none return of capital. At June 30, 2010, total contributions amounted to $9,248,390 and $3,875,334, respectively, none return of capital.

The cumulative unrealized gain for both Funds at June 30, 2011 were $1,519,475 and $1,388,836 respectively. At June 30, 2010, the cumulative unrealized gain (loss) for both funds were $896,618 and ($354,641), respectively. Fair value of the investments at June 30, 2011 and 2010, amounted to $10,436,606 and $5,591,352, respectively. Off-balance-sheet derivatives, option contracts, commodities, private placements, limited partnerships other than real estate, and venture-capital investments are among the assets that are specifically prohibited.

On May 19, 2011, Invesco Real Estate Fund II sent a capital demand notice to contribute $2,000,000 to the fund. The Administration refused to make the contribution based on the section 3.8 (a) of the partnership agreement which establish the requirements to elect a limited Opt-out Right. At June 30, 2011 the Administration and Invesco Real Estate Fund II are in a legal process on this issue. According to the Administration's legal consultants the risk in the case would be the contribution of $2,000,000.

## NOTE C - INVESTMENTS – CONTINUED

The Administration's cash reserve should be invested in high quality, short-term investments including commercial paper, US Treasury obligations, certificates of deposit, bankers' acceptances, and repurchase agreements collateralized by US Government securities.

The Administration's Statement of Investment Policy, Objectives and Guidelines provides more specific information regarding investment requirements.

The estimated market value of debt securities at June 30, 2011 and 2010, by contractual maturity is shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties:

| | 2011 | | | | | |
|---|---|---|---|---|---|---|
| Investment Type: | Within One Year | After one to Five Years | After Five to Ten Years | After Ten Years | Without Maturity | Total |
| Corporate bonds | $ 2,261,761 | $ 6,709,268 | $ 13,568,448 | $ 497,994 | $ - | $ 23,037,471 |
| U.S. sponsored agencies notes: | | | | | | |
| Federal Home Loan Bank (FHLB) | 253,802 | 1,592,596 | - | - | - | 1,846,398 |
| Federal Home Mortgage Corporation (FHLMC) | - | 2,632,540 | - | - | | 2,632,540 |
| Federal National Mortgage Association (FNMA) | 1,758,284 | 3,336,877 | 343,158 | - | | 5,438,319 |
| U.S. Government bonds | 1,521,475 | 17,300,110 | 11,973,945 | - | | 30,795,530 |
| Mortgage and assets-backed securities: | | | | | | |
| FNMA | - | - | - | 3,404,363 | - | 3,404,363 |
| FHLMC | - | - | 67,158 | 233,448 | - | 300,606 |
| Asset Backed Securities | - | - | 161,317 | 563 | - | 161,880 |
| Commercial Mortgage - Backed | - | - | - | 2,811,839 | - | 2,811,839 |
| Municipal/provincial bonds | 479,247 | 346,446 | 347,442 | 479,947 | - | 1,653,082 |
| U.S. corporate stocks | - | - | - | - | 46,921,414 | 46,921,414 |
| Non U.S. corporate stocks | - | - | - | - | 18,073,595 | 18,073,595 |
| Real Estate | - | - | - | - | 10,436,606 | 10,436,606 |
| Total investments | $ 6,274,569 | $ 31,917,837 | $ 26,461,468 | $ 7,428,154 | $ 75,431,615 | $ 147,513,643 |

## NOTE C - INVESTMENTS - CONTINUED

| | 2010 | | | | | |
|---|---|---|---|---|---|---|
| Investment Type: | Within One Year | After one to Five Years | After Five to Ten Years | After Ten Years | Without Maturity | Total |
| Corporate bonds | $ 103,556 | $ 10,137,133 | $ 16,033,715 | $ 1,833,659 | $ - | $ 28,108,063 |
| U.S. sponsored agencies notes: | | | | | | |
| Federal Home Loan Bank (FHLB) | 1,900,180 | 1,834,362 | - | - | - | 3,734,542 |
| Federal National Mortgage Association (FNMA) | 201,488 | 2,430,322 | 342,271 | - | | 2,974,081 |
| Federal Farm Credit Bank (FFCB) | 1,542,291 | - | - | - | | 1,542,291 |
| U.S. Government bonds | 1,805,041 | 17,901,241 | 6,416,845 | - | | 26,123,127 |
| Mortgage and assets-backed securities: | | | | | | |
| FNMA | 8 | 54,565 | 110,999 | 2,539,677 | - | 2,705,249 |
| FHLMC | - | 141,515 | 84,718 | 1,473,314 | - | 1,699,547 |
| Other fixed income | - | - | - | - | 12,588 | 12,588 |
| Asset Backed Securities | - | 403,436 | 227,009 | 1,796 | - | 632,241 |
| Commercial Mortgage - Backed | - | - | - | 3,715,951 | - | 3,715,951 |
| Municipal/provincial bonds | - | 478,601 | 506,772 | 1,355,687 | - | 2,341,060 |
| U.S. corporate stocks | - | - | - | - | 38,802,060 | 38,802,060 |
| Non U.S. corporate stocks | - | - | - | - | 13,276,714 | 13,276,714 |
| Real Estate | - | - | - | - | 5,591,352 | 5,591,352 |
| Total investments | $ 5,552,564 | $ 33,381,175 | $ 23,722,329 | $ 10,920,084 | $ 57,682,714 | $ 131,258,866 |

## NOTE C - INVESTMENTS - CONTINUED

During the fiscal years ended June 30, 2011 and 2010, the Administration sold a number of investments as part of its investment strategy. The results of said sales are as follow:

| | 2011 | 2010 |
|---|---|---|
| Proceeds from sale of investments | $ 106,458,783 | $ 115,535,357 |
| Amortized cost of investments and net effect of receivable/payable on sale/purchase transactions | 108,003,960 | 113,719,138 |
| Realized (losses) gains in sales of investments | $ (1,545,177) | $ 1,816,219 |

The accompanying financial statements were prepared on the basis of accounting policies required by GASB Statement No. 31. Therefore all investment securities are accounted for at fair market value rather than cost. Thus, the accompanying financial statements reflect changes in the market value as well as realized (losses) gains of the Administration's investment portfolio as follows:

| | 2011 | 2010 |
|---|---|---|
| Realized (losses) gains in sales of investments | $ (1,545,177) | $ 1,816,219 |
| Change in fair value of investments securities | 19,641,038 | 5,098,664 |
| Net change in fair value of investments | $ 18,095,861 | $ 6,914,883 |

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. At June 30, 2011 and 2010 the Administration has investments of approximately $147,500,000 and $131,259,000, respectively, which are not insured by the Federal Deposit Insurance Corporation (FDIC). The Administration mitigates this risk by maintaining a diversified investing portfolio.

Interest rate is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Administration manages its exposure to declines in fair value by (1) maintaining a diversified portfolio of debt and equity investments and (2) diversifying the weighted average maturity of its investments in debt securities.

## NOTE C - INVESTMENTS - CONTINUED

Foreign exchange risk is the risk that changes in exchanges rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines the Administration's investing in foreign securities (or any other types of investments for which foreign exchange risk exposure may be significant) is limited to 15% of the total portfolio. According, management has concluded that the foreign exchange risk related to the Administration's investments is considered low at June 30, 2011 and 2010.

## NOTE D - SECURITIES LENDING PROGRAM

The Administration used to loan securities to brokers/dealers and other entities (borrowers) for collateral that will be returned in the future as part of a securities lending program. In October 2010 the Administration reduced the loan cap of securities to lend in the securities lending program by 55%, and subsequently in December 2010 withdrew totally from the program.

The custodian bank managed the securities lending program and receives cash, government securities and letters of credit as collateral. The collateral received could not be pledged or sold by the Administration unless the borrower defaulted. The program provided for an initial minimum collateralization of 102 percent of the market value of the securities lent plus accrued income.

Additional collateral had to be provided by the close of the next business day if its value fell to less than 100 percent. The contract with the custodian bank required that should a collateral deficiency occur beyond custodian's responsibilities the deficiency should be allocated among all client lenders within the program.

Either the custodian bank or the borrower could terminate all securities loans at any time. Cash collateral was invested in the program's agent short-term investment pools, which at fiscal year end had a weighted average maturity of 134 days. Cash collateral may had also be invested separately in "term loans" in which case the investments matched the loan term.

During 2009, the Administration incurred a collateral deficiency loss amounting to $205,219, of which $88,931 and $116,288 were recognized as a realized and as unrealized loss, respectively. As of June 30, 2010, the Administration paid the total amount of $88,931, and the remaining $116,288 was condoned.

## NOTE D - SECURITIES LENDING PROGRAM - CONTINUED

The following represents the balances relating to the securities on loan as of June 30, 2011 and 2010:

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | Fair Value of Securities Lending | Amount of Cash Collateral | Fair Value of Securities Lending | Amount of Cash Collateral |
| Stocks | $ - | $ - | $ 16,455,790 | $ 16,973,142 |
| Corporate bonds | - | - | 5,013,821 | 5,143,587 |
| U.S. Treasury bills, bonds and notes | - | - | 19,811,828 | 20,237,088 |
| U.S. Agencies | - | - | 852,265 | 868,667 |
| | $ - | $ - | $ 42,133,704 | $ 43,222,484 |

## NOTE E - OTHER ACCOUNTS RECEIVABLE

Other accounts receivable consist of the following:

| | 2011 | 2010 |
|---|---|---|
| Commonwealth of Puerto Rico: | | |
| State Insurance Fund Corporation (related party) | $ 1,071,752 | $ 1,073,597 |
| Government agencies and Puerto Rico Safety Traffic Commision (related party) | 987,340 | 669,910 |
| Sub Total | 2,059,092 | 1,743,507 |
| Recovery from beneficiaries | 9,285,808 | 7,604,885 |
| Insurance companies | 1,516,385 | 1,511,208 |
| All others | 138,987 | 55,083 |
| | 13,000,272 | 10,914,683 |
| Less allowance for doubtful accounts | (12,247,122) | (8,085,725) |
| | $ 753,150 | $ 2,828,958 |

## NOTE F - CAPITAL ASSETS

Capital assets activity for the years ended June 30, 2011 and 2010, were as follow:

| | 2011 | | | | |
|---|---|---|---|---|---|
| | June 30, 2010 | Additions | Retirements | Reclassified | June 30, 2011 |
| **Capital assets being depreciated** | | | | | |
| Building | $ 6,975,930 | $ - | $ - | $ - | $ 6,975,930 |
| Equipment | 938,250 | - | - | - | 938,250 |
| Computer and software | 4,336,990 | 120,599 | - | (2,355) | 4,455,234 |
| Motor Vehicles | 171,239 | 29,980 | - | - | 201,219 |
| Furniture and fixtures | 2,057,415 | 46,974 | - | 2,355 | 2,106,744 |
| Leasehold improvements | 3,461,176 | 150,007 | - | - | 3,611,183 |
| | 17,941,000 | 347,560 | - | - | 18,288,560 |
| Less accumulated depreciation and amortization: | | | | | |
| Building and leasehold improvements | (6,385,655) | (408,560) | - | - | (6,794,215) |
| Other | (6,700,379) | (283,248) | - | - | (6,983,627) |
| | 4,854,966 | (344,248) | - | - | 4,510,718 |
| **Capital assets not being depreciated** | | | | | |
| Land | 900,881 | - | - | - | 900,881 |
| Software being developed | 3,139,499 | - | (963,247) | - | 2,176,252 |
| | 4,040,380 | - | (963,247) | - | 3,077,133 |
| | $ 8,895,346 | $ (344,248) | $ (963,247) | $ - | $ 7,587,851 |

## NOTE F - CAPITAL ASSETS - CONTINUED

| | 2010 | | | |
|---|---|---|---|---|
| | June 30, 2009 | Additions | Retirements | June 30, 2010 |
| **Capital assets being depreciated** | | | | |
| Building | $ 6,975,930 | $ - | $ - | $ 6,975,930 |
| Equipment | 938,250 | - | - | 938,250 |
| Computer and software | 4,185,220 | 151,770 | - | 4,336,990 |
| Motor Vehicles | 171,239 | - | - | 171,239 |
| Furniture and fixtures | 2,051,880 | 5,535 | - | 2,057,415 |
| Leasehold improvements | 3,402,103 | 59,073 | - | 3,461,176 |
| | 17,724,622 | 216,378 | - | 17,941,000 |
| Less accumulated depreciation and amortization: | | | | |
| Building and leasehold improvements | (6,045,105) | (340,550) | - | (6,385,655) |
| Other | (6,315,499) | (384,880) | - | (6,700,379) |
| | 5,364,018 | (509,052) | - | 4,854,966 |
| **Capital assets not being depreciated** | | | | |
| Land | 900,881 | - | - | 900,881 |
| Software being developed | 2,953,993 | 185,506 | - | 3,139,499 |
| | 3,854,874 | 185,506 | - | 4,040,380 |
| | $ 9,218,892 | $ (323,546) | $ - | $ 8,895,346 |

In November 2005, the Administration entered into an agreement with a third party to obtain and implement a cost effective information system infrastructure to automate the administration and payment of medical services providers and claimants. For the fiscal year ended June 30, 2011, the Administration recognized an impairment loss for approximately $963,000 associated with the significantly and unexpectedly decline in service utility of some modules of the system. The provision for impairment represents the difference between the net carrying cost and the fair market value. The write-down is included in operating expenses in the Administration's statement of revenues, expenses and change in net assets (deficit).

## NOTE G - RESERVES FOR FUTURE BENEFITS

The balance of the estimated liabilities for the payment of future benefits consists of the following:

| | 2011 | 2010 |
|---|---|---|
| Death and funeral: | | |
| Death | $ 14,419,079 | $ 16,488,032 |
| Funeral | 237,049 | 369,305 |
| Disability | 3,944,578 | 5,791,456 |
| Accident and health: | | |
| Medical hospitalization - basic | 46,421,242 | 44,514,636 |
| Medical hospitalization - extended benefits | 101,256,702 | 98,371,246 |
| Dismemberment | 317,267 | 392,107 |
| | $ 166,595,917 | $ 165,926,782 |

The activity in the reserves for future benefits for the years ended June 30, 2011 and 2010, is as follows:

| | 2011 | 2010 |
|---|---|---|
| Reserves for future benefits at beginning of year, presented based on undiscounted method | $ 165,926,782 | $ 166,351,764 |
| Incurred claims: | | |
| Provision for insured events of current year | 63,179,854 | 74,089,700 |
| Payment of claims: | | |
| Current year insured events | (24,292,894) | (27,114,858) |
| Prior years insured events | (38,217,825) | (47,399,824) |
| | (62,510,719) | (74,514,682) |
| Reserves for future benefits at end of year, presented based on undiscounted method | $ 166,595,917 | $ 165,926,782 |

## NOTE H - LEASE COMMITMENTS

The Administration leases certain facilities for its regional offices, as well as certain office equipment. Office facilities are leased under non-cancelable lease agreements, which expire on various dates through the year 2022.

Future minimum rental payments under non-cancelable operating leases in force are as follow:

| Year ending June 30, | Amount |
|---|---|
| 2012 | $ 1,238,761 |
| 2013 | 1,085,053 |
| 2014 | 844,843 |
| 2015 | 567,421 |
| 2016 | 443,700 |
| 2017 - 2022 | 1,041,550 |
| | $ 5,221,328 |

Rent expense for the years ended June 30, 2011 and 2010, was approximately $1,075,000 and $1,060,000, respectively.

***Rental income to be received under noncancelable operating lease***

The Administration rents office spaces under two noncancelable operating leases expiring in February and August 2020, respectively. The future minimum rentals to be received under these agreements are as follows:

| Year ending June 30, | Amount |
|---|---|
| 2012 | $ 120,000 |
| 2013 | 120,000 |
| 2014 | 120,000 |
| 2015 | 120,000 |
| 2016 | 120,000 |
| Thereafter | 442,000 |
| | $ 1,042,000 |

## NOTE I - RETIREMENT SYSTEMS

### *Defined-Benefit Pension Plan*

The Employee Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities (also known as the Retirement System), was created pursuant to Act. No. 447 of May 15, 1951, as amended, and is a cost-sharing, multiple-employer, defined benefit pension plan sponsored by and reported as a component unit of the Commonwealth of Puerto Rico. All regular employees of the Administration hired before January 1, 2000, and less than 55 years of age at the date of employment became members of the Retirement System as a condition of their employment. No benefits are payable if the participant receives a refund of his/her accumulated contributions.

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

Members who have attained 55 years of age and have completed at least 25 years of creditable service, or members who have attained 58 years of age and have completed 10 years of creditable service, are entitled to an annual benefit, payable monthly for life. The amount of the annuity shall be 1.5% of the average compensation, as defined, multiplied by the number of years of creditable service up to 20 years, plus 2% of the average compensation, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than $200 per month.

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

Current legislation requires employees to contribute 5.775% of the first $550 of their monthly gross salary and 8.275% of the excess over $550 of the monthly gross salary. The Administration is required by the same statute to contribute an amount equal to 9.275% of each participant's gross salary.

### *Defined Contribution Plan*

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

## NOTE I - RETIREMENT SYSTEMS - CONTINUED

### *Defined Contribution Plan - Continued*

Act No. 305 requires employees to contribute 8.275% of their monthly gross salary to the Program. Employees may elect to increase their contribution up to 10% of their monthly gross salary. Employee contributions are credited to individual accounts established under the Program. Participants have three options to invest their contributions in the Program. Investment income is credited to the participant's account semiannually.

The Administration is required by Act No. 305 to contribute an amount equal to 9.275% of each participant's gross salary. The Retirement System will use these contributions to increase its asset level and reduce the unfunded status of the defined-benefit pension plan.

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

Total employee and employer's contributions to the above mentioned plans during the year ended June 30, 2011 was approximately $1,449,000 and $1,619,000, respectively, and the contributions for the year ended June 30, 2010, amounted to approximately $1,741,000 and $1,940,000, respectively. Loans repayments for the year ended June 30, 2011 and 2010, amounted to approximately $491,000 and $642,100, respectively. These amounts represented 100% of the required contribution for the corresponding year. Individual information for each option is not available since the allocation is performed by the Retirement System itself.

Additional information on the Retirement System is provided in its stand-alone financial statements for the years ended June 30, 2011 and 2010, a copy of which can be obtained from the Employees' Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities, PO Box 42005, San Juan, PR 00940-2005.

## NOTE J - PUERTO RICO TRAFFIC SAFETY COMMISSION

Act No. 33, "Prevention of Traffic Accidents" of May 25, 1972, as amended, provides that the Administration should contribute to the Puerto Rico Traffic Safety Commission (the Commission) the funds needed for the Commission's operational expenses. In addition, at June 30, 2011 and 2010 the Administration held in custody cash of the Commission of $12,411 and $378,619 respectively. For the years ended June 30, 2011 and 2010, the Administration contributed to the Commission approximately $1,680,365 and $1,076,100, respectively.

## NOTE K - CONTINGENCIES

The Administration acts as defendant in various legal proceedings or claims in the ordinary course of its operations. Most of these lawsuits principally involve claims on policies which are typical for the Administration and for the insurance industry in general. At June 30, 2011 and 2010, the Administration has an accrual of $717,000 and $555,000, respectively. Management, based on the opinion of its legal counsel, believes that the ultimate liability resulting from these pending proceedings and legal actions in the aggregate will not have a material effect on the Administration's financial statements.

## NOTE L - DATE OF MANAGEMENT REVIEW

The Administration has evaluated subsequent events through September 27, 2011, the date the financial statements were available to be issued.

Aquino, De Córdova, Alfaro & Co., LLP
CERTIFIED PUBLIC ACCOUNTANTS & BUSINESS ADVISORS
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# REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Board of Directors of
Automobile Accidents Compensations Administration

We have audited the financial statements of the Automobile Accidents Compensations Administration as of and for the year ended June 30, 2011, and have issued our report thereon dated September 27, 2011. 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 of America.

## Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Automobile Accidents Compensations Administration's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Automobile Accidents Compensations Administration's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Automobile Accidents Compensations Administration's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weakness, as defined above.



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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Administration's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Automobile Accidents Compensations Administration in a separate letter dated September 27, 2011.

This report is intended solely for the information and use of the Administration's Board of Directors, others within the Administration, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties,

September 27, 2011

Stamp number 2621775
has been affixed to the
original report

Aquino, De Córdova, Alfaro & Co., LLP

by

Lic. 3171