

# VALDES, GARCIA & MARIN

CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

## PARTNERS

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Hon. Carmen Feliciano de Melecio  
Secretary  
Department of Health  
Commonwealth of Puerto Rico  
San Juan, Puerto Rico

## INDEPENDENT AUDITORS' REPORT

We have audited the accompanying financial statements of the Health Facilities and Services Administration (the Administration), a component unit of the Department of Health of the Commonwealth of Puerto Rico, as of and for the years ended June 30, 1998 and 1997, as listed in the table of contents. These financial statements are the responsibility of the Administration's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in Note 1, the accompanying financial statements present only the Health Facilities and Services Administration and are not intended to present fairly the financial position of the Department of Health of the Commonwealth of Puerto Rico, and the results of its operations and the cash flows of its proprietary fund types and trust funds in conformity with generally accepted accounting principles.

In our opinion, the accompanying *financial statements* referred to above present fairly, in all material respects, the combined financial position of the Administration at June 30, 1998 and 1997, and the results of operations and the cash flows of the enterprise fund for the years then ended in conformity with generally accepted accounting principles.

As explained in Note 2, the Administration and the Department of Health have initiated an active plan toward the privatization of health facilities mostly owned by the Administration. The realizable value upon the sale or other disposition of the health facilities may be substantially different from the amounts recorded in the books at June 30, 1998. The final outcome of these actions and its effect on the accompanying financial statements and on the future operations of the Administration are uncertain at this time.

As explained in Note 21, subsequent to the date of the accompanying financial statements, Act No. 187 was enacted to repeal the Law that created the Administration on or before June 30, 1999 and to consolidate the operational activities of the Administration with the Department of Health and to dispose of health facilities either by sale or lease.

San Juan, Puerto Rico  
November 13, 1998

A handwritten signature in dark ink, appearing to read "Victor J. García", is written over the typed name.

Stamp 1540167 was affixed  
to the original.

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

Combined Balance Sheets

ASSETS

	June 30, 1998		June 30, 1997
	Enterprise Fund	Trust Fund	Total (memorandum only)
<b>CURRENT ASSETS</b>			
Cash	\$ 15 468 039	\$ 6 959 513	\$ 13 041 406
Patient receivables - net			
Medicare	9 975 343	-	9 975 343
Due from other third parties	19 979 387	-	19 979 387
Estimated third party payor			
Medicare	3 263 837	-	3 263 837
Due from other governmental agencies			
Due from trust fund	9 598 370	4 493 840	14 092 210
Other accounts receivable - net	4 724 958	-	4 724 958
Inventories	28 321 413	-	28 321 413
Other assets	10 446 937	-	10 446 937
	-	-	-
Total current assets	101 778 284	11 453 353	113 231 637
<b>RESTRICTED CASH</b>	317 550	-	317 550
<b>DUE FROM FEDERAL GOVERNMENT</b>	105 347	-	105 347
<b>PROPERTY AND EQUIPMENT, net</b>	305 315 572	-	305 315 572
Total assets	\$407 516 753	\$ 11 453 353	\$418 970 106

(Continues)

See accompanying notes to financial statements.

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

Combined Balance Sheets  
(Continued)

LIABILITIES AND FUND EQUITY (DEFICIT)	June 30, 1998			June 30, 1997	
	Enterprise Fund	Trust Fund	Total (memorandum only)	Total (memorandum only)	
<b>CURRENT LIABILITIES</b>					
Current portion of long-term debt					
Loans payable	\$ 13 863 408	\$ -	\$ 13 863 408	\$ 24 018 917	
Capital lease obligations	13 294 898	-	13 294 898	13 088 743	
Accounts payable and accrued liabilities	87 609 826	250 873	87 860 699	57 073 551	
Interest payable	53 432 114	-	53 432 114	36 922 174	
Accrued compensated absences	60 622 923	-	60 622 923	80 382 468	
Due to other governmental agencies	131 561 052	-	131 561 062	52 329 820	
Due to enterprise fund	-	4 724 958	4 724 958	4 619 269	
Total current liabilities	360 384 231	4 975 831	365 360 062	268 434 942	
LONG-TERM LOANS PAYABLE - net	722 988 655	-	722 988 665	554 272 695	
LONG-TERM CAPITAL LEASE OBLIGATIONS - net	242 558 767	-	242 558 767	315 066 720	
DUE TO OTHER AGENCIES	12 000 000	-	12 000 000	34 253 986	
Total liabilities	1 337 931 653	4 975 831	1 342 907 494	1 172 028 343	
<b>COMMITMENTS AND CONTINGENCIES</b>	-	-	-	-	
<b>FUND EQUITY (DEFICIT)</b>					
Deficit	(930 414 910)	-	(930 414 910)	(688 571 282)	
Fund balance	-	6 477 522	6 477 522	7 444 051	
Total fund equity (deficit)	(930 414 910)	6 477 522	(923 937 388)	(681 127 231)	
Total liabilities and fund equity (deficit)	\$ 407 516 753	\$ 11 453 353	\$ 418 970 106	\$ 490 901 112	

See accompanying notes to financial statements.

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

STATEMENTS OF REVENUES AND EXPENSES  
OF THE ENTERPRISE FUND

	For the years ended June 30,	
	1998	1997
OPERATING REVENUES		
Net patient service revenue		
Medicaid	\$ 64 338 202	\$ 77 111 274
Medicare	44 866 750	48 676 500
Revenue from other third parties	86 496 553	59 433 852
Other	5 310 560	4 203 594
Premium revenue	5 545 852	7 434 337
Other	7 323 865	6 135 395
Total operating revenues	<u>213 881 782</u>	<u>202 994 952</u>
OPERATING EXPENSES		
Salaries and fringe benefits	246 459 179	303 134 196
Professional services	72 481 141	74 613 751
Inter-Agency services	69 563 637	66 464 864
Materials and supplies	66 706 965	73 989 213
Subsidies - community hospitals	59 602 121	80 049 177
Subsidies - other	14 006 785	12 034 839
Repairs and maintenance	9 321 203	5 806 083
Rent	17 829 395	4 246 955
Utilities	34 624 572	21 100 340
Bad debts	25 545 753	23 792 723
Depreciation and amortization	25 744 510	25 944 877
Other	19 638 166	20 904 428
Total operating expenses	<u>661 523 427</u>	<u>712 081 446</u>
LOSS FROM OPERATIONS	<u>(447 641 645)</u>	<u>(509 086 494)</u>
NON-OPERATING REVENUES (EXPENSES)		
Federal grants	963 790	2 172 655
Rent and other income (expense) -net	(3 482 416)	21 689 222
Sale of facilities	42 779 188	-
Interest	(66 913 773)	(58 449 095)
Total non-operating revenues (expenses)	<u>(26 653 211)</u>	<u>(34 587 218)</u>
LOSS BEFORE OPERATING TRANSFERS	<u>(474 294 856)</u>	<u>(543 673 712)</u>
TRANSFERS		
Operating transfers from:		
Primary government	222 451 514	374 231 223
Department of Health	5 418 962	-
Transfers to other government agency	(18 876 447)	-
Transfers from other government agency	39 435 400	-
Total transfers - net	<u>248 429 429</u>	<u>374 231 223</u>
LOSS FOR THE YEAR	<u>(\$225 865 427)</u>	<u>(\$169 442 489)</u>
	=====	=====

See accompanying notes to financial statements.

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

STATEMENTS OF CHANGES IN DEFICIT  
OF THE ENTERPRISE FUND

	For the years ended June 30,	
	<u>1998</u>	<u>1997</u>
Deficit, at beginning of year as previously reported	(\$688 571 282)	(\$510 516 694)
Prior period adjustments	<u>(15 978 201)</u>	<u>(8 612 099)</u>
Deficit, at beginning of year, as restated	(704 549 483)	(519 128 793)
Loss for the year	<u>(225 865 427)</u>	<u>(169 442 489)</u>
Deficit, at end of year	(\$930 414 910) =====	(\$688 571 282) =====

See accompanying notes to financial statements.

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION  
STATEMENTS OF REVENUES, EXPENDITURES AND CHANGES  
IN FUND BALANCE OF THE TRUST FUND

	For the years ended June 30,	
	<u>1998</u>	<u>1997</u>
Revenues	\$ 168 772	\$ 140 524
Expenditures	<u>(1 135 301)</u>	<u>(1 485 773)</u>
Excess of expenditures over revenues for the year	(966 529)	(1 345 249)
Fund balance, at beginning of year	<u>7 444 051</u>	<u>8 789 300</u>
Fund balance, at end of the year	\$6 477 522 =====	\$ 7 444 051 =====

See accompanying notes to financial statements.

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

STATEMENTS OF CASH FLOWS  
OF THE ENTERPRISE FUND

	For the years ended June 30,	
	<u>1998</u>	<u>1997</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Loss from operations	(\$447 641 645)	(\$509 086 494)
Adjustments to reconcile the loss from operations to the net cash used in operating activities:		
Bad debts expense	25 545 754	23 792 723
Depreciation and amortization	25 744 510	25 944 877
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Accounts receivable	(11 086 909)	(19 460 693)
Inventory	3 333 848	2 671 504
Other assets	1 480 131	60 628
Increase (decrease) in:		
Accounts payable and accrued liabilities	(2 771 393)	(6 943 650)
Other operating liabilities	<u>142 485 517</u>	<u>16 053 475</u>
Net cash used in operating activities	<u>(262 910 107)</u>	<u>(466 967 630)</u>
<b>CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:</b>		
Contributions from the Commonwealth of Puerto Rico	291 312 635	515 813 176
Transfers to other agency	(18 876 447)	-
Transfers from other agency	39 435 400	-
Operating grants received	7 648 620	1 894 344
Increase in due from other fund	<u>(105 689)</u>	<u>(640 636)</u>
Net cash provided by non- capital financing activities	<u>319 414 519</u>	<u>517 066 884</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>		
Acquisition of property and equipment	(8 379 864)	(13 555 144)
Interest paid on long-term debt	<u>(46 079 105)</u>	<u>(54 604 870)</u>
Net cash used in capital and related financing activities	<u>(54 458 969)</u>	<u>(68 160 014)</u>

(Continues)

See accompanying notes to financial statements.



COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

STATEMENTS OF CASH FLOWS  
OF THE ENTERPRISE FUND  
(CONTINUED)

	For the years ended June 30,	
	1998	1997
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest income received	\$ 589 825	\$ 831 133
Other income received	6 773 840	6 631 617
Net cash provided by investing activities	7 363 665	7 462 750
NET INCREASE (DECREASE) IN CASH	9 409 028	(10 598 010)
CASH AT BEGINNING OF YEAR	6 376 561	16 974 571
CASH AT END OF YEAR	\$ 15 785 589	\$ 6 376 561
	=====	=====
<b><u>Reconciliation of cash to balance sheets of the enterprise fund</u></b>		
Cash in current assets	\$ 15 468 039	\$ 4 945 652
Restricted cash	317 550	1 430 909
Total cash	\$ 15 785 589	\$ 6 376 561
	=====	=====

See accompanying notes to the financial statements.

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 1998 AND 1997

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Health Facilities and Services Administration (the Administration) is a governmental instrumentality of the Commonwealth of Puerto Rico (the Commonwealth) created by Act No. 26 of November 13, 1975, as amended. The Administration is a component unit of the Department of Health of the Commonwealth of Puerto Rico (the Department). As a component unit of the Department, the Administration is also included as part of the Department's and Commonwealth's reporting entity. Refer to Note 21 on Act No. 187 approved on August 7, 1998 to dissolve the Administration.

The Administration is authorized to operate independently from the Department of Treasury and empowered, among other things, to lease and operate hospitals, clinics, health care centers and any other health facilities acquired in the future and to provide for the improvements, alteration or repair of such facilities. In addition, it is empowered to borrow money and issue notes or other obligations for the purpose of financing the cost of improvements and providing health services to the general public.

As a governmental entity, the Administration is exempt from the payment of any taxes on its revenues and properties.

Basis of presentation

The Administration reports its financial position and results of operations in funds, each of which is considered an independent fiscal entity. The operations of each fund are accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures/expenses. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds is maintained consistent with legal and managerial requirements.

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COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Administration has established the following fund categories:

Enterprise fund

The main financial activities of the Administration have been classified as an enterprise fund. Enterprise funds are used to account for operations that: (a) are financed and operated in a manner similar to private business enterprises, where the intent is that the costs of providing goods or services to the general public on a continuing basis are financed or recovered primarily through user charges, or (b) where the Commonwealth has decided that periodic determination of revenues earned, expenses incurred, and net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The enterprise fund accounts for resources devoted to financing the general services that the Administration provides to the general public. Appropriations from the Legislature of the Commonwealth of Puerto Rico, contributions from the Federal Government, billing to patients or medical plans for services rendered in the Administration's hospitals and diagnostic treatment centers and other sources of revenue, used to finance the fundamental operations of the Administration, are included in this fund. The fund is charged with all costs of operating the Administration for which a separate fund has not been established.

Trust fund

This specific purpose fund accounts for monies received by the Administration on a fiduciary basis to acquire certain goods or render certain services, or monies to be kept on behalf of inpatients or outpatients attended in the facilities managed by the Administration.

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COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of accounting

The accrual basis of accounting is used by the enterprise fund. Under the accrual basis, revenue is recognized when earned and expenses are recorded as liabilities when incurred, without regard to receipt or payment of cash.

Regulations promulgated by the Secretary of Health establish norms for the billing, collection, deposit, accounting, control and use of funds. Pursuant to such regulations, patients admitted to an institution under the jurisdiction of the Administration, who are indigent, receive hospital and medical services free of charge, and those who are totally or partially solvent pay for the total or partial cost of such services.

The modified accrual basis of accounting is followed by the trust fund. Under the modified accrual basis of accounting, revenues are recorded when they become measurable and available to pay liabilities of the current period.

Net patient service revenue

The Administration has agreements with third-party payors that provide for payments to the Administration at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. (See Note 3).

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

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COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Administration did not maintain sufficient records to determine the amounts of charity allowances provided to indigent patients. Similarly, the absence of such records did not permit the determination of amounts relating to courtesy allowances. No attempt has been made to determine or estimate, for disclosure purposes pursuant to generally accepted accounting principles, the amounts of charity allowances.

Premium revenue

The Administration has agreements with various Health Maintenance Organizations (HMOs) to provide medical services to subscribing participants. Under these agreements, the Administration receives capitation payments based on the number of HMO's participants, regardless of services actually performed by the Administration. In addition, the HMOs make fee-for-service payments to the Administration for certain covered services based upon discounted fee schedules.

Inventories

Inventories are accounted for at the lower of average cost or market. Inventories consist of drugs, medicines, provisions, medical, surgical and other materials.

Property and equipment

Property and equipment are recorded at cost, or if donated, at fair market value at the time of donation. 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.

Maintenance and repairs are charged to operations as incurred, significant renewals and betterments are capitalized.

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COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Depreciation and amortization

Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Property and equipment under capital leases and leasehold improvements are amortized using the straight-line method over the shorter of, the lease term or the estimated useful life of the assets. Such amortization is included in the depreciation and amortization expense in the financial statements.

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 90 days.

As per Law Number 156 of August 20, 1996, for fiscal years beginning on July 1, 1997, the employee has the right to accumulate the excess of 60 days in vacation and 90 days in sick leave until December 31st. of each year. The excess should be paid to the employee before March 31st. of the following year.

Use of estimates

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

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COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Accounting for pension costs

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

The SGAS No. 27 establishes standards of accounting and financial reporting for pension expenditures/expense and related 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.

Accounting standards

Pursuant to Governmental Accounting Standards Board Statement (SGAS) No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting", the Administration has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989.

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 charged to the Administration's account with the Department of Treasury.

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COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Total column (Memorandum only)

Total columns on the financial statements captioned "Total Memorandum Only" are not necessary for a fair presentation of the financial statements and are presented for information purposes only. These columns are not comparable to a consolidation, accordingly, they do not present consolidated financial information since interfund eliminations have not been made.

NOTE 2 HEALTH CARE REFORM

On February 1, 1993, the Commonwealth of Puerto Rico created the Health Care Reform (Reform) with the purpose of providing citizens with a better uniform care system at reasonable costs. The Reform changed the actual functions of the Department and the Administration from health care providers to regulators and evaluators of health services provided by private administrative corporations under an unique service delivery system. The health services will be provided in the physical facilities and with medical equipment rented or acquired from the Department of Health as well as in privately owned health care units. The health plan has already been established in several regions and municipalities of Puerto Rico.

On September 5, 1996, the Legislature of Puerto Rico signed the Act 190 to regulate the process of privatization of the Governmental Health Facilities, as amended on July 6, 1997. Under Act 190, the Department of Health, the Administration and the Government Development Bank for Puerto Rico (GDB) has started a plan to privatize all government owned health facilities, most of them now operated by the Administration. This privatization process is looking mainly for the sale, lease or sublease of the facilities in order to accomplish the main objective of the Health Care Reform which is to change the actual function of the Department from provider to regulator and evaluator and assume the role of promoter and procure a better health system for the people of Puerto Rico.

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COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 2 HEALTH CARE REFORM (CONTINUED)

During fiscal year 1997-98, the Department of Health, the Administration and GDB sold eighteen health facilities to the private sector and will continue to do so during fiscal year 1998-1999. (See Note 20).

The Administration will continue to operate health facilities as long as such facilities are not fully privatized. Afterwards, its manpower and resources will be combined with those of the Department to complement the normative, regulatory and supervisory functions of the Department.

On July 28, 1995, as part of the Health Care Reform, the Secretary of the Department of Health of the Commonwealth of Puerto Rico signed the administrative order number 99, as amended on September 29, 1995 by the administrative order number 104. This administrative order formalizes the transfer of various divisions and offices from the Administration to the Department.

Refer to Note 21 on Act No. 187 approved on August 7, 1998 to dissolve the Administration.

NOTE 3 NET PATIENT SERVICE REVENUE

The Administration has agreements with third-party payors that provide for reimbursement to the Administration for services rendered by the health facilities operated by the Administration. A summary of the basis of reimbursement with major third-party payors follows:

Medicare - Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge.

Inpatient nonacute services and outpatient services rates vary according to a patient classification system based on clinical, diagnostic, and other factors.

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COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 3 NET PATIENT SERVICE REVENUE (CONTINUED)

Defined capital and medical education and other pass through costs related to Medicare beneficiaries are paid based upon a cost reimbursement methodology. The Administration is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Administration and audits thereof by the Medicare fiscal intermediary. For the years ended June 30, 1998 and 1997 the annual medicare cost reports have not been yet audited by the Medicare fiscal intermediary.

Medicaid - Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. The Administration is reimbursed at a defined rate based on previous period medicare cost report.

Blue Cross - Inpatient services rendered to Blue Cross subscribers are reimbursed at a negotiated all inclusive per diem rate. The prospectively determined per diem rates are not subject to retroactive adjustment.

Other - The Administration has also entered into reimbursement agreements with certain commercial insurance carriers, health maintenance organization and preferred provider organizations. The basis for reimbursement under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined per diem rates.

NOTE 4 CASH

The Administration is authorized to deposit only in institutions approved by the Department of Treasury of the Commonwealth of Puerto Rico, and such deposits should be kept in separate accounts in the name of the Administration. The Administration's deposits as of June 30, 1998 in commercial

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COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 4. CASH (CONTINUED)

banks were entirely covered by Federal depository insurance or by collateral held by the Puerto Rico Department of Treasury. The amounts deposited in the Government Development Bank are uncollateralized.

The Administration's cash deposits and the respective risk category as of June 30, 1998 are as follows:

	Bank Balance	Carrying amount	Credit risk category		
			1	2	3
Unrestricted					
cash	\$25 541 936	\$22 349 861	\$25 541 936	\$ -	\$ -
	=====	=====	=====	=====	=====
Restricted					
cash	\$ 317 550	\$ 317 550	\$ -	\$ -	\$317 550
	=====	=====	=====	=====	=====

Following is a description of the categories of credit risk:

<u>Category</u>	<u>Description</u>
1	The deposits are collateralized by Federal Deposit Insurance Corporation or collateralized by securities pledged with the Department of Treasury of the Commonwealth of Puerto Rico. .
2	The deposits are collateralized by securities held by the pledging financial institution's trust department or agent.
3	The deposits are uncollateralized.

Unrestricted cash as of June 30, 1998 and 1997 in the combined balance sheets consist of the following:

	<u>1998</u>	<u>1997</u>
Cash in bank	\$22 349 861	\$12 962 600
Cash on hand	<u>77 691</u>	<u>78 806</u>
	\$22 427 552	\$13 041 406
	=====	=====

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 5 ACCOUNTS RECEIVABLE

A. Patient receivable:

Patient receivable - net in the enterprise fund consists of the following as of June 30, 1998 and 1997:

	<u>1998</u>		<u>1997</u>	
	Due from		Due from	
	other		other	
	<u>third party</u>	<u>Medicare</u>	<u>third party</u>	<u>Medicare</u>
Current amount	\$42 048 491	\$13 412 846	\$29 044 620	\$12 735 137
Allowance for doubtful accounts	(22 069 104)	(3 437 503)	(16 257 483)	(3 158 284)
Patient receivable - net	\$19 979 387	\$ 9 975 343	\$12 787 137	\$ 9 576 853
	=====	=====	=====	=====

B. Other accounts receivable:

Other accounts receivable in the enterprise fund consist of the following as of June 30, 1998 and 1997:

	<u>1998</u>	<u>1997</u>
Institutions under Health Reform	\$80 557 938	\$63 544 267
Governmental Development Bank	13 814 084	-
Other claims	<u>7 095 960</u>	<u>3 805 153</u>
	101 467 982	67 349 420
Allowance for doubtful accounts	(73 146 569)	(41 738 098)
	\$28 321 413	\$25 611 322
	-----	-----

For 1998 and 1997 management decided to provide for bad debts using the allowance method based on historical experience and management's evaluation of outstanding accounts receivable.

(Continues)

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 5 ACCOUNTS RECEIVABLE (CONTINUED)

From the total bad debt expense for 1998 amounting to \$56,282,420 (\$49,638,333, in 1997), \$25,545,753 (\$23,792,723 in 1997) have been recorded as bad debt expense and \$30,736,667 (\$25,845,610 in 1997) have been reduced, as an allowance for possible uncollectibles, from the rent and other income caption in the accompanying statement of revenues and expenses of the enterprise fund. The rent and other income includes, among other, the non-operating revenues resulting from the privatization of hospital and facilities under the Health Reform.

NOTE 6 PROPERTY AND EQUIPMENT

A summary of the property and equipment of the enterprise fund as of June 30, 1998 and 1997 is as follows:

	<u>1998</u>	<u>1997</u>	<u>Estimated Useful life</u>
Land and buildings	\$281 339 008	\$358 759 613	25 to 30 yrs.
Machinery and equipment	92 795 835	122 006 258	5 to 20 yrs.
Motor vehicles	12 169 355	12 169 355	4 to 12 yrs.
Leasehold improvements	<u>94 897 523</u>	<u>88 492 330</u>	20 to 25 yrs.
	481 201 721	581 427 556	
Less accumulated depreciation and amortization	<u>175 886 149</u>	<u>207 135 212</u>	
Property and equipment, net	\$305 315 572	\$374 292 344	
	=====	=====	

NOTE 7 DUE FROM FEDERAL GOVERNMENT

The balance due from Federal Government represents an excess of expenses over cash receipts for grants that require monies to be used for specified purposes. Generally, due from balances, are caused by differences in the timing of cash receipts and expenses that will be reversed in the next fiscal year. Effective on October 1, 1995 all federal programs were transferred to the Department of Health of the Commonwealth of Puerto Rico. Refer to Note 15.

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 8 LONG-TERM DEBT

Long-term debt of the enterprise fund as of June 30, 1998 and 1997 consists of following:

	<u>1998</u>	<u>1997</u>
A. Long-term debt to the Government Development Bank for the amount of \$364,150,000 dated December 8, 1992, payable in seven (7) principal consecutive annual installments, commencing on July 1, 1993; bearing 8% annual interest rate, payable in July 1 of each fiscal year. On August 9, 1995 the Administration restructured and refinanced the long-term debt balance of \$298,815,000. The new annual installments were reduced to \$34,910,420 (principal and interest) and was extended from fiscal year 2000 to 2010.	\$263 968 071	\$276 804 560
B. 8% long-term debt to the Government Development Bank, for the amount of \$145,000,000 dated June 27, 1996, payable in ten (10) annual installments commencing on July 1, 1997 plus interest through July 1, 2006. On June 25, 1997 the Administration obtained an additional \$200,000,000 under the terms of this loan and the agreement was changed on June 27, 1997. The loan was converted into a revolving line of credit		
Sub-total	<u>263 968 071</u>	<u>276 804 560</u>

(Continues)

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 8 LONG TERM DEBT (CONTINUED)

	<u>1998</u>	<u>1997</u>
Sub-total	\$263 968 071	\$276 804 560
payable in a period of ten years with legislative appropriations to be recommended by the Management and Budget Office of Puerto Rico. The due date of the loan is June 2006.	309 181 071	301 487 052
C. 8% non-revolving line of credit with the Government Development Bank, for the amount of \$204,000,000 dated June 1998, payable in annual principal installments plus interest through legislative appropriations to be recommended by Management and Budget Office of Puerto Rico. The due date of the loan is September 30, 2000.	<u>163 702 931</u>	<u>-</u>
	736 852 073	578 291 612
Less current portion	<u>13 863 408</u>	<u>24 018 917</u>
	\$722 988 665	\$554 272 695
	=====	=====

The scheduled contractual principal payments on long-term debt as of June 30, 1998 for the next five years and thereafter are as follows:

Year ending <u>June 30,</u>	<u>Amount</u>
1999	\$ 13 863 408
2000	14 972 481
2001	179 873 210
2002	17 463 902
2003	18 861 014
Thereafter	<u>491 818 058</u>
	\$736 852 073
	=====

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 9 CAPITAL LEASE OBLIGATIONS

The Administration is the lessee of various real and personal properties under capital leases with the Public Building Authority (lessor) expiring in different years through 2025. The assets and liabilities under capital leases are recorded at the lower of the present value of the minimum lease payments or the fair value of the asset. The buildings and equipment are depreciated over the lower of their related lease terms or their estimated productive lives. Depreciation of assets under capital leases is included in the depreciation expense for 1998 and 1997.

The lessee and lessor are both instrumentalities of the Commonwealth of Puerto Rico. Leased health facilities were constructed by the Public Buildings Authority and include land, buildings, and medical equipment in the Regional Hospitals and Centers for Diagnosis and Treatment throughout Puerto Rico.

Annual lease payments are currently fixed, but are subject to change, as deemed necessary by the Executive Director of the Public Buildings Authority.

Scheduled minimum lease payments on capital lease obligations for the enterprise fund as of June 30, 1998 for the next five years and thereafter follows:

<u>Year ending</u> <u>June 30,</u>	<u>Amount</u>
1999	\$ 54 625 567
2000	38 178 809
2001	38 186 789
2002	38 343 029
2003	38 475 119
Thereafter	<u>485 219 376</u>
	693 028 689
Less amount representing executory costs under capital leases	<u>171 563 546</u>
Net minimum lease payments	521 465 143
Less amount representing interest	<u>265 611 478</u>
Present value of net minimum lease payments and obligations under capital lease	255 853 665
Less current portion	<u>13 294 898</u>
	\$242 558 767
	=====

(Continues)



COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 9 CAPITAL LEASE OBLIGATIONS (CONTINUED)

Total imputed annual interest at fluctuating rates from 5% to 10%, charged to operations under the aforementioned leases amounted to approximately \$22,434,000 and \$25,196,000 for the years ended June 30, 1998 and 1997, respectively.

Property and equipment in the accompanying combined balance sheets include the following property under capital leases by major classes as of June 30, 1998 and 1997:

	<u>1998</u>	<u>1997</u>
Land and buildings	\$281 339 008	\$358 759 613
Machinery and equipment	<u>48 908 150</u>	<u>52 190 572</u>
	330 247 158	410 950 185
Less accumulated amortization	<u>125 172 597</u>	<u>146 198 186</u>
	\$205 074 561	\$264 751 999
	=====	=====

Amortization expense under the aforementioned leases amounted to approximately \$16,188,000 and \$15,971,000 for the years ended June 30, 1998 and 1997, respectively.

Land under lease agreements is less than 25% of the total real estate leased and is, therefore, amortized over the lease term of 30 years as a single unit along with buildings. Machinery and equipment are amortized over an estimated useful life of 10 years.

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 10 DUE TO OTHER AGENCIES

The balance due to other agencies in the enterprise fund as of June 30, 1998 and 1997 consists of the following:

	<u>1998</u>	<u>1997</u>
Medical Sciences Campus of the University of Puerto Rico	\$51 062 023	\$21 671 496
Puerto Rico Medical Service Administration	58 432 903	52 213 692
Puerto Rico Department of Education	3 700 000	3 200 214
Cardiovascular Center of Puerto Rico and Caribbean	11 311 476	4 628 274
Puerto Rico Electric Power Authority	6 324 251	1 868 685
Commonwealth Employee Association	1 239 169	1 568 125
Puerto Rico Department of Labor	195 392	195 430
Puerto Rico Telephone Company	6 475 437	478 067
Puerto Rico Water and Sewer Authority	4 568 914	152 282
State Insurance Fund Corporation	19 821	73 431
Puerto Rico General Services Administration	112 237	144 048
Agricultural Services Administration	94 960	219 349
Puerto Rico Department of Treasury	<u>24 479</u>	<u>170 713</u>
	143 561 062	86 583 806
Less current portion	<u>131 561 062</u>	<u>52 329 820</u>
	\$12 000 000	\$34 253 986
	=====	=====

(Continues)

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 10 DUE TO OTHER AGENCIES (CONTINUED)

On August 23, 1994, the Administration signed an agreement with the Medical Science Campus of the University of Puerto Rico (MSC) in relation to the Pediatric Hospital. The agreement stipulates that the MSC will transfer to the Administration all the inventory (drugs, supplies and others) and equipment on hand as of March 2, 1993. The Pediatric Hospital was administered by the MSC from 1982 to March 1993. During those years the costs of indigent patients were greater than the amount assigned to the MSC for this purpose. As a result, an operational deficit of \$17,305,645 was accumulated which the Administration has agreed to absorb and pay in six annual installments of \$2,884,274, due in June 30<sup>th</sup> of each year, starting on June 30, 1996. The total amount due under this agreement as of June 30, 1998 was \$9,000,957.

On May 1, 1996, the Administration signed another agreement with the MSC related with medical and health services rendered until June 30, 1995. The agreement stipulates that the Administration will pay the total amount of \$12,669,810 in five annual installments of \$2,533,962 due in July 1<sup>st</sup> of each year, starting on July 1, 1996. The total amount due under this agreement as of June 30, 1998 was \$7,251,577.

Subsequent to the date of the accompanying financial statements, the total balance due of \$16,252,534 to MSC was paid directly by Department of Treasury of Puerto Rico with legislative appropriations.

The Administration accumulated debts for the years 1988 to 1994 to the Puerto Rico Medical Service Administration (PRMSA) in the amount of \$39,516,288. PRMSA is a governmental instrumentality of the Commonwealth of Puerto Rico, and a component unit of the Department. PRMSA provides auxiliary and ancillary medical services, and commercial and administrative services to several hospitals of the Administration. On March 2, 1995, the Administration signed

(Continues)

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 10 DUE TO OTHER AGENCIES (CONTINUED)

an agreement with PRMSA to pay \$3,516,288, as a down payment, and six annual installments of \$6,000,000 for services provided to the Administration during years 1988 to 1994. The annual installment is due each July 1<sup>st</sup> commencing in 1995. The total amount due under this agreement as of June 30, 1998 was \$18,000,000.

The Administration also makes advances to PRMSA for the services rendered. At the end of each fiscal year both instrumentalities have to reconcile the services rendered with the payments and the difference, if any, will be liquidated by corresponding party.

The schedule of contractual payments on amounts due to other agencies for the next three years follows:

<u>Year ending</u> <u>June 30,</u>	<u>Amount</u>
1999	\$131 561 062
2000	6 000 000
2001	<u>6 000 000</u>
	\$143 561 062
	=====

NOTE 11 FUND EQUITY (DEFICIT)

The enterprise fund's deficit balance in the fund equity section of \$930,414,910 is the cumulative result of revenues insufficient to cover expenses including depreciation.

NOTE 12 PENSION PLAN

The Employee's Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities (ERS) is a cost-sharing multiple-employer defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth of Puerto Rico. All regular employees of the Administration under age 55 at the date of employment become members of the System as a condition to their employment.

(Continues)

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 12 PENSION PLAN (CONTINUED)

The System provides retirement, death and disability benefits pursuant to Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

Members who have attained an age of at least fifty-five (55) years and have completed at least twenty-five (25) years of creditable service or members who have attained age of at least fifty-eight (58) years 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 one and one-half percent of the average compensation multiplied by the number of years of creditable service up to twenty years, plus 2 percent of the average compensation multiplied by the number of years of creditable service in excess of twenty years. In no case will the annuity be less than \$200 per month.

Participants who have completed at least thirty 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 or if they have attained fifty-five (55) years of age will receive 75% of the average compensation. Disability retirement benefits are available to members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten (10) years of service.

No benefit is payable if the participant receives a refund of his accumulated contributions.

(Continues)

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 12 PENSION PLAN (CONTINUED)

Commonwealth legislation requires employees to contribute 5.775% for the first \$6,600 of their annual gross salary and 8.275% for the salary in excess of \$6,600 for employees hired on or before March 31, 1990. For employees hired on or after April 1, 1990 the required contribution is 8.275% of gross salary. The Administration's contributions are 9.275% of gross salary. Total employee and employer contributions during the year ended June 30, 1998 amounted to approximately \$12,601,000 (\$14,315,000 in 1997) and approximately \$15,065,000 (\$17,158,000 in 1997), respectively. Total payroll covered for the year was approximately \$156,372,000 (\$175,513,000 in 1997).

For the two preceding fiscal years the Administration contributed approximately \$17,158,000 and \$14,818,000 in 1997 and 1996, respectively, which represented 100% of required contributions.

No pension liability or asset was recorded at the beginning of the year measured in accordance with SGAS 27.

Additional information on ERS is provided in its financial statements for the year ended June 30, 1998, a copy of which can be obtained from Mr. Andrés Barbeito, Administrator, Retirement System Administration, PO Box 42003, San Juan, Puerto Rico 00949.

On July 28, 1998, subsequent to the date of the accompanying financial statements, the Legislature of Puerto Rico approved the Law No. 182. This law provides to certain employees of the Commonwealth of Puerto Rico the option for early retirement. To qualify the employee should make an election between August 1, 1998 and November 2, 1998 and, among other requirements, must have twenty-five (25) years of creditable service or fifty-five (55) years or more of age. After November 2, 1998, the Administration has a period of 30 days to determine the feasibility to implement the Early Retirement Plan.

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 13 PRIOR PERIOD ADJUSTMENTS

The deficit balance at beginning of 1998 was adjusted to correct an error on the accounts payable balance as of June 30, 1997. The effect of this correction was to increase the deficit by \$15,978,201.

In 1997, the Administration corrected the accounting for certain lease contracts to conform with the requirements of the Financial Accounting Standards Board. Leases that had previously been accounted for as operating leases and that met certain criteria were classified as capital leases, and the related property and lease obligations were recorded as assets and liabilities. The effect of capitalizing these contracts was to increase the deficit at the beginning of 1997 by \$829,820.

In addition, the deficit at the beginning of 1997 was adjusted to correct various accruals made before 1996 and the amount due from the Federal Government. The net effect of the adjustment was to increase the deficit by \$5,128,222.

The deficit balance at the beginning of 1997 was also adjusted to correct an accounting error in 1996 regarding the estimated receivable from third party payor settlements for Medicare in the amount of \$2,654,057. The effect of the correction of this error was to increase the deficit at beginning of the year by \$2,654,057 in 1997.

NOTE 14 COMMITMENTS

- A. The Administration leases certain facilities and equipment under various leases treated as operational lease contracts. Total rental expense under operating leases amounted to approximately \$17,829,000 for the year ended June 30, 1998 (\$4,247,000 in 1997).

(Continues)

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 14 COMMITMENTS (CONTINUED)

Future commitments under existing non-cancelable operating lease agreements for facilities and equipment as of June 30, 1998 are as follows:

<u>Year ending</u> <u>June 30,</u>	<u>Minimum</u> <u>lease payments</u>
1999	\$ 2 050 122
2000	535 993
2001	171 110
2002	10 955
2003	<u>3 175</u>
	\$ 2 771 355
	=====

- B. Both the Department and the Administration, as part of the Health Care Reform, have entered into various lease agreements as lessors for certain properties consisting principally of health facilities. The Health Care Reform contemplates the privatization of health facilities where the health plan has already been established.

On October 8, 1997, the Department and the Administration had to recover the health facilities of nine institutions which were not managed according to the terms of the lease contracts. From the nine institutions, two were sold during year ended June 30, 1998. Also, on July 23, 1998, subsequent to the date of the accompanying financial statements the Administration recovered other four institutions, and another one on November 2, 1998.



COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 15 CONTINGENCIES

Litigations

The Administration is a defendant and co-defendant in numerous lawsuits arising from normal operations. The claims include breach of contract, torts, medical malpractice and employees related cases. Preliminary hearings and discovery proceedings are in progress. In the opinion of the Administration's legal counsel, it is not possible to predict at this time the extent of the Administration's liability, if any.

The Secretary of Justice of the Commonwealth of Puerto Rico reports that numerous lawsuits have been filed against the Administration, but that according to the laws of Puerto Rico, the Administration is fully represented by the Department of Justice in the defense of those cases, and any successful claims would be paid from the General Fund of the Commonwealth of Puerto Rico, with no effect on the functional budget of the Administration. Accordingly, the Administration has not recorded in the financial statements a provision for the settlement of such claims, if any.

Federal and State Programs

The Administration participated in numerous Federal and State assisted grant programs. These programs are subject to financial and compliance audits by the grantors or their representatives. As of June 30, 1998, the audits of certain grant programs have not been completed. Accordingly, the Administration's compliance with applicable grant requirements will be determined at a later date. In the opinion of the management of the Administration, expected disallowance will not have a material effect on the financial statements as of June 30, 1998. Effective on October 1, 1995 all federal programs were transferred to the Department of Health for their administration. Refer to Note 7.

(Continues)

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 15 CONTINGENCIES (CONTINUED)

WIC Program

In August 1994, the Department of Health Internal Audit Division and the Federal Agriculture Department Audit Division, started an evaluation of the internal compliance and special requirements governing the WIC Program. In addition, the audit divisions investigated the price list of food products and the acquisition of nutrition food of participants with the vendors. On September 8, 1995, the Department accepted the final result of charging indirect cost based on an expired rate from the Food and Consumer Service. The settlement required the Administration to pay \$3,094,588 (\$2,913,823 principal and \$180,765 in interest) in two installments of \$1,037,250 (August 1995 and 1996) and a last payment of \$1,020,088 in 1997.

Line of credit

On May 4, 1994, the Administration entered into a revolving line of credit agreement with the Government Development Bank for Puerto Rico which provides for borrowings up to a maximum of \$200,000,000 through June 30, 1997. During 1997, the line of credit available was increased to \$332,000,000. Borrowings outstanding under this revolving line of credit bear variable interest and are payable quarterly before the tenth (10) day of July, October, January and April. Advances under the revolving line of credit are made only upon the authorization of the Director of the Office of Management and Budget of the Commonwealth of Puerto Rico. The line of credit is guaranteed by a note payable for the same amount and it will be used solely for the purpose of implementing the Health Care Reform. As of June 30, 1998, \$294,752,305 were outstanding on this line, with an annual interest rate of 6.71%. The proceeds of the line of credit were recorded in the financial statements of the Puerto Rico Health Insurance Administration, a component unit of Commonwealth. In the opinion of the management of the Administration, this line of credit does not constitute a debt of the Administration and is not reflected in the accompanying financial statements. The Administration has not been called to make any direct payment on this line of credit.

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 16 CONCENTRATION OF CREDIT RISK

In addition to cash secured by collateral as described in Note 4, another financial instrument that potentially subjects the Administration to a concentration of credit risk is its accounts receivable.

The Administration provides health services to patients located in Puerto Rico. The Administration grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements and the credit losses are provided for currently through the allowance for doubtful accounts.

NOTE 17 SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION

In 1997, the Administration capitalized property and equipment under capital lease with an aggregate cost of approximately \$76,767,000.

During the year 1998, the Government Development Bank made advances from lines of credit for \$182,579,378 (\$196,346,084 in 1997) to the Administration. The proceeds from these loans were deposited directly in the Department of Treasury on behalf of the Administration. In addition, the Department of Treasury made a payment to the Government Development Bank for the principal amount of \$24,018,917 (\$50,864,252 in 1997) on behalf of the Administration.

The amount of \$5,418,962 in 1998 paid to the Medical Sciences Campus of University of Puerto Rico was processed by the Department of Health on behalf of the Administration.

The funds that were transferred from the Government Development Bank to the Administration for the sale of health facilities amounting to \$20,383,790 were deposited directly in the Department of Treasury.

(Continues)

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 17 SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION  
(CONTINUED)

In 1998, the Administration retired from its books the net book value of the Psychiatry Hospital, for the amount of \$2,876,915, since the correctional program was transferred away from the Administration. This transaction was recorded in the financial statements as a non-operating revenue.

Other payments made by the Department of Treasury on behalf of the Administration as of June 30, 1998 and 1997 are as follows:

	<u>1998</u>	<u>1997</u>
Public Building Authority	\$33 008 994	\$12 161 886
	=====	=====
Puerto Rico Medical Services Administration	\$60 721 105	\$ 6 000 000
	=====	=====
Medical Sciences Campus of the University of Puerto Rico	\$ -	\$ 5 418 962
	=====	=====
Puerto Rico Electric Power Authority	\$16 748 991	\$ -
	=====	=====
Puerto Rico Telephone Company	\$ 1 480 703	\$ -
	=====	=====
Puerto Rico Water and Sewer Authority	\$ 1 138 500	\$ -
	=====	=====

NOTE 18 INTERNAL REVENUE SERVICE AUDIT

During the fiscal year 1997-98, an Internal Revenue Service examination was conducted for the calendar years 1995 and 1996. The examination resulted in the reclassification of sub-contracted independent contractors to employees under the Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA). Also, the Administration has the responsibility to verify and calculate any underpaid contributions for years 1997 and 1998. Even though a final settlement has not been signed, the opinion of management is that an estimate of \$4,000,000 will be the additional tax to be contributed for the four years, including interest. This amount was accrued as of June 30, 1998 in the accompanying financial statements.

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 19 YEAR 2000 ISSUE

The Department of Health of the Commonwealth of Puerto Rico is responsible for the Y2000 compliance for the Department and other related component units for which the Department provides electronic data processing service and support. The Administration is one of these component units. A preliminary status report of year 2000 compliance indicates that the Department is significantly behind schedule in its compliance implementation which is estimated at a cost of approximately \$3,000,000.

Even though there is a plan to completely liquidate the Administration by June 30, 1999 (refer to Note 21A) certain critical computerized applications used by the Administration, may be significantly affected if the Department is not successful in the implementation of its year 2000 compliance plan.

NOTE 20 SALE OF HEALTH FACILITIES

Pursuant to the Act No. 190 of September 5, 1996, as amended, the Commonwealth through the Department of Health, the Administration and the Government Development Bank for Puerto Rico (GDB) sold eighteen health facilities to the private sector during the year ended June 30, 1998. The GDB, as liquidator, receives the proceeds of each sale, and out of them, funds are partially transferred to the Administration. From the facilities sold during the fiscal year 1997-98, the Administration received \$20,383,790 in February 1998 and subsequent to the date of the accompanying financial statements it received \$13,814,084.

There is no formal plan for the distribution of the proceeds received from the sales. As a result, the Administration recorded as proceeds from sales the amounts transferred, retired the assets, the accumulated depreciation and the related obligations. The difference was recorded as a gain from the sale of facilities.

Subsequent to June 30, 1998, the Commonwealth sold other health facilities to private investors and will continue to do so during fiscal year 1998-99.

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF HEALTH  
HEALTH FACILITIES AND SERVICES ADMINISTRATION

NOTES TO FINANCIAL STATEMENTS

NOTE 21 SUBSEQUENT EVENTS

A. Act No. 187 of August 7, 1998

On August 7, 1998 the Legislature of the Commonwealth of Puerto Rico enacted Act No. 187 which has the effect to repeal the law that created the Health Facilities and Service Administration effective on or before June 30, 1999 and consolidate it with the Department of Health of the Commonwealth of Puerto Rico. Said Act empowers the Secretary of Health in conjunction with the Management and Budget Office and the approval of the Governor of Puerto Rico, to carry out the necessary measures to consolidate the facilities and obligations of the Administration with the Department. In addition, the Law authorizes the Secretary of Health and the Secretary of Transportation and Public Works to dispose of health facilities either through sale or lease in accordance with the regulations established for these purposes.

B. Act No. 223 of August 9, 1998

On August 9, 1998 the Legislature of the Commonwealth of Puerto Rico enacted Act 223 which authorize the Administration to restructure and refinance the balance of the lines of credit with the Government Development Bank, and to consolidate them into one long-term debt in an amount up to \$595,000,000 to be paid in a period of twenty years at an interest rate not to exceed 7.25%. Refer to Note 8.

C. Hurricane Georges

On September 21, 1998, subsequent to the date of the accompanying financial statements, Puerto Rico was affected by Hurricane Georges. The preliminary estimated costs for the damages to facilities of the Administration amounted to \$6,500,000. Management considers that the losses incurred will be recovered from the insurance policies in force, and the Federal Emergency Management Agency, and that, other losses not covered will not affect significantly the financial statements of the Administration.