

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

*Basic Financial Statements and Required Supplemental
Information as of and for the Year Ended June 30, 2011
and Independent Auditors' Report Thereon with Reports
Required Under OMB Circular A-133*

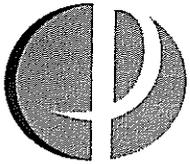
Puerto Rico Health Insurance Administration

(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and Required Supplemental Information as of and for the Year Ended June 30, 2011 and Independent Auditors' Report Thereon with Reports Required Under OMB Circular A-133

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PARISSI P.S.C.

Certified Public Accountants, Tax & Business Advisors

Independent Auditors' Report

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

We have audited the accompanying basic financial statements of the Puerto Rico Health Insurance Administration (the Administration), a component unit of the Commonwealth of Puerto Rico, as of June 30, 2011 and for the year then ended, as listed in the table of contents. These basic financial statements are the responsibility of the Administration's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Puerto Rico Health Insurance Administration as of June 30, 2011 and the changes in financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated November 11, 2011, 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 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 audit.

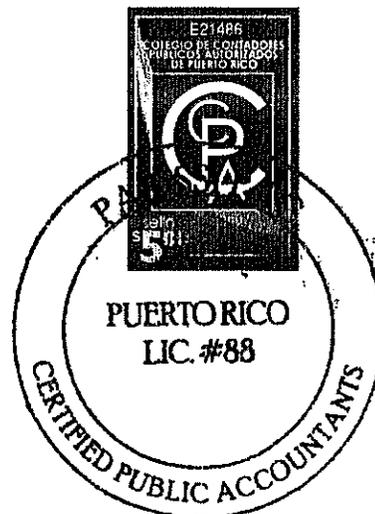
Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 to 9 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental 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.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise Administration's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is not a required part of the basic financial statements. The schedule of expenditures of federal awards is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Ricardo PSC

November 11, 2011
San Juan, Puerto Rico

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Puerto Rico Health Insurance Administration
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Management's Discussion and Analysis

June 30, 2011

This section of the financial statements is classified by the Governmental Accounting Standards Board (GASB) as required supplementary information. It is intended to provide an objective and easily readable analyses of the government's financial activities. Along with the notes to the financial statements, the management discussion and analysis should provide the user with the most relevant information regarding the financial condition of the Puerto Rico Health Insurance Administration (the Administration) as of June 30, 2011 and 2010.

Overview of the Financial Statements

The annual report includes the management's discussion and analysis report, the independent auditors' report, and the basic financial statements. The financial statements also include notes that explain in more detail the information contained in the financial statements. The discussion will focus on major components of the financial statements.

Financial Analysis of the Administration as a Whole

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

The condensed net deficit information is presented as follows:

	June 30		Change	
	2011	2010	In dollars	Percentage
Current assets	\$ 246,879,635	245,342,437	1,537,198	0.63%
Capital assets, net	166,934	210,419	(43,485)	(20.67)%
Total assets	\$ 247,046,569	245,552,856	1,493,713	0.61%
Current liabilities	\$ 285,655,006	492,704,009	(207,049,003)	(42.02)%
Non current liabilities	239,719,844	348,558	239,371,286	68,674.74%
Total liabilities	525,374,850	493,052,567	32,322,283	6.56%
Net deficit:				
Invested in capital assets, net of related debt	166,934	210,419	(43,485)	(20.67)%
Unrestricted deficit	(278,495,215)	(247,710,130)	(30,785,085)	12.43%
Total net deficit	(278,328,281)	(247,499,711)	(30,828,570)	12.46%
Total liabilities and net deficit	\$ 247,046,569	245,552,856	1,493,713	0.61%

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

Management's Discussion and Analysis

June 30, 2011

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

Analysis of Net Assets at June 30, 2011 and 2010

Total net deficit of \$278 million is composed of \$166,934, invested in capital assets, net of related debt; and an unrestricted net deficit of \$278 million. Total deficit increased from \$247.5 million to \$278 million, a difference of approximately \$31 million or 12%, mainly because operating revenues from municipalities decreased from the previous year.

Current assets increased from \$245.3 million to \$246.9 million, an increase of \$1.5 million or 1% mainly due to a decrease in cash and cash equivalents that was compensated by a greater increase in accounts receivable.

Current liabilities decreased from \$492.7 million to \$285.7 million or approximately \$207 million, mainly as a result of the Administration entering into a non-revolving line of credit agreement with the Government Development Bank to pay premiums due to health insurance companies. The line of credit balance at June 30, 2011 is \$173 million, including interest. The line of credit will be payable in annual installments beginning in fiscal year 2014-2015 and is, therefore, recorded as non-current liabilities. The line of credit will be repaid from appropriations from the Legislature of Puerto Rico. In addition, during fiscal year 2010-2011, the Administration signed loan agreements with three insurance companies renegotiating payment terms, as a result, \$64 million due to those insurance companies are recorded as non-current liabilities. The effect of opening the line of credit and renegotiating debt with the insurance companies reduced current liabilities by \$237 million. This reduction was partially compensated by an increase in medical insurance premiums and claims incurred and health care costs of approximately \$30 million.

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Long-term liabilities increased from \$348,558 to \$239.7 million or approximately \$239 million as a result of the effect the line of credit (\$173 million) and the payment terms negotiation (\$64 million) mentioned in the previous paragraph. In addition the Administration implemented an early retirement plan which had the effect of increasing non-current liabilities by \$2 million. Please refer to Note 10 to the basic financial statements for further details.

Analysis of Net Assets at June 30, 2010 and 2009

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

The condensed changes in net deficit information are presented below:

	Year Ended June 30,		Change	
	2011	2010	In dollars	Percentage
Operating revenue:				
Contributions from: Department of Health of Puerto Rico, municipalities, employers and rebates	\$ 764,425,586	721,864,201	42,561,385	5.90%
Non operating revenue:				
Interest income and transfers	1,222,040,036	1,170,582,718	51,457,318	4.40%
Total revenue	1,986,465,622	1,892,446,919	94,018,703	4.97%
Operating expenses:				
Medical insurance premiums	1,897,765,202	1,554,435,330	343,329,872	22.09%
Claims incurred and health care costs	96,782,956	370,106,750	(273,323,794)	(73.85)%
General and administrative	22,655,286	37,937,920	(15,282,634)	(40.28)%
Depreciation and amortization	90,748	72,481	18,267	25.20%
Total operating expenses	2,017,294,192	1,962,552,481	54,741,711	2.79%
Increase in net deficit	(30,828,570)	(70,105,562)	39,276,992	(56.03)%
Net deficit, beginning of year	(247,499,711)	(177,394,149)	(70,105,562)	39.52%
Net deficit, end of year	\$ (278,328,281)	(247,499,711)	(30,828,570)	12.46%

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Puerto Rico Health Insurance Administration
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June 30, 2011

	Year Ended June 30,		Change	
	2010	2009	In dollars	Percentage
Operating revenue:				
Contributions from: Department of Health of Puerto Rico, municipalities, employers and rebates	\$ 721,864,201	767,243,395	(45,379,194)	(5.91)%
Non operating revenue:				
Interest income and transfers	1,170,582,718	1,011,588,127	158,994,591	15.72%
Total revenue	1,892,446,919	1,778,831,522	113,615,397	6.39%
Operating expenses:				
Medical insurance premiums	1,554,435,330	1,563,847,759	(9,412,429)	(0.60)%
Claims incurred and health care costs	370,106,750	280,672,494	89,434,256	31.86%
General and administrative	37,937,920	16,354,062	21,583,858	131.98%
Depreciation and amortization	72,481	246,070	(173,589)	(70.54)%
Total operating expenses	1,962,552,481	1,861,120,385	101,432,096	5.45%
Increase in net deficit	(70,105,562)	(82,288,863)	12,183,301	(14.81)%
Net deficit, beginning of year	(177,394,149)	(95,105,286)	(82,288,863)	86.52%
Net deficit, end of year	\$ (247,499,711)	(177,394,149)	(70,105,562)	39.52%

Year Ended June 30, 2011 and June 30, 2010

The Administration's revenue increased by approximately \$94 million or 4.97 % mostly as a result of:

1. An increase of \$51.5 million from Commonwealth and COFINA transfers.
2. A net increase of \$42.5 million in operating revenues. This increase is the effect of an increase in federal funds of \$92 million, mostly the result of the receipt of ARRA funds, offset by a decrease of \$37.5 million in contributions from municipalities and a \$12 million decrease from revenues from the pharmacy rebate program and contributions from employers.

The Administration's expenses increased by \$54.7 million or 2.8% mostly as a result of:

1. An increase in medical insurance premiums of \$343.3 million or 22%. This increase is the result of a decrease in the population under direct contracting projects from approximately 190,000 lives at June 30, 2010 to approximately 11,000 lives at June 30, 2011. This change in lives occurred effective October 1, 2010, when the Metro North direct contracting project was changed to an insurance premium model. In addition, the insured population, increased from approximately 1,473,000 lives at June 30, 2010 to over 1,500,000 lives at June 30, 2011.
2. The claims incurred and health care costs and other operating costs decreased by \$288.6 million mostly due to a reduction of lives under the direct contracting project mentioned above.

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Year Ended June 30, 2010 and June 30, 2009

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

The Administration's expenses increased by \$101.4 million or 5.45% mostly as a result of the increase in claims and health care cost incurred of approximately \$89.4 million mainly because the claims paid in the metro-north region increased, a decrease in medical insurance premiums of \$9.4 million and an increase in general administrative expenses of \$21.6 million due to the increase in the allowance for bad debts of \$21 million. This was offset by a \$174 thousand decrease in depreciation and amortization expenses.

Capital Assets

The Administration's investment in capital assets as of June 30, 2011 and 2010 amounted to \$166,934 and \$210,419, respectively, net of accumulated depreciation. Capital assets include equipment, furniture, and vehicles.

During the years ended June 30, 2011, and 2010, the Administration invested approximately \$47,263 and \$74,046 in capital assets, respectively.

Depreciation and amortization expense for the years ended June 30, 2011 and 2010 amounted to \$90,748 and \$72,481, respectively.

Debt Administration

On March 14, 2011, the Administration entered into a Credit Agreement with the Government Development Bank of Puerto Rico in order to meet its obligations incurred prior to fiscal year 2009-2010 to insurers. As of June 30, 2011, the principal outstanding balance amounted to \$171,080,000 and the accrued interest amounted to \$2,065,335. The Administration will pay the principal and interest with the appropriations made by the Legislature of Puerto Rico.

Direct Contracting Project

Starting on July 1st, 2003 and through today, the Administration has entered into direct contracting projects in different regions. The projects differ from the traditional model since the Administration bears most of the coverage risks.

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June 30, 2011

At June 30, 2011, the Administration had limited the direct contracting project to cover the Municipalities of Vieques and Guaynabo. For the Vieques project, the Government assumes all the risk. A third party administrator (TPA), handles all the administrative work related to the operation such as payments of claims, some actuarial work, contracting service providers and general administration of the project.

On October 2007, the Administration entered into a contract with the Municipality of Guaynabo with 13,592 covered lives. Under this contract, the municipality of Guaynabo bears the risk of the basic and special coverage. A TPA handles all the administrative work related to the payment of claims of services provided outside the municipality's facilities. As a result of this arrangement, the Administration no longer received the municipality's contribution. This contract was modified effective May 2, 2011, and the Administration now bears the cost of the special, mental, dental, cardiovascular coverage, high tech laboratory services, among other services but up to 12,500 lives. The Administration will compensate the Municipality if the insured lives using Guaynabo's medical facility surpasses 12,000 lives and the Municipality will compensate the Administration if those lives fall below 11,000. The compensation in both cases will be \$45.34 PMPM (per member per month). There are incentives for the TPA if the medical utilization is less than expected, as defined.

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

Mi Salud Plan

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

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

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June 30, 2011

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

In addition, the Administration will implement certain cost containment strategies to control costs. Among these strategies are establishing a co-payment that will apply for the unjustified use of emergency rooms, detection and control of prescription drug overuse, implementation of disease management program for respiratory conditions, modification in provider fees and better coordination of benefits for the population having other medical insurance.

Projections for fiscal year 2011-2012

The budget for fiscal year 2011-2012 projects that revenues will cover all projected costs. The most relevant assumptions are as follows:

- \$867,570,000 from the legislative appropriation
- \$934,027,000 from federal funds
- \$193,210,000 from other sources
- \$3,801,000 for operational expenses of the Administration and from the stabilization fund

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

Contacting the Administration Financial Management

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

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

Balance Sheet

June 30, 2011

Assets

Current assets:

Cash and cash equivalents \$ 125,761,460

Accounts receivable:

Accounts receivable - net of allowance for doubtful
accounts of \$26,984,762 59,764,518

Accounts receivable from Municipalities - net of allowance
for doubtful accounts of \$34,386,989 23,743,445

Accounts receivable of pharmacy rebates 21,842,986

Total accounts receivable 105,350,949

Due from other governmental agencies 15,688,668

Prepaid expenses 78,558

Total current assets 246,879,635

Capital assets - net 166,934

Total assets \$ 247,046,569

Liabilities and Deficit

Current liabilities:

Premiums and pharmacy rebates payable \$ 239,078,046

Claims payable 35,453,795

Due to other governmental agencies 7,239,104

Accounts payable and accrued expenses 3,238,003

Accrued termination benefits 188,422

Accrued compensated absences 457,636

Total current liabilities 285,655,006

Non-current liabilities:

Line of credit 171,080,000

Interest payable 2,065,335

Premiums payable 64,290,608

Accrued termination benefits 1,978,810

Accrued compensated absences 305,091

Total non-current liabilities 239,719,844

Total liabilities 525,374,850

Commitments and contingencies

Net deficit:

Invested in capital assets, net of related debt 166,934

Deficit (278,495,215)

Total deficit (278,328,281)

Total liabilities and deficit \$ 247,046,569

See accompanying notes to financial statements.

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)
Statement of Revenue, Expenses and Changes in Net Deficit
Year Ended June 30, 2011

Operating revenue:	
Contributions from:	
Department of Health of Puerto Rico	\$ 529,234,922
Municipalities	153,556,280
Employers	22,294,704
Pharmacy rebate program - net	<u>59,339,680</u>
Total operating revenue	<u>764,425,586</u>
Operating expenses:	
Medical insurance premiums	1,897,765,202
Claims incurred and health care costs	96,782,956
General and administrative	20,589,951
Interest expenses	2,065,335
Depreciation and amortization	<u>90,748</u>
Total operating expenses	<u>2,017,294,192</u>
Loss from operations	<u>(1,252,868,606)</u>
Non-operating revenue:	
Transfers from the Commonwealth of Puerto Rico	1,132,048,668
Transfers from COFINA	85,000,000
Interest income and other	<u>4,991,368</u>
Total non-operating revenue	<u>1,222,040,036</u>
Increase in net deficit	(30,828,570)
Net deficit at beginning of year	<u>(247,499,711)</u>
Net deficit at end of year	<u>\$ (278,328,281)</u>

See accompanying notes to financial statements.

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)
Statement of Cash Flows
Year Ended June 30, 2011

Cash flows from operating activities:	
Cash receipts from contributions	\$ 636,598,404
Cash receipts from pharmacy rebate program	49,321,153
Cash payments of premiums	(1,971,365,137)
Cash payments to employees	(3,860,913)
Cash payments to vendors for goods and services	(60,031,715)
Cash payments to health care organizations and third party administrators	<u>(120,781,954)</u>
Net cash used in operating activities	<u>(1,470,120,162)</u>
Cash flows from non-capital and related financing activities:	
Transfers from the Commonwealth of Puerto Rico	1,132,048,668
Transfers from COFINA	85,000,000
Proceed from line of credit	171,080,000
Collections of other income	<u>4,651,523</u>
Net cash provided by non-capital and related financing activities	<u>1,392,780,191</u>
Purchase of capital assets and net cash used in capital and related financing activities	<u>(47,263)</u>
Interest collected and net cash provided by investing activities	<u>339,845</u>
Net decrease in cash and cash equivalents	(77,047,389)
Cash and cash equivalents, at beginning of year	<u>202,808,849</u>
Cash and cash equivalents, at end of year	<u><u>\$ 125,761,460</u></u>

See accompanying notes to financial statements.

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)
Statement of Assets and Liabilities – Agency Fund
June 30, 2011

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

See accompanying notes to financial statements.

Puerto Rico Health Insurance Administration

Notes to Basic Financial Statements

Year Ended June 30, 2011

1. REPORTING ENTITY

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

The Administration is responsible for implementing, administering and negotiating a health insurance system, through contracts with insurance underwriters, to provide quality medical and hospital care to the Commonwealth residents regardless of their financial condition and capacity to pay. The Administration pays a monthly premium to such insurance underwriters based on a contracted premium and the number of members subscribed in the health plan. Funds to pay for such premiums are requested from the Commonwealth net of funds available for such purposes from all other sources. The Administration is exempt from taxation on taxes imposed by the Commonwealth of Puerto Rico.

The Single State Medicaid Agency is the Department of Health. Within the Department, the Officer of economic aid to the medically indigent has responsibility for the Medicaid Program.

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

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

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

Puerto Rico Health Insurance Administration

Notes to Basic Financial Statements

Year Ended June 30, 2011

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Accounting

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

(b) Basis of Presentation

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

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

(c) Cash and Cash Equivalents

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

(d) Allowance for Doubtful Accounts

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

(e) Transfers from the Commonwealth of Puerto Rico and COFINA

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

Puerto Rico Health Insurance Administration

Notes to Basic Financial Statements

Year Ended June 30, 2011

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

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

(g) Contributions from Municipalities

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

(h) Fund Accounting

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

Proprietary Fund

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

Agency Fund

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

(i) Use of Estimates

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

Puerto Rico Health Insurance Administration

Notes to Basic Financial Statements

Year Ended June 30, 2011

(j) Revenue Recognition

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

(k) Capital Assets

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

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

(l) Depreciation and Amortization

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

(m) Compensated Absences

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

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

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

(n) Risk Management

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

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

Puerto Rico Health Insurance Administration

Notes to Basic Financial Statements

Year Ended June 30, 2011

(o) *Statement of Cash Flows*

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

(p) *Pharmacy Rebate Program*

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

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

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

(q) *Accounting for Pension Costs*

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

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

(r) *Claims Payable*

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

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

Puerto Rico Health Insurance Administration

Notes to Basic Financial Statements

Year Ended June 30, 2011

(s) Medical Cost Recognition

Medical costs include claim payments, capitation payments, and various other costs incurred to provide medical care to beneficiaries as well as estimates of future payments for medical care provided prior to the date of the statement of net assets. Capitation payments represent monthly prepaid fees disbursed to participating primary care physicians and other providers who are responsible for providing medical care to members. The estimates of future medical claims and other expense payments are developed using actuarial methods and assumptions based upon payment patterns, medical inflation, historical development and other relevant factors. Estimates of future payments relating to services incurred in the current and prior periods are continually reviewed by management and adjusted as necessary. Risks related to catastrophic diseases are assumed by the Administration.

(t) Subsequent Events

The Administration has evaluated the impact of subsequent events through November 11, 2011, which is the date these financial statements were issued. Refer to Note 12.

3. MANAGEMENT PLANS

As reflected in the accompanying basic financial statements, the Administration has a deficit of approximately \$278 million and incurred in an increase in net deficit of approximately \$31 million during the year ended June 30, 2011. Effective November 23, 2010, the Act No 72 of the Legislature of the Commonwealth was amended to authorize the Administration to incur in obligations up to \$186 million in order to pay outstanding debts incurred prior to July 1, 2010. The obligation will be paid directly by the Office of Management and Budget.

The budget for fiscal year 2011-2012 projects that revenues will cover all projected costs. The most relevant assumptions are as follows:

- \$867,570,000 from the legislative appropriation
- \$934,027,000 from federal funds
- \$193,210,000 from other sources
- \$3,801,000 for operational expenses of the Administration and from the stabilization fund

In addition, the Legislature has approved a revolving line of credit from either Government Development Bank or a commercial bank to pay for health insurance premiums, claims incurred and other health costs and finance charges related to the line of credit. The line of credit will be guaranteed by federal grant awards. Please refer to Note 12 for further details.

Puerto Rico Health Insurance Administration

Notes to Basic Financial Statements

Year Ended June 30, 2011

4. CUSTODIAL CREDIT RISK - DEPOSITS

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

For the year ended June 30, 2011, the custodial risk of the administration amounted to \$150 million, which is the bank balance of cash and cash equivalents deposited at the Government Development Bank for Puerto Rico. These deposits are exempt from the collateral requirement established by the Commonwealth.

5. ACCOUNTS RECEIVABLE

Accounts receivable and the allowance for doubtful accounts as of June 30, 2011 consist of the following:

Department of Health of Puerto Rico	\$ 55,812,604
Governmental agencies	27,650,438
Municipalities	58,130,434
Pharmacy rebate program	21,842,986
Other	3,286,238
	<u>166,722,700</u>
Allowance for doubtful accounts	<u>(61,371,751)</u>
Account receivable, net	<u>\$ 105,350,949</u>

Allowance for doubtful accounts is divided in three sections. The first section is related to governmental agencies for employer contributions for the medical health plan amounting to approximately \$27 million. The second section of the reserve is related to municipalities based on a retroactive receivable amounting to approximately \$34 million. The third one represents mainly uncollected premiums amounting to \$31 thousand.

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Puerto Rico Health Insurance Administration

Notes to Basic Financial Statements

Year Ended June 30, 2011

6. CAPITAL ASSETS

The activities of the capital assets accounts of the Administration for the fiscal year ended June 30, 2011 was as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Equipment, computer and software	\$ 1,221,619	4,874	(26,302)	1,200,191
Vehicles	78,459	—	—	78,459
Leasehold improvements	121,545	—	—	121,545
Furniture and others	242,135	42,389	(2,486)	282,038
	<u>1,663,758</u>	<u>47,263</u>	<u>(28,788)</u>	<u>1,682,233</u>
Accumulated depreciation	<u>(1,453,339)</u>	<u>(90,748)</u>	<u>28,788</u>	<u>(1,515,299)</u>
Capital assets, net	<u>\$ 210,419</u>	<u>(43,485)</u>	<u>—</u>	<u>166,934</u>

7. LINE OF CREDIT

On March 14, 2011, the Administration entered into a Credit Agreement with the Government Development Bank for Puerto Rico in order to pay its obligations to insurers incurred prior to fiscal year 2009-2010.

The aggregate principal amount of the non revolving line of credit is \$186,000,000 and will be payable in nine payments of \$20,666,667 each due on March 14 of the years 2015 through 2023. Interest will be payable annually on each March at a fluctuating annual rate of interest equal to the greater of (1) 1.5% over prime rate, and (2) 6%. As of June 30, 2011, the outstanding principal balance amounted to \$171,080,000.

The Administration will pay the principal and interest with the appropriations made by the Legislature of Puerto Rico pursuant to Act No. 173.

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Puerto Rico Health Insurance Administration

Notes to Basic Financial Statements

Year Ended June 30, 2011

8. PREMIUMS PAYABLE

During the fiscal year, the Administration signed loan agreements with three insurance companies renegotiating payment terms of recorded liabilities up to September 2010. Maturities of premium payable at June 30, 2011 are as follows:

<u>June 30,</u>	<u>Amount</u>
2012	\$ 16,830,953
2013	16,830,953
2014	16,746,429
2015	<u>13,882,273</u>
	<u>\$ 64,290,608</u>

9. RETIREMENT SYSTEM

Defined Benefit Pension Plan

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

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

Members who have attained at least fifty five (55) years of age and have completed at least twenty five (25) years of creditable service or members who have attained fifty eight (58) years of age and have completed at least ten (10) years of creditable service, are entitled to an annual benefit, payable monthly for life. The amount of the annuity shall be 1.5% of the average compensation, as defined, multiplied by the number of years of creditable service up to twenty (20) years, plus 2% of the average compensation, as defined, multiplied by the number of years of creditable service in excess of twenty (20) years. In no case will the annuity be less than \$400 per month.

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

Puerto Rico Health Insurance Administration

Notes to Basic Financial Statements

Year Ended June 30, 2011

Commonwealth legislation requires employees hired on or before March 31, 1990 to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$550 of monthly gross salary. Employees hired on or after April 1, 1990 are required to contribute 8.275% of their monthly salary. The Administration is required by the same statute to contribute 9.275% of the participants' gross-salary.

Defined Contribution Plan

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

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

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

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

Total employee contributions to the above mentioned plans during the year ended June 30, 2011 amounted to approximately \$244,000.

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

Puerto Rico Health Insurance Administration

Notes to Basic Financial Statements

Year Ended June 30, 2011

10. EARLY TERMINATION BENEFITS

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

The implementation of this early retirement program had an impact in the Statement of Revenues, Expenses and Changes in Net Deficit of \$2.1 million for the year ended June 30, 2011. At June 30, 2011, unpaid long-term benefits granted on this program were discounted at 3%.

11. COMMITMENTS AND CONTINGENCIES

Commitments

The Administration conducts its operations in a leased facility under a long-term operating lease agreement expiring during 2012. Rent expense for the year ended June 30, 2011 amounted to \$411,592. Minimum future rental payments under the non-cancellable operating lease as of June 30, 2011 are \$215,696.

Contingencies

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

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

Puerto Rico Health Insurance Administration

Notes to Basic Financial Statements

Year Ended June 30, 2011

Federal Grants

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

12. SUBSEQUENT EVENT

Effective October 1, 2011, the Administration decided to expand the direct contracting project to cover, in addition to Vieques and Guaynabo, the West, the Metro North, the North, the San Juan, the Northeast and the Virtual Regions. These regions, previously covered by MCS Health Management Options, Inc. under coverage for premium arrangement will be managed by Triple-S Salud, Inc. as TPA starting on November 1, 2011. Under this arrangement, Triple-S Salud, Inc. will receive a PMPM for performing administrative services. In addition, the Administration will implement certain cost containment strategies to control costs. Among these strategies are establishing a co-payment that will apply for the unjustified use of emergency rooms, detection and control of prescription drug overuse, implementation of disease management program for respiratory conditions, modification in provider fees and better coordination of benefits for the population having other medical insurance.

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

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Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)
Schedule of Expenditures of Federal Awards
For the Fiscal Year Ended June 30, 2011

<u>Federal Grantor/Pass-through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
US Department of Health and Human Services			
Major Programs:			
Passed through the PR Health Department:			
Medical Assistance Program (Medicaid; Title XIX)	93.778	66-043-7470	\$ 267,065,628
Arra - Medical Assistance Program (Medicaid; Title XIX)	93.778	66-043-7470	162,018,572
Children's Health Insurance Program (CHIP)	93.767	66-043-7470	100,150,722
Total Expenditures			\$ 529,234,922

See notes to schedule of expenditures of federal awards.

Puerto Rico Health Insurance Administration
(A Component Unit of the Commonwealth of Puerto Rico)
Notes to Schedule of Expenditures of Federal Awards
For the Fiscal Year Ended June 30, 2011

1. BASIS OF PRESENTATION

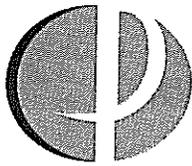
The accompanying schedule of expenditures of federal awards includes the federal grant activity of the PR Health Administration and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

2. PASS-THROUGH ENTITY IDENTIFYING NUMBER

State or local government redistributions of federal awards to the Administration, known as "pass-through awards", should be treated by the Administration as though they were received directly from the federal government. OMB Circular A-133 requires the schedule to include the name of the pass-through entity and the identifying number assigned to the pass-through entity for the federal awards received.



Reports required under OMB Circular A-133



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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
Puerto Rico Health Insurance Administration:

We have audited the financial statements of the governmental activities of the Puerto Rico Health Insurance Administration (the Administration) as of and for the year ended June 30, 2011 which collectively comprise the Administration's basic financial statements and have issued our report thereon dated November 11, 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.

Internal control over financial reporting

In planning and performing our audit, we considered the 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 Administration internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the 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 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 the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not design 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 weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and questioned costs that we consider to be significant deficiencies in internal control over financial reporting as item 2011-01 – 2011-07, in Section 2. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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, non-compliance with which could have a direct and material effect on the determination of the 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 an 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 other matters that we reported to management of the Administration in a separate letter dated March 29, 2012.

The Administration's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit Administration's responses and, accordingly, we express no opinion on the responses.

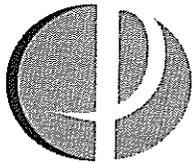
This report is intended solely for the information and use of the Board of Directors, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Raisa, PSE

November 11, 2011
San Juan, Puerto Rico

Stamp No. E21487 was affixed
to the original of this report.
License No. 88 Exp. December 1, 2014





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REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

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

Compliance

We have audited the compliance of the Puerto Rico Health Insurance Administration (the Administration) with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that could have a direct and material effect on each of the Administration major federal programs for the year ended June 30, 2011. The Administration's major programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Administration's management. Our responsibility is to express an opinion on the Administration's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States and Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program identified in the accompanying schedule of findings and questioned costs occurred. An audit includes examining, on a test basis, evidence about the Administration's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Administration compliance with those requirements.

In our opinion, the Administration complied in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011. However, the results of our auditing procedures disclosed instances of non-compliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items SA-2011-01 to SA-2011-09, in Section 3.

Internal Control Over Compliance

Management of the Administration is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Administration's internal control over compliance with the requirements that could have a direct and material effect on a major

federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Administration's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance 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 compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies as described in the accompanying schedule of findings and questioned costs as items SA-2011-01 to SA-2011-9, in section 3. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

The Administration's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned cost. We did not audit the Administration's responses and, accordingly, we express no opinion on the responses.

The Administration's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit Administration's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of the Board of Directors, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Rosa PSC

March 29, 2012
San Juan, Puerto Rico

Stamp No. E21488 was affixed
to the original of this report.
License No. 88 Exp. December 1, 2014



Puerto Rico Health Insurance Administration

Schedule of Findings and Questioned Costs

For the Fiscal Year Ended June 30, 2011

Section 1 – Summary of Auditor’s Results

Financial Statements:

Type of auditor’s report issued:	Unqualified
Internal control over financing reporting:	
1. Material weakness identified?	No
2. Significant deficiencies that are not considered to be material weakness?	Yes
Noncompliance material to financial statement noted?	No

Federal awards:

Internal control over major programs:	
1. Material weaknesses identified?	No
2. Significant deficiencies that are not considered to be material weaknesses?	Yes
Type of auditor’s report issued on compliance for major program?	Unqualified
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)	Yes

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
93.778	Medical Assistance Program (Medicaid; Title XIX)
93.767	Children's Health Insurance Program (CHIP)

Dollar threshold used to distinguish between Type A and Type B programs:	\$ 3,000,000
Auditee qualified as a low-risk auditee?	No

Puerto Rico Health Insurance Administration

Schedule of Findings and Questioned Costs

For the Fiscal Year Ended June 30, 2011

Section 2 – Financial Statements Findings

Finding No. 2011-01 - Cash reconciliations

- **Condition** – The Administration did not perform cash reconciliations on a timely basis. Not reconciling the accounts on a monthly basis means that errors or other problems might not be recognized and resolved on a timely basis.
- **Criteria** – Effective internal controls required that all bank accounts should be reconciled on a monthly basis as of the date of the bank statement. The Administration needs timely financial information to help management in making well informed business decisions and to allow proper administration. Bank account reconciliations must be performed on a timely basis to identify and reconcile differences and correct material errors that could affect the fair presentation of the Administration's financial statements.
- **Cause** – The Administration failed to reconcile cash reconciliations on a timely basis because of a lack of personnel.
- **Effect** – The lack of reconciliation led to the inability to obtain accurate cash information. Also, it affects the business decision making process.
- **Recommendation** – The Administration should establish accounting policies and procedures to ensure that formal monthly closing procedures are performed. The Administration should reconcile bank accounts on a monthly and timely basis in order to identify, investigate and correct any error. A systematic method should be implemented in order to ensure that timely and complete monthly reconciliation procedures take place.
- **Corrective Action Plan** – Management has established a schedule in order to have all cash accounts reconciled on a timely basis. By May 2012, we expect to have all bank accounts reconciled within 30 calendar days.

Finding No. 2011-02 - Accounts Payable Reconciliation of Insurance Providers

- **Condition** – The Administration did not perform accounts payable reconciliations with insurance providers on a monthly basis. Not reconciling the accounts on a monthly basis means that errors or other problems might not be recognized and solved on a timely basis.
- **Criteria** – Effective internal controls required that accounts payable of insurance providers should be reconciled on a monthly basis. The Administration needs timely financial information to help management in making well informed business decisions and to allow proper administration. Accounts payable reconciliations with insurance companies must be performed on a timely basis in order to identify, investigate, and correct any error promptly.
- **Cause** – The Administration failed to reconcile accounts payable of insurance providers on a timely basis because of a lack of personnel.

Puerto Rico Health Insurance Administration

Schedule of Findings and Questioned Costs

For the Fiscal Year Ended June 30, 2011

- ***Effect*** – The lack of reconciliation led to the inability to obtain accurate accounts payable information. Also, it affects the business decision making process.
- ***Recommendation*** – The Administration should establish accounting policies and procedures to ensure that formal monthly closing procedures are performed. The Administration should reconcile accounts payable on a monthly and timely basis in order to identify, investigate and correct any error on a timely basis. The Administration must designate a person to perform periodic reconciliations, including communication with insurance providers, to agree with the outstanding balance of the accounts payable. Old unidentified balances must be written off.
- ***Corrective Action Plan*** – Payments to insurance providers are determined by multiplying the number of enrollees as of the last day of the month preceding the month in which payment is made multiplied by the negotiated Per Member Per Month payment agreed to between the Contractor and the Administration for each Service Region covered by the Contract. In order to determine the enrollees, the Administration receives a file with Certification and Negative Redetermination Decision data from the Puerto Rico Medicaid Program on a daily basis, and notifies the insurance providers of a Certification and Negative Redetermination Decision within one (1) Business Day of receiving notice of it via said file. The Administration forwards this data to the insurance providers in an electronic format agreed to between the Parties (the “Daily Update/Carrier Eligibility File Format”). The differences found during the audit were caused by having the insurance providers determining the amounts owed to them based on the wrong number of enrollees. These differences are eventually corrected by the insurance providers. The Administration is aware that there are certain accounts payable balances that are old and that need to be investigated to determine if they represent liabilities. As part of the monthly closing process the Finance Department is investigating these balances and adjusting them as needed.

Finding No. 2011-03 - Accounts Receivable

- ***Condition*** – The account receivable subsidiary has a large number of accounts receivable are past due.
- ***Criteria*** – Strong and effective controls over accounts receivable can be critical to the Administration. Poor practice has a direct negative effect because this affects cash flows, which is an important factor that keeps the Administration operating. Improved collections will increase profitability and availability of funds. A strong control system over accounts receivable includes policy, an accurate accounting system, timely reconciliations, and effective review and follow up on individual accounts on a monthly basis.
- ***Cause*** – The Administration did not established formal collections procedures because accounts receivable were not received on a timely manner.
- ***Effect*** – The account receivable outstanding balance has a large amount of old balances. To improve control over receivables, past due balance should be reviewed on a monthly basis.
- ***Recommendation*** – The Administrations should establish a collection process as follows:
 1. The continuous review of accounts receivable for old and slow-paying accounts.

Puerto Rico Health Insurance Administration

Schedule of Findings and Questioned Costs

For the Fiscal Year Ended June 30, 2011

2. A formal periodic review of the accounts receivable subsidiary.
3. The increased use of collection agencies or attorneys to aid in collecting delinquent accounts.

Increased management effort in this area can result in a reduction in the number and amount of delinquent and potential delinquent receivables. The positive results from this process may include significantly improvements in cash flows.

- ***Corrective Action Plan*** – At June 30, 2011, the Administration had \$105 million in accounts receivable, net of an allowance for doubtful accounts of \$61 million. Of this amount \$55.8 million (53% of the \$105 million) have been collected from CMS, representing accounts receivable under the different federal programs, \$21.8 million (21% of the \$105 million) have been collected as rebates from the different pharmaceutical companies. In addition \$14.4 million (14% of the \$105 million) have been collected from the Municipalities of Cataño and Trujillo Alto. In summary, approximately 88% of the receivables, net have been collected subsequent to June 30, 2011. Management recognizes the importance of collecting receivables on a timely basis and is considering contracting collection agencies to assist us with this task.

Finding No. 2011-04 - Accounts Payable

- ***Condition*** – The accounts payable subsidiary was not reconciled with general ledger and therefore overstated.
- ***Criteria*** – Strong and effective controls over accounts payable can be critical to the Administration. Poor practice has a direct negative effect because this affects cash flows, which is an important factor that keeps the Administration operating. A strong control system over accounts payable includes policy, an accurate accounting system, timely reconciliations, and effective review and follow up on individual accounts on a monthly basis.
- ***Cause*** – The Administration failed to reconcile accounts payable on a timely basis because of a lack of personnel.
- ***Effect*** – The lack of reconciliation led to the inability to obtain accurate accounts payable information. Also, it affects the business decision making process.
- ***Recommendation*** – The Administration should review and reconcile accounts payable and accounts should be adjusted to the correct amount.
- ***Corrective Action Plan*** – Management recognizes it has to strengthen its financial reporting function. As a result, it has contracted consultants to help standardize and mechanize as many journal entries as possible; to mechanize bank account reconciliations, etc. in order to be able to emphasize the analysis of accounts, including all recorded liabilities, and the timely preparation of interim financial statements. In addition, the Administration has hired a new person that will be responsible for the financial reporting function. This person has experience both in sage software and in financial reporting. Management expects, by June 30, 2012, to be performing monthly closings that include the analysis and adjustment, when needed of all major accounts.

Puerto Rico Health Insurance Administration

Schedule of Findings and Questioned Costs

For the Fiscal Year Ended June 30, 2011

Finding No. 2011-05 - Third Party Administrator (TPA) Cash Account

- **Condition** – The Administration failed to reconcile the TPA cash accounts on a timely basis in order to ensure properly recording of cash transaction. Also, the Administration should request the SAS 70 report to the TPA in order that the TPA internal controls are adequate and properly placed in operations. The Administration has a cash account for each TPA. The TPA is the administrator of the check register in relation to the claims payments. The risk of material misstatement is high.
- **Criteria** – Effective internal controls required that cash accounts should be reconciled on a monthly basis as of the date of the bank statement. The Administration needs timely financial information to help management in making well informed business decisions and to allow proper administration. Cash account reconciliations must be performed on a timely basis to identify and reconcile differences and correct material errors that could affect the fair presentation of the Administration's financial statements.
- **Cause** – The Administration has a cash account for each TPA. The TPA is the administrator of the check register in relation to the claims payments.
- **Effect** – The lack of reconciliation on a timely basis led to the inability to obtain accurate information for the process of the decision making.
- **Recommendation** – The Administration should perform monitoring reviews of the claims payments made by the TPA in order to verify that disbursements have the appropriate supporting documentation and checks are issued only for valid disbursements.
- **Corrective Action Plan** – The TPA submits a pre check register of all amounts being paid. The Administration reviews this pre check register and gives its approval or denial to the TPA before it pays. In addition, the Administration requests from its TPA a SAS 70 report in order to assure that the TPAs internal controls are adequate. In addition, now that the population being covered under a TPA model has significantly increased, the Administration is working with two consulting firms to make computer program modifications at the Administration's and to verify that only approved providers serving eligible Mi Salud members are paid. In addition, the Executive Director has requested the Compliance Department to make a sample of all disbursements made through the TPA in order to verify the following:
 - a. That the payment is made to an authorized provider,
 - b. That the service being paid is one covered under the Mi Salud program,
 - c. That the fees being paid is the one contracted and
 - d. That the beneficiary is an eligible member.

Puerto Rico Health Insurance Administration

Schedule of Findings and Questioned Costs

For the Fiscal Year Ended June 30, 2011

Finding No. 2011-06 - Incurred But Not Reported (IBNR) reserve

- **Condition** – The Administration does not adjust the IBNR reserve on a monthly basis.
- **Criteria** – The IBNR is an estimate of the amount of an insurer's liability for claim generating events that have taken place but have not yet been reported to the insurer. The calculation of the IBNR reserve is a process that requires judgment. Reserving is increasingly undertaken by actuaries who are professionally qualified people.
- **Cause** – The Administration failed to obtain monthly IBNR reports for the regions managed under a Third Party Administrator model in order to adjust the claims payable accordingly.
- **Effect** – The lack of information related with IBNR led to the inability to obtain accurate accounts payable information. Also, it affects the business decision making process.
- **Recommendation** – The Administration should obtain from the TPA the IBNR report on a monthly basis in order to adjust it in the general ledger. Since the Administration should report to the Governmental Development Bank a monthly reporting package, is necessary to maintain accurate accounting records.
- **Corrective Action Plan** – Management recognize the importance of obtaining monthly IBNR reports for the regions managed under a Third Party Administrator model in order to adjust the claims payable accordingly. As a result, the Administration's contract with Triple-S Salud that began effective November 1, 2011, requires the monthly submission of an IBNR for each of the region. The Administration will adjust its accounts payable considering this report.

Finding No. 2011-07 – Children Health Insurance Program (CHIP)

- **Condition** – During the audit we noted that approximately \$45 million, related with the CHIP program for the months from January 2011 to June 2011, were recorded as receivable as of June 30, 2011 and were subsequently received. Those funds were received as part of an analysis performed on the CHIP population. During FY 2008-2009, the Administration received more CHIP funds than they could justify. As a result, the Administration had to analyze its membership to identify children that could be reclassified as CHIP population and, therefore, justify the CHIP funds they had received.
- **Criteria** – Title XXI of the Social Security Act (Act) authorizes the CHIP to assist State efforts in initiating and expanding the provision of child health assistance to uninsured, low-income children. Under title XXI, State may provide child health assistance primarily for obtaining health benefits coverage through (1) obtaining coverage under a separate child health program that meets specific requirements; (2) expanding benefits under the State's Medicaid plan under title XIX of the Act; or (3) a combination of both. To be eligible for funds under this program, the Administration must submit a child health plan.
- **Cause** – The Administration was not analyzing the utilization of federal funds to comply with federal regulations because additional personnel or external support was needed.

Puerto Rico Health Insurance Administration

Schedule of Findings and Questioned Costs

For the Fiscal Year Ended June 30, 2011

- ***Effect*** – The classification of insured population in the CHIP and Medicaid programs were not appropriate in order to maximize the utilization of federal funds.
- ***Recommendation*** – The Administration should analyze the classification of the persons included in the CHIP and Medicaid programs in order to properly evidence the population in each category to support the assignment of the federal funds.
- ***Corrective Action Plan*** – The Administration has established, among its objectives, to maximize the utilization of federal funds and to redesign its financial reporting system, in coordination with CMS. Therefore, it has contracted Mercer Government Services Consulting, LLC and Llavona-Casas, CPA PSC to reclassify the insured population to the appropriate Medicaid and the CHIP programs to maximize the utilization of federal funds and, in coordination with CMS, redesign its financial reporting system at both the Puerto Rico Medicaid Office and at the Puerto Rico Health Insurance Administration to comply with federal regulation.

Puerto Rico Health Insurance Administration

Schedule of Findings and Questioned Costs

For the Fiscal Year Ended June 30, 2011

Section 3 – Federal Awards Findings and Questioned Costs

Finding No. SA-2011-01

Program CFDA No.: 93.778

CFDA program title: Medical Assistance Program

Program CFDA No.: 93.767

CFDA program title: Children's Health Insurance Program

Special test and provisions- Utilization control and program integrity

- **Condition** – The Administration does not perform monitoring procedures in order to assure the safeguarding against unnecessary utilization of care and services. To promote the most effective and appropriate use of available services and facilities, the Administration must have procedures for the on-going evaluation of the need for and the quality and timeliness of Medicaid services.
- **Criteria** – The Administration must have a post-payment review process that 1) allows its personnel to develop and review recipient utilization profiles, provider service profile, and exceptions criteria; and 2) identifies exceptions so that the Administration can correct misutilization practices of recipients and providers. The Administration must establish and use written criteria for evaluating the appropriateness and quality of Medicaid services (42 CFR part 456).
- **Cause** – The Administration does not have the sufficient personnel to perform monitoring procedures over the federal compliance requirements and/or over the compliance with the insurance companies' contracts.
- **Effect** – Payments that involve unallowed activities, unallowed cost and/or participants not eligible may not be identified and addressed on a timely basis and therefore the Administration could be disbursing money in excess of the appropriate amounts.
- **Questioned Costs** – None
- **Recommendations** – The Administration should perform a reorganization of its departments and duties or expand its labor resources in order to properly perform the required monitoring procedures and comply efficiently with the compliance requirements established in the A-133 Compliance Supplement.
- **Corrective Action Plan** – The compliance office will be conducting a monitoring program to ensure compliance with Circular A-133. For these purposes we will be hiring the services of an accounting firm to prepare a detailed plan of compliance and monitoring which will be submitted once is concluded. In order to conduct an effective and correctly process we will seek for alternatives to train our staff on the requirements of this Circular Letter. In addition ASES will make an assessment of the need for staff to determine what additional resources are needed to perform this and other tasks. In addition, the Administration is finalizing the RFP process to select a Quality Improvement Organization which will be evaluating quality aspects of the program and other services such as the pre authorizations and denials of the Health Insurance Organizations contracted in order to determine unnecessary and under utilization of care and services.

Puerto Rico Health Insurance Administration

Schedule of Findings and Questioned Costs

For the Fiscal Year Ended June 30, 2011

Finding No. SA-2011-02

Program CFDA No.: 93.778

Program CFDA No.: 93.767

CFDA program title: Medical Assistance Program

CFDA program title: Children's Health Insurance Program

Special test and provisions- Medicaid Fraud Control Unit

- ***Condition*** – The Administration does not maintain a State Medicaid Fraud Control Unit (MFCU) to investigate and prosecute fraud by Medicaid providers.
- ***Criteria*** – State is required, as part of their Medicaid State plans, to maintain a MFCU, unless the Secretary of HHS determines that certain safeguards are met regarding fraud and abuse. State is required to refer all suspected violations of applicable Medicaid laws and regulations by providers to the MFCU. The MFCU must be a single identifiable entity of State government (42 CFR part 1007).
- ***Cause*** – The Administration is limited to monitor the compliance department of the contracted insurance companies for the implementation of certain safeguards regarding fraud and abuse, including the referral to law enforcement officials or Office of the Inspector General (OIG), when applicable.
- ***Effect*** – Not having a MFCU may cause that violations of Medicaid laws and regulations by providers could not be identified and referred to an office with authority to prosecute cases of provider fraud.
- ***Questioned Costs*** – None
- ***Recommendations*** – The Administration, with the approval of the Office of the Inspector General (OIG), should develop a plan in order to design and implement a MFCU that meets the federal requirements and the Administration needs.
- ***Corrective Action Plan*** – The Medicaid Office of Puerto Rico and the Puerto Rico Department of Health (PRDOH) have created a task force to investigate and prosecute fraud by Medicaid and Medicare providers. This Task Force is being trained by the Federal Bureau of Investigation.

Puerto Rico Health Insurance Administration

Schedule of Findings and Questioned Costs

For the Fiscal Year Ended June 30, 2011

Finding No. SA-2011-03

Program CFDA No. 93.778

Program CFDA No. 93.767

CFDA program title: Medical Assistance Program

CFDA program title: Children's Health Insurance Program

Special test and provisions- Inpatient Hospital Services and Long-term Care Facility Audits

- ***Condition*** – The Administration does not perform periodic audits of financial and statistical data of participating providers in order to validate claims paid with Medicaid funds. The Administration should ensure that the payment for services is not in excess of normal amounts depending on the patient condition.
- ***Criteria*** – The Administration must provide for periodic audits of financial and statistical records of participating providers. The Administration pays for inpatient hospital services and long-term care facility services through the use of rates that are reasonable and adequate to meet the costs that must be incurred by efficiently and economically operated providers. These audits are an important control for the Administration in ensuring that established payment rates are proper (42 CFR section 447.253).
- ***Cause*** – The Administration does not have sufficient personnel to perform monitoring procedures over the federal compliance requirements and/or over the compliance with the insurance companies' contracts.
- ***Effect*** – The rates established for the payment for inpatient hospital services and long-term care facility services may not be reasonable and therefore the Administration could be disbursing money in excess of the appropriate amounts. This condition may have the effect that fraudulent transactions be paid with Medicaid funds and not be timely detected and addressed.
- ***Questioned Costs*** – None
- ***Recommendations*** – The Administration should perform a reorganization of its departments and duties or expand its labor resources in order to properly perform the required monitoring procedures and comply efficiently with the compliance requirements established in the A-133 Compliance Supplement.
- ***Corrective Action Plan*** – The compliance office will be conducting a monitoring program to ensure compliance with Circular Letter A-133. For these purposes we will be hiring the services of an accounting firm to prepare a detailed plan of compliance and monitoring which will be submitted once is concluded. In order to conduct an effective and correctly process we will seek for alternatives to train our staff on the requirements of this Circular Letter. In addition ASES will make an assessment of the need for staff to determine what additional resources are needed to perform this and other tasks. In addition, the Administration is finalizing the RFP process to select a Quality Improvement Organization which will be evaluating quality aspects of the program and other services such as the pre authorizations and denials of the Health Insurance Organizations contracted in order to determine unnecessary and under utilization of care and services.

Puerto Rico Health Insurance Administration

Schedule of Findings and Questioned Costs

For the Fiscal Year Ended June 30, 2011

Finding No. SA-2011-04

Program CFDA No. 93.778

Program CFDA No. 93.767

CFDA program title: Medical Assistance Program

CFDA program title: Children's Health Insurance Program

Special test and provisions- Automated Data Processing (ADP) Risk Analyses and System Security Reviews

- ***Condition*** – The Administration does not perform and does not have a report on its biennial ADP system reviews.
- ***Criteria*** – The Administration must establish and maintain a program for conducting periodic risk analyses to ensure appropriate, cost effective safeguards are incorporated into new and existing systems. The Administration must perform risk analyses whenever significant system changes occur. The Administration shall review the ADP System security installations involved in the administration of HHS programs on a biennial basis. At a minimum the reviews shall include an evaluation of physical and data security operating procedures, and personnel practices (45 CFR section 95.621).
- ***Cause*** – The Administration did not timely contract a professional in order to perform the ADP security reviews.
- ***Effect*** – The Administration may not timely identify inappropriate personnel practices or the lack of security procedures that could increase the risk of confidential data loss.
- ***Questioned Costs*** – None
- ***Recommendations*** – The Administration may implement policies and procedures, and perform and document the frequency, timing, and scope of ADP security system reviews and risk analysis.
- ***Corrective Action Plan*** – The Administration is currently in a migration project where it is considered to improve existing processes to unify databases and restructuring of programs to the same line of business.

Puerto Rico Health Insurance Administration

Schedule of Findings and Questioned Costs

For the Fiscal Year Ended June 30, 2011

Finding No. SA-2011-05

Program CFDA No. 93.778

Program CFDA No. 93.767

CFDA program title: Medical Assistance Program

CFDA program title: Children's Health Insurance Program

Special test and provisions- Medicaid Management Information System (MMIS)

- ***Condition*** – The Administration does not have an automated Medicaid benefits claims processing and information retrieval systems. The system implemented by the Administration does not have edits and controls to identify unusual items for follow-up by the compliance department.
- ***Criteria*** – The State is required to have a Medicaid management information system, unless this requirement is waived by the Secretary of Health and Human Services. The Secretary provides general systems guidelines (42 CFR sections 433.110 through 433.131) but does not provide detailed system requirements or specifications for States to use in the development of a Medicaid management information system.
- ***Cause*** – The Administration failed to maintain a Medicaid management information system because the funds designated to prepare a development plan are in process of approval.
- ***Effect*** – The Administration may not identify material unusual items for the proper follow-up that could result in questioned costs to the Administration.
- ***Questioned Costs*** – None
- ***Recommendations*** – The Administration should perform the necessary follow-up procedures with the PRDOH for the approval of funds designated for the development plan of a Medicaid management information system.
- ***Corrective Action Plan*** – The PRDOH is in the process of developing a plan of a Medicaid MMIS. This system, once implemented, would validate Medicaid provider claims and is authorized by CMS. The firm of Sellers & Dorsey has been contracted to assist in this process. This firm has helped other 23 states in this developing MMIS plans. The due date for the approval of the implementation system is October 2012.

Puerto Rico Health Insurance Administration

Schedule of Findings and Questioned Costs

For the Fiscal Year Ended June 30, 2011

Finding No. SA-2011-06

Program CFDA No. 93.778

Program CFDA No. 93.767

CFDA program title: Medical Assistance Program

CFDA program title: Children's Health Insurance Program

Special test and provisions- Provider Eligibility

- ***Condition*** – The Administration does not perform physical inspection to participant providers in order to assure that those providers are in compliance with the provider's eligibility requirements.
- ***Criteria*** – In order to receive Medicaid payments, providers of medical services furnishing services must be licensed in accordance with State and local laws and regulations to participate in the Medicaid program (42 CFR sections 431.107 and 447.10) and the providers must make certain disclosures to the State (42 CFR part 455, subpart B).
- ***Cause*** – The Administration understands that PRDOH is responsible of monitoring the licensing and entering into agreements with providers.
- ***Effect*** – The lack of physical inspections may cause that providers of the medical services are not licensed to participate in the Medicaid program and therefore receive Medicaid payments.
- ***Questioned Costs*** – None
- ***Recommendations*** – The Administration should perform a reorganization of its departments and duties or expand its labor resources in order to properly perform the required monitoring procedures and comply efficiently with the compliance requirements established in the A-133 Compliance Supplement. Providers' eligibility can be performed in combination with physical facilities inspection. The Administration should establish monitoring procedures in order to gather adequate documentation to support those facilities that are not in compliance and perform a Denial for Good Cause.
- ***Corrective Action Plan*** – The PRDOH is the government entity responsible for granting providers licenses to operate. The insurance companies carry out the process of credentials which ensure that providers comply with the requirements established by the Government. As part of this process, the PRDOH validates that the provider has licenses.

Puerto Rico Health Insurance Administration

Schedule of Findings and Questioned Costs

For the Fiscal Year Ended June 30, 2011

Finding No. SA-2011-07

Program CFDA No. 93.778

CFDA program title: Medical Assistance Program

Program CFDA No. 93.767

CFDA program title: Children's Health Insurance
Program

Special test and provisions- Provider Health and Safety Standards

- ***Condition*** – The Administration does not perform physical inspection to participant providers in order to assure that those providers are in compliance with the health and safety standards.
- ***Criteria*** – Providers must meet the prescribed health and safety standards for hospital, nursing facilities, and intermediate care facilities for the mentally retarded (42 CFR section 442). The standards may be modified in the State plan.
- ***Cause*** – The Administration understands that PRDOH is responsible of monitoring hospital and nursing facilities and intermediate care facilities for mentally retarder or persons with related conditions to be in compliance with federal requirement, due to they provide certifications to operate those facilities.
- ***Effect*** – The lack of physical inspections may cause that facilities that does not meet civil rights requirements set forth in 45 CFR parts 80, 84 and 90 to has an agreement to provide services and therefore receive Medicaid payments.
- ***Questioned Costs*** – None
- ***Recommendations*** –The Administration should perform a reorganization of its departments and duties or expand its labor resources in order to properly perform the required monitoring procedures and comply efficiently with the compliance requirements established in the A-133 Compliance Supplement. Inspection of physical facilities can be performed in combination with provider eligibility. The Administration should establish monitoring procedures in order to gather adequate documentation to support those facilities that are not in compliance and perform a Denial for Good Cause.
- ***Corrective Action Plan*** –The PRDOH is the entity responsible for ensuring that providers comply with the health and safety standards. One of the components of the PRDOH known as SARAFS is the organization that is in charge to certify that the hospital facilities fulfill the safety standards required by Medicaid.

Puerto Rico Health Insurance Administration

Schedule of Findings and Questioned Costs

For the Fiscal Year Ended June 30, 2011

Finding No. SA-2011-08

Program CFDA No.: 93.778

Program CFDA No.: 93.767

CFDA program title: Medical Assistance Program

CFDA program title: Children's Health Insurance Program

Reporting

- **Condition** – During the examination of reporting we noted the following conditions:
 - Amounts reported on the CMS-64, *Quarterly Statement of Expenditures for the Medical Assistance Program* do not match with the federal funds expended during the year by \$16,858,859 the total computable amount and by \$45,629,638 the total federal share amount.
- **Criteria – Financial Reporting (OMB Circular A-133)**
 - CMS-64, *Quarterly Statement of Expenditures for the Medical Assistance Program* (OMB No. 0938-0067) is required to be prepared quarterly and submitted electronically to CMS within 30 days after the end of the quarter.
- **Cause** – PRDOH filed CMS-64 with estimated data provided by the Administration but did not timely amended them with actual data subsequently sent by the Administration.
- **Effect** – The information presented in the reports is not consistent with the information recorded in the accounting system. The information presented to the federal agencies is misleading.
- **Questioned Costs** – None
- **Recommendations** – The PRDOH must make the appropriate corrections to the reports in order to record accurate information. Also, the Administration should review the reports prior to their submission to the federal agencies in order to ensure that the information is complete and accurate.
- **Corrective Action Plan** – The Memorandum of Understanding (MOU) between the Medicaid Program of the Puerto Rico Department of Health and the Puerto Rico Health Insurance Administration (PRHIA) establishes that “Once the billing process is culminated, the PRHIA will provide a Monthly Certification to Puerto Rico MEDICAID Office with the Recipients Enrolled and the incurred expenses of the PRHIA per month. The MEDICAID Office will use this information to complete forms CMS 37 and CMS 64. The Certification will be signed by the following personnel of the Administration: Executive Director, Information System Director and Finance Director”.

Puerto Rico Health Insurance Administration

Schedule of Findings and Questioned Costs

For the Fiscal Year Ended June 30, 2011

Finding No. SA-2011-09

Program CFDA No.: 93.778
Program CFDA No.: 93.767

CFDA program title: Medical Assistance Program
CFDA program title: Children's Health Insurance
Program

Maintenance of Effort – American Recovery Investment Act (ARRA) funds

- **Condition** – The Administration does not properly monitor that applicable claims paid with ARRA funds complies with the ARRA prompt pay provisions.
- **Criteria** – Under title XIX of the Social Security Act and Federal Medicaid regulations at 42 CFR section 447.45(d) in effect prior to the enactment of ARRA, and which continue to be in effect, there are two prompt pay standards referenced by the ARRA prompt pay provisions which are applicable to claims (as specified in the regulation) that are received from practitioners on or after February 18, 2009: a) 90% of clean claims received by the State must be paid within 30 days of receipt; and b) 99% of clean claims received by the State must be paid within 90 days of receipt.
- **Cause** – The Administration does not have the sufficient personnel to performed monitoring procedures over the federal compliance requirements and/or over the compliance with the insurance companies' contracts.
- **Effect** – If the Administration does not meet the ARRA funds requirements, the Administration (and/or PRDOH) may not continue to be eligible under ARRA for the increase in their federal medical assistance percentages which are used for the purpose of determining the amounts of federal funds available to States for their medical assistance expenditures under the Medicaid program.
- **Questioned Costs** – None
- **Recommendations** – The Administration should perform a reorganization of its departments or expand its labor resources in order to properly perform the required monitoring procedures and comply efficiently with the compliance requirements established in the A-133 Compliance Supplement.
- **Corrective Action Plan** – The Administration has included clauses in all of its contracts with health insurance companies that require complying with the prompt pay requirements. This clause assures every provider the right to get paid on a timely basis, as defined, and to receive interests on late payments.

Puerto Rico Health Insurance Administration

Schedule of Prior Year Audit Findings

Year Ended June 30, 2011

REPORT ON THE STATUS OF UNCORRECTED MATERIAL FINDINGS AND RECOMMENDATIONS FROM PRIOR AUDITS THAT AFFECT THE FINANCIAL STATEMENT AUDIT AS REQUIRED BY GOVERNMENT AUDITING STANDARDS

Section 2 - Finding No. 2010-01 - Cash reconciliations are not performed on a timely basis

- **Condition** – The Administration does not perform bank reconciliations on a timely basis for several cash accounts such as Acct #1110 SSS and Acct #1110 Humana. All bank accounts should be reconciled on a monthly basis as of the date of the bank statement. Not reconciling the accounts on a monthly basis means that errors or other problems might not be recognized and resolved on a timely basis.
- **Status** – The Administration will prepare a bank reconciliation checklist to ensure the completion of all reconciliations, including the date in which it was reconciled. The checklist will be sign by the Finance Director after review and approve the reconciliations, on a monthly basis. However, a similar finding was noted during current year included as finding 2011- 01, section 2.

Section 3 - Finding No. SA-2010-01 - Special test and provisions- Medicaid Management Information System

- **Condition** – The Administration does not have an automated Medicaid benefits claims processing and information retrieval systems. The system implemented by the Administration does not have edits and controls to identify unusual items for follow-up by the Compliance Department.
- **Status** – At this moment, the Administration have a system run by Milliman-Medinsight, where you do the validation of claims and encounters submitted by insurers. The Administration is developing a program to validate the eligibility of claims and encounters submitted by insurers in our systems. However, a similar finding was noted during current year included as finding SA-2011-05, section 3.

Section 3 - Finding No. SA-2010-02 - Special test and provisions- Automated Data Processing (ADP) Risk Analyses and System Security Reviews

- **Condition** – The Administration does not have a contingency plans to meet critical processing needs in the event of an interruption of service; neither a designation of an agency ADP security manager.
- **Status** – There has been identifying ways to create a disaster plan for our systems. However, a similar finding was noted during current year included as finding SA-2011-04, section 3.

Section 3 - Finding No. SA-2010-03 - Special test and provisions- Inpatient Hospital Services and Long-term Care Facility Audits

- **Condition** – The Administration does not have documentation to support periodic audits of financial and statistical data of participating providers in order to validate claims paid with Medicaid funds. The Administration should ensure that the payment for services is not in excess of normal amounts depending on the patient condition.

Puerto Rico Health Insurance Administration

Schedule of Findings and Questioned Costs

For the Fiscal Year Ended June 30, 2011

- ***Status*** – The Administration is implementing as part of work plan of the Compliance Department the examination of insurance company's compliance. However, a similar finding was noted during current year included as finding SA-2011-03, section 3.

Section 3- Finding No. SA-2010-04 - Special test and provisions- Provider Health and Safety Standards

- ***Condition*** – The Administration did not perform physical inspection to participant providers during the current year, in order to assure that those providers are in compliance with the health and safety standards.
- ***Status*** – One of the components of the Department of Health known as SARAFS is the governmental organization that is in charge to certify that the hospital facilities fulfill the safety standards required by Medicaid. The Administration is implementing as part of a work plan of the Compliance Department the examination of insurance company's compliance. However, a similar finding was noted during current year included as finding SA-2011-07, section 3.