STATE INSURANCE FUND CORPORATION

(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and
Required Supplementary Information
as of and for the year ended June 30, 2011,
and Independent Auditors' Report

STATE INSURANCE FUND CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)

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SCHERRER
HERNANDEZ & CO.
Member of Polaris International

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
State Insurance Fund Corporation:

We have audited the accompanying statement of net assets of State Insurance Fund Corporation (the "Corporation") (a component unit of the Commonwealth of Puerto Rico) as of June 30, 2011, and the related statements of revenues, expenses and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements 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 State Insurance Fund Corporation as of June 30, 2011, and the changes in its net assets, 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 January 17, 2012 on our consideration of the Corporation's internal controls over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. This 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.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying management's discussion and analysis is not a required part of the basic financial statements, but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries to management regarding the methods of measurement and presentation of the required supplementary information. We did not audit such information and express no opinion on it.

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Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The required supplementary information comprising the Ten-Year Claims Development Information and the Schedules of Funding Progress and Employer Contributions for Pension Costs and Postemployment Benefits Other than Pensions on pages 49 thru 52, are not a required part of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries to management regarding the methods of measurement and presentation of the required supplementary information. We did not audit such information and express no opinion on it.

Scherer Hernández & Co.

San Juan, Puerto Rico

January 17, 2012

Certified Public Accountants
(of Puerto Rico)
License No. 53 expires December 1, 2012
Stamp 2619553 of the P.R. Society of
Certified Public Accountants has been
affixed to the file copy of this report

INTRODUCTION

State Insurance Fund Corporation (the "Corporation") is a component unit of the Commonwealth of Puerto Rico (the "Commonwealth") created by Law No. 45 of April 18, 1935, as amended, known as the Workmen Compensation Insurance Act (the "Act"). Under the provisions of the Act, the Corporation is the exclusive provider of insurance coverage for work related accidents, deaths, and illnesses suffered by workers in Puerto Rico. On October 29, 1992, the Act was amended by Law No. 83 to convert the agency into a governmental corporation and to establish the functions and responsibilities of the Board of Directors, the Administrator and the Industrial Medical Advisory Board.

The Act provides that the Corporation's administrative expenses shall not exceed 22% of the total insurance premiums collected during the previous fiscal year. Administrative expenses exclude depreciation and amortization expense, provision for (recoveries of) uncollectible accounts, interest expense and investment managers' fees. The Corporation complied with this requirement of the Act for the year ended June 30, 2011.

This section presents a narrative overview and analysis of the financial performance of the Corporation as of and for the year ended June 30, 2011. The information presented here should be read in conjuction with the basic financial statements, including the notes thereto.

FINANCIAL HIGHLIGHTS

- Return on the average balance of investments and cash and cash equivalents was 8.54% in 2011 compared to 7.63% in 2010.

- Note payable to GDB was refinanced with a private financial institution. New interest rate is the 30 day LIBOR plus a 2.25% spread compared to an interest rate equal to the three month LIBOR plus a 4% spread.

- Decrease in salaries of $8.9 million in 2011 when compared to 2010.

- The actuarially determined expense of compensation benefits, medical benefits and benefit adjustment expenses went from a provision of $23.0 million in 2010 to a credit of $4.5 million in 2011.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

This discussion and analysis is required supplementary information to the basic financial statements and is intended to serve as an introduction to the basic financial statements of the Corporation. The Corporation is a self–supporting entity and follows the enterprise fund reporting; accordingly, the financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. Enterprise fund statements offer short and long term financial information about the activities and operations of the Corporation.

The basic financial statements include the following: (1) Statement of Net Assets, (2) Statement of Revenues, Expenses, and Changes in Net Assets, (3) Statement of Cash Flows, and (4) Notes to the Basic Financial Statements. The Corporation also includes additional information to supplement the basic financial statements.

The statement of net assets provides information on the Corporation's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Corporation is improving or deteriorating.

The statement of revenues, expenses and changes in net assets presents information on how the Corporation's net assets changed during the reporting period. Changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows.

The statement of cash flows shows changes in cash and cash equivalents, resulting from operating, non–capital and capital financing and investing activities, which include cash receipts and cash disbursements information.

The notes to the basic financial statements provide additional information that is essential for a full understanding of the data provided in the basic financial statements.

The required supplementary information consists of three schedules concerning the following: (1) the ten–year claims development information required by the Governmental Accounting Standards Board ("GASB") Statement No. 10, ***Accounting and Financial Reporting for Risk Financing and Related Insurance Issues***, as amended, (2) the supplementary information of the Corporation's Pension Costs as required by GASB Statement No. 27, ***Accounting for Pensions by State and Local Governmental Employers*** and, (3) the supplementary information of the Corporation's Postemployment Benefits other than Pensions Program as required by the GASB Statement No. 45, ***Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions***.

FINANCIAL ANALYSIS

The following is the condensed financial position of the Corporation as of June 30, 2011 and 2010:

Condensed Statement of Net Assets

	June 30,		Change	
	2011	**2010**	**Amount**	**Percent**
Assets:				
Cash and cash equivalents	$ 408,084,597	$ 346,443,297	$ 61,641,300	17.79%
Accounts receivable	187,587,822	114,085,344	73,502,478	64.43%
Investments	1,185,747,192	1,356,613,894	(170,866,702)	-12.60%
Other assets	105,181,982	100,017,778	5,164,204	5.16%
Total assets	1,886,601,593	1,917,160,313	(30,558,720)	-1.59%
Liabilities:				
Liability for incurred but unpaid benefits and benefit adjustment expenses	784,017,663	778,243,075	5,774,588	0.74%
Other liabilities	482,191,134	552,013,870	(69,822,736)	-12.65%
Note payable	242,000,000	220,000,000	22,000,000	10.00%
Total liabilities	1,508,208,797	1,550,256,945	(42,048,148)	-2.71%
Net assets:				
Invested in capital assets	25,676,516	17,357,200	8,319,316	47.93%
Restricted	72,600,000	-	72,600,000	-
Unrestricted	280,116,280	349,546,168	(69,429,888)	-19.86%
Total net assets	378,392,796	366,903,368	11,489,428	3.13%
Total liabilities and net assets	$ 1,886,601,593	$ 1,917,160,313	$ (30,558,720)	-1.59%

- **The Corporation's total assets decreased by $30.6 million in 2011 (or 2%)**

Total assets of the Corporation decreased from $1,917 million in 2010 to $1,887 in 2011. The decrease is mainly the result of the decrease investments offset by an increase in cash and cash equivalents and accounts receivable-net. Such decrease and the increases are interrelated. They are mostly the result of a redistribution of investments between money managers at the close of fiscal year 2011. The decrease in investments is also the result of a decrease in the amount of investments available for the securities lending program due to the fact that some of the investments are now pledged for the repayment of the note payable amounting to $242 million. As a result of this, investments held as collateral under the securities lending program decreased from $155.3 million in 2010 to $84.3 million in 2011. The increase in accounts receivable-net is directly related to the increase in securities sold but not yet delivered from $13.3 million in 2010 to $101.0 million in 2011.

- **The Corporation's total liabilities decreased by $42.0 million in 2011 (or 3%)**

Decrease in total liabilities to $1,508 million in 2011 from $1,550 million in 2010 is also related to the facts explained above. Liability in securities lending obligations in 2011 is $84,283,875 down from $155,341,866 in 2010 due to lower amounts of investments available for the securities lending program as a result of the pledge of Investments. Such decrease was offset with an increase in accounts payable amounting to $16.9 million and an increase in note payable of $22 million. Increase in accounts payable was due to an increase in securities purchased but not yet received of approximately $17.1 million due to the redistribution of the Investment portfolio between money managers. Increase of $22 million in note payable is due to the refinancing of the note payable to GDB with a private financial institution. Proceeds of the loan were used to repay a note payable and interest payable to the Government Development Bank for Puerto Rico ($223,273,000), purchase of two buildings ($8,490,000 for building purchased before June 30, 2011 and $10,100,000 for building purchased after June 30, 2011) and other purposes ($137,000).

Total liabilities also includes a reserve for both reported and unreported insured events (compensation and medical benefits), which includes an estimation of future payments and related adjustment expenses. This liability is developed by an independent actuary from historical benefit expenses and/or payments gathered by the Corporation. The liability for compensation and medical benefits is based on historical claims experience data, assumptions, and projections of future events, including the frequency, severity and persistency of the claims, as well as the inflationary trends. The accrual for reimbursement of premiums represents an estimate actuarially determined as a result of the settlement of premiums under the policies. The assumptions used in estimating and establishing these liabilities are reviewed annually based on current circumstances and trends.

The liability for incurred but unpaid compensation and medical benefits, including benefit adjustment expenses, increased by $5.8 million or 1% from $778.2 million at June 30, 2010, to $784.0 million at June 30, 2011. For the year ended June 30, 2011, incurred compensation and medical benefits amounted to $525.6 million; meanwhile, compensation and medical benefits payments amounted to $519.8 million for the year ended June 30, 2011.

- **The Corporation's net assets increased by $11.5 million in 2011 (or 3%)**

As of June 30, 2011, the Corporation had $280.1 million in net assets categorized as unrestricted assets, $72.6 million in restricted assets and $25.7 million invested in capital assets-net of related debt, for a total net asset of $378.4 million. In fiscal year 2011, net assets increased by $11.5 million or 3%, from $366.9 million as of June 30, 2010, due to a net non-operating revenue of $129.5 million, net of an operating loss of $66.8 million and of a net transfers to other governmental agencies of $51.2 million.

The following summarizes the condensed changes in net assets of the Corporation for the years ended June 30, 2011 and 2010:

Condensed statement of revenues, expenses and changes in net assets (in thousands):	2011	2010	Change	
Operating revenues	$ 600,160	$ 628,442	$ (28,282)	-4.50%
Operating expenses:				
Compensation and medical benefits	525,007	556,650	(31,643)	-5.68%
General and administrative	141,944	147,394	(5,450)	-3.70%
Total operating expenses	666,951	704,044	(37,093)	-5.27%
Operating loss	(66,791)	(75,602)	8,811	-11.65%
Non–operating revenues (expenses) – net	129,458	124,097	5,361	4.32%
Transfers to other governmental agencies – net	(51,178)	(43,798)	(7,380)	16.85%
Changes in net assets	11,489	4,697	6,792	144.60%
Net assets – beginning of the year, as previously reported	366,903	356,760	10,143	2.84%
Prior period adjustments	-	5,446	(5,446)	-100.00%
Net assets – beginning of the year, as restated	366,903	362,206	4,697	1.30%
Net assets – end of year	$ 378,392	$ 366,903	$ 11,489	3.13%

The Corporation recognizes as income the subscribed premiums, which represent the preliminary premiums assessed at the beginning of the fiscal year plus additional premiums imposed or expected to be imposed as a result of the final settlement of premiums under the insurance policy or reduced by any unearned or reimbursable portion or provision for uncollectible accounts, as determined. Premiums are based on individual employers' reported payroll ledgers using predetermined insurance rates based on the employers' risk classifications. The regular policies are issued for a one–year period consistent with the Corporation's fiscal year, which runs from July 1 to June 30. Incidental policies are issued to cover special risks over a pre-determined period of time. Unearned premiums represent the remaining portion at the end of the fiscal year, which is attributed to the unexpired term of the incidental policies issued during the fiscal year.

Policy costs consist mainly of salaries and certain underwriting expenses. Benefits are recorded on an accrual basis, which includes benefit paid and a liability to cover estimated incurred but unpaid benefits and benefit adjustments expenses based on the ultimate settling cost, as determined by the independent actuary.

- **Operating revenues decreased by $28.3 million in 2011 (or 5%)**

Operating revenues decreased by $28.3 million or 5% during the year ended June 30, 2011. The decrease in operating revenues was primarily due to the increase of $55.9 million in the provision for uncollectible insurance premiums offset by an increase of $29 million in insurance premiums earned.

- **Compensation and medical benefits decreased by $31.6 million in 2011 (or 6%)**

Compensation and medical benefits decreased by $31.6 million or 6% during the year ended June 30, 2011. Compensation benefits for the year ended June 30, 2011 amounted to $175.5 million, an increase of $4.1 million or 2%, when compared to $171.4 million for the prior year. The increase is related to Law No. 263 of September 8, 2004, which amends Law 45 of 1935, raising the compensation payment to injured workers for partial permanent disability, total permanent disability and death. Medical benefits for the year ended June 30, 2011 amounted to $354 million, a decrease of $8.3 million or 2%, when compared to $362.3 million for the prior year. Such lower expenses are mainly related to the efforts of management to decrease the controllable costs like salaries and contracted services.

The main driver for the decrease in compensation and medical benefits was a decrease from a provision for compensation benefits, medical benefits and benefits adjustments expenses amounting to $22.9 million in 2010 to a credit for compensation benefits, medical benefits and benefits adjustments expenses amounting to $4.5 million in 2011 for a net change of $27.4 million. This net change from 2010 to 2011 was mainly caused by an increase in the discounting factor used to calculate the present value of the estimated outstanding losses as determined by the independent actuary. Such discounting factor is based on the investment yield of the Corporation (4.2% in 2011 and 3.8% in 2010).

- **General and administrative expenses decreased by $5.5 million in 2011 (or 4%)**

General and administrative expenses decreased by $5.5 million or 4% during the year ended June 30, 2011 mainly as a result of decreases in salaries due to the continued efforts of management of controlling this cost.

- **Non–operating revenues-net increased by $5.4 million in 2011 (or 4%)**

Net non–operating revenues represent principally interest and dividend income, net change in fair value of investments, including derivative instruments, and interest expense. Government accounting policies requires that investments be carried at fair value; thus realized gains and losses from the sale of securities and unrealized changes in the fair value of outstanding securities are recorded through operations.

The investments in debt and equity securities continued to be positively impacted by the US market improvement in fiscal year 2011. Net increase in fair value of investments, including derivative instruments, amounted to $100.3 million in 2011, an increase of $11.0 million or 12% when compared to an increase in fair value of investments of $89.3 million in 2010. On the other hand, interest and dividend income, net of costs (investment managers' fees) amounted to $40.7 million in 2011, a decrease of $2.0 million or 5%, when compared to $42.7 million in 2010.

Interest expense amounted to $11.3 million in 2011, an increase of $3.7 million or 49%, when compared to $7.6 million in 2010.

- **Transfers to other governmental agencies-net increased by $7.4 million in 2011 (or 17%)**

Net transfers to other governmental agencies increased by $7.4 million or 17% during the year ended June 30, 2011 mainly as a result of the transfers to the Department of Labor and Human Resources, Job Training Program for Puerto Rico's New Workforce, which were made in accordance with Executive Order OE-2011-016, which requires the Corporation to transfer $7,500,000 for fiscal years 2011 and 2012.

The Corporation is required by legislation to transfer to other governmental agencies funds for programs related to injured employees and their families. During the year ended June 30, 2011, the Corporation transferred funds to the Industrial Commission of Puerto Rico, the Department of Labor and Human Resources, the Department of the Family, Puerto Rico Housing Finance Authority and the Labor Affairs Office amounting to $51.2 million compared to $43.8 million in 2010.

CAPITAL ASSETS AND LONG-TERM DEBTS

- **Capital assets-net increased by $5.7 million in 2011 (or 6%)**

Capital assets are comprised of buildings used to render services to workers, medical and offices' equipment, motor vehicles and assets under capital lease. During the year ended June 30, 2011 capital assets, net of depreciation and amortization, increased by $5.7 million or 6% mainly due to the acquisition of a building for the amount of $8.5 million offset by depreciation and amortization expense of $4.7 million. Refer to Note 6 to the basic financial statements for further information regarding the Corporation's net capital assets.

- **Note payable increased by $22.0 million (or 10%)**

On May 11, 2011, the Corporation entered into a loan agreement ("the Loan") with a private financial institution for the amount of $242,000,000. The Loan matures on May 1, 2028 and carries a variable interest rate of 30 day LIBOR plus a 2.25% spread. This loan requires the Corporation to comply with certain restrictive covenants, which, in the event of non–compliance, provide the financial institution the right to declare the outstanding debt as due and payable in cancellation of the loan agreement. One of the covenants requires the Corporation to pledge 130% of the outstanding principal on the loan in securities in its investment portfolio. Proceeds of the loan were used to repay a note payable and interest payable to the Government Development Bank for Puerto Rico ($220,000,000 principal and $3,273,000 in interest), purchase of two buildings ($8,490,000 for building purchased before June 30, 2011 and $10,100,000 for building purchased after June 30, 2011) and other purposes ($137,000).

CONTACTING THE CORPORATION'S FINANCIAL MANAGEMENT

This report is designed to provide all interested parties with a general overview of the Corporation's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to State Insurance Fund Corporation, PO Box 365028, San Juan, Puerto Rico, 00936-5028.

STATE INSURANCE FUND CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF NET ASSETS
JUNE 30, 2011

ASSETS	2011
CURRENT ASSETS:	
Cash and cash equivalents	$ 404,361,054
Accounts receivable-net	187,587,822
Inventories	6,401,157
Prepaid expenses	300,960
Investments	510,244,144
Total current assets	1,108,895,137
NON-CURRENT ASSETS:	
Investments	364,626,591
Restricted assets:	
Cash and cash equivalents	3,723,543
Investments	310,876,457
Capital assets-net of accumulated depreciation/amortization:	
Land	13,010,166
Depreciable assets, including software	85,469,699
Total non-current assets	777,706,456
TOTAL ASSETS	$ 1,886,601,593
LIABILITIES AND NET ASSETS	
CURRENT LIABILITIES:	
Liability for incurred but unpaid benefits and benefit adjustment expenses	$ 196,708,048
Accounts payable	90,351,716
Accrued liabilities	35,035,559
Unearned premiums	25,708,661
Accrual for reimbursement of premiums	60,889,772
Securities lending obligations	84,283,874
Current portion of:	
Other notes payable	3,991,864
Obligation under capital lease	563,908
Total current liabilities	$ 497,533,402

(Continued)

The accompanying notes are an integral part of these financial statements.

STATE INSURANCE FUND CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF NET ASSETS
JUNE 30, 2011

NON-CURRENT LIABILITIES:	
Liability for incurred but unpaid benefits and benefit adjustment expenses	587,309,615
Accrued liabilities	45,907,975
Accrual for reimbursement of premiums	67,210,228
Other notes payable	37,651,432
Obligation under capital lease	30,596,145
Liabilities payable from restricted assets:	
Note payable-due in more than one year	242,000,000
Total non-current liabilities	1,010,675,395
Total liabilities	$ 1,508,208,797
COMMITMENTS AND CONTINGENCIES (Notes 19 and 20)	
NET ASSETS:	
Invested in capital assets-net of related debt	25,676,516
Restricted	72,600,000
Unrestricted	280,116,280
Total net assets	378,392,796
TOTAL LIABILITIES AND NET ASSETS	$ 1,886,601,593

(Concluded)

The accompanying notes are an integral part of these financial statements.

STATE INSURANCE FUND CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2011

	2011
OPERATING REVENUES:	
Insurance premiums earned	713,610,692
Miscellaneous income-net	1,755,175
Plus (less):	
Reimbursement of insurance premiums	(62,419,335)
Provision for uncollectible insurance premiums	(52,786,369)
Total operating revenues	600,160,163
OPERATING EXPENSES:	
Compensation benefits	175,458,283
Medical benefits and legal fees	354,036,388
Provision for compensation benefits, medical benefits, and benefit adjustment expenses	(4,488,105)
Administrative expenses	137,284,819
Depreciation and amortization	4,659,111
Total operating expenses	666,950,496
OPERATING LOSS	(66,790,333)
NON–OPERATING REVENUES (EXPENSES):	
Interest and dividend income-net	40,748,385
Net increase in fair value of investments	100,340,401
Cost of securities lending transactions	(309,838)
Interest on notes payable and obligation under capital lease	(11,320,734)
Total non–operating revenues-net	129,458,214
REVENUE BEFORE TRANSFERS TO OTHER GOVERNMENTAL AGENCIES	62,667,881
TRANSFERS TO OTHER GOVERNMENTAL AGENCIES	(51,178,453)
CHANGES IN NET ASSETS	11,489,428
NET ASSETS-Beginning of year	366,903,368
NET ASSETS-End of year	$ 378,392,796

The accompanying notes are an integral part of these financial statements.

STATE INSURANCE FUND CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2011

	2011
CASH FLOWS FROM OPERATING ACTIVITIES:	
Excess of collections over reimbursements of insurance premiums	$ 608,147,719
Payments of compensation benefits	(164,857,609)
Payments of medical benefits and legal fees	(325,198,964)
Payments of administrative expenses	(190,774,152)
Net cash used in operating activities	(72,683,006)
CASH FLOWS FROM NON–CAPITAL FINANCING ACTIVITIES:	
Transfers to governmental agencies	(51,178,453)
Decrease in securities lending obligations	(71,058,012)
Proceeds from note payable	242,000,000
Payments of note payable to Government Development Bank	(220,000,000)
Payments of interest on note payable to Government Development Bank	(5,105,027)
Payments of securities lending transaction costs	(309,838)
Net cash used in non–capital financing activities	(105,651,330)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:	
Acquisition of capital assets	(10,309,473)
Payments of notes payable-net of imputed interest	(2,159,647)
Payments of obligation under capital lease	(509,307)
Payments of interest on notes payable and obligation under capital lease	(6,791,782)
Net cash used in capital and related financing activities	(19,770,209)
CASH FLOWS FROM INVESTING ACTIVITIES:	
Proceeds from sales and redemptions of debt and equity securities	1,771,962,135
Purchases of debt and equity securities	(1,559,624,453)
Collections of interest and dividend income	42,481,550
Cash received on derivative transactions	4,571,430
Collections in excess of originations of employees loans	355,183
Net cash provided by investing activities	259,745,845
NET INCREASE IN CASH AND CASH EQUIVALENTS	61,641,300
CASH AND CASH EQUIVALENTS-Beginning of year	346,443,297
CASH AND CASH EQUIVALENTS-End of year	$ 408,084,597

(Continued)

The accompanying notes are an integral part of these financial statements.

STATE INSURANCE FUND CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2011

RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES:		
Operating loss	$	(66,790,333)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization		4,659,111
Provision for uncollectible accounts		52,786,369
Changes in assets and liabilities:		
Decrease/(increase) in operating assets:		
Accounts receivable		(73,502,388)
Inventories		449,978
Prepaid expenses		36,089
Increase/(decrease) in operating liabilities:		
Liability for incurred but unpaid benefits and benefit adjustment expenses		5,774,588
Accounts payable		16,822,788
Accrued liabilities		(9,140,399)
Unearned premiums		1,780,191
Accrual for reimbursement of premiums		(5,559,000)
Net cash used in operating activities	$	(72,683,006)
SUMMARY OF NON–CASH TRANSACTIONS:		
Securities purchased but not yet received	$	26,160,308
Securities sold but not yet delivered	$	100,956,099
Net increase (unrealized) in the fair value of investments	$	18,338,449
Accretion of discount on investments	$	92,022
Transfers payable to other governmental agencies		
Retirement of capital assets -		
Cost	$	204,157
Accumulated depreciation	$	204,157

(Concluded)

The accompanying notes are an integral part of these financial statements.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization-State Insurance Fund Corporation (the "Corporation") is a discretely presented component unit of the Commonwealth of Puerto Rico (the "Commonwealth") created by Law No. 45 of April 18, 1935, as amended, known as the Workmen Compensation Insurance Act (the "Act"). The objectives of the law are to:

- protect workers against the effects of employment related accidents and illness;
- establish employers' responsibility to insure its employees;
- establish the type of insurance coverage; and
- regulate the insurance coverage to make it mandatory for employers.

This insurance covers workers against injuries, disability or death because of work or employment related accidents, or because of illness suffered as a consequence of their employment. On October 29, 1992, the Act was amended by Law No. 83 to convert the agency into a governmental corporation and to establish the functions and responsibilities of the Corporation's Board of Directors and Administrator, and the Industrial Medical Advisory Board.

Summary of Significant Accounting Policies-The accounting and reporting policies of the Corporation conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities. The Corporation follows Governmental Accounting Standards Board ("GASB") Statement No. 55, "*The Hierarchy of Generally Accepted Principles for State and Local Governments*", in the preparation of its financial statements.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Following is a description of the most significant accounting policies:

Basis of Accounting-The Corporation accounts for insurance premiums, claim costs, acquisition costs, loss contingencies and others related costs in accordance with provisions of the GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, as amended, which requires that the financial statements of the Corporation be presented on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America.

Basis of Presentation-The Corporation's financial statements are presented as an enterprise fund and conform to the provisions of GASB Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis- for State and Local Governments*. GASB Statement 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 statement of net assets and the statement of revenues, expenses, and changes in net assets report information on all activities of the Corporation. The statement of net assets presents the Corporation's assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- Invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- Restricted net assets result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation. As of June 30, 2011, the Corporation's restricted net assets amounted to $72,600,000. Refer to Note 11 for restrictions related to new note payable.
- Unrestricted net assets consist of net assets that do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, in order to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on use that are imposed by management, but such constraints may be removed or modified.

The statement of revenues, expenses, and changes in net assets presents information on how the Corporation's net assets changed during the reporting period. The Corporation distinguishes operating revenues and expenses from non–operating items. Operating revenues and expenses are those that result from the Corporation providing the services that correspond to their principal ongoing operations, which include those that result from providing insurance coverage and compensation benefits to the injured and disabled workers, including death benefits. Revenues and expenses not meeting these definitions are reported as non–operating revenues and expenses.

The statement of cash flows shows changes in cash and cash equivalents, resulting from operating, non-capital and capital financing and investing activities, which include cash receipts and cash disbursements information.

As permitted by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and other Governmental Entities that Use Proprietary Fund Accounting*, the Corporation has elected to apply all Financial Accounting Standards Board authoritative guidance issued after November 30, 1989 that does not conflict with those issued by GASB.

Revenue Recognition and Unearned Premiums-The Corporation recognizes as income the subscribed premiums, which include the preliminary premiums assessed at the beginning of the fiscal year plus additional premiums imposed as a result of the final settlement of premiums under the insurance policy during the year and an estimate for additional premiums not yet imposed. Premiums are based on individual employers' reported payroll ledgers using predetermined insurance rates based on employers' risk classifications. The regular policies are issued for a one–year period consistent with the Corporation's fiscal year, which runs from July 1 to June 30. Incidental policies are issued to cover special risks over a pre-determined period of time. Unearned premiums represent the remaining portion at the end of the fiscal year, which is attributed to the unexpired term of the incidental policies issued during the fiscal year.

Insurance premiums due to the Corporation are recorded as insurance premiums receivable, net of the allowance for uncollectible accounts. Premiums receivable consist of both billed and unbilled amounts. Unbilled amounts include premiums for policies, which have not been assessed plus an estimate for additional premiums that are expected to be imposed as a result of the final settlement of premiums under the insurance policy.

The estimates made for the additional and the reimbursable premiums are based on previous experience. The difference between the estimated and the actual amount of the premiums and the reimbursable premiums is recorded in the year when it is determined. The estimate of additional premiums is determined by management and covers the result of the final settlement of premium under the policies and through the audit of the employers' payroll ledgers. The accrual of premiums to be reimbursed represents an estimate actuarially determined based on the historical and projected results of the settlement of premiums under the policies. These amounts are estimates, and while the Corporation believes such amounts are reasonable, there can be no assurance that the amounts ultimately received or disbursed will equal the recorded amounts.

The accrual for reimbursement of premiums was discounted to reflect the present value of future reimbursable premium payments using a discounting factor of 4.62% at June 30, 2011. Management believes that discounting such liability results in a better matching of costs and revenues since reimbursable premiums have a long payment cycle.

Current and non–current portions of the liability for reimbursement of premiums are based on projected actuarially determined payments.

Policy Acquisition Costs-Acquisition costs consists of salaries and certain underwriting expenses, which are primarily related to the issuance of new policies. These costs are expensed as incurred since regular policies are issued for a one–year period, which is consistent with the Corporation's fiscal year, July 1st to June 30th. Acquisition costs related to incidental policies with terms beyond one year are deemed to be insignificant and are charged to expense as incurred.

Reinsurance-The Corporation does not use reinsurance agreements to reduce its exposure to large losses.

Incurred but Unpaid Benefits and Benefit Adjustment Expenses-Benefit expenses are recorded as incurred. The Corporation establishes liabilities for estimated incurred but unpaid benefits and benefit adjustment expenses based on the ultimate estimated cost of settling the benefits.

Incurred but unpaid benefits and benefit adjustment expenses include: (a) individual case estimates for reported cases (b) aggregate accrual estimates for reported and unreported cases based on past experience modified for current trends, and (c) an estimate of expenses for investigating and settling cases. The liabilities for cases reported which have not been adjudged and cases incurred but not yet reported are estimated by an independent actuary. The estimated liability also includes cases under reconsideration or on appeal before the Industrial Commission of Puerto Rico, a governmental agency, for additional medical treatment or benefits.

The liabilities for incurred but unpaid benefits and benefit adjustment expenses were discounted to reflect the present value of future benefit payments using a discounting factor of 4.20% at June 30, 2011. Management believes that discounting such liability results in a better matching of costs and revenues since compensation benefits have a long payment cycle.

Management believes that the liability for incurred but unpaid benefits and benefit adjustment expenses, actuarially determined at June 30, 2011, is a reasonable estimate of the ultimate net cost of settling benefits and benefit expenses incurred. Because actual benefit costs depend upon such factors as duration of worker disability, medical cost trends, occupational disease, inflation, and other social and economic factors, the process used in computing the ultimate cost of settling benefits and expenses for administering benefits is necessarily based on estimates. The amount ultimately paid may be above or below such estimates. Adjustments resulting from changes in estimates of these liabilities are charged or credited to operations in the period in which they occur.

Current and non–current portions of the liability for estimated incurred but unpaid benefits and benefit adjustment expenses are based on projected actuarially determined payments.

Securities Purchased under Agreements to Resell-From time to time, the Corporation enters into purchases of securities under agreements to resell ("resell agreements"). The amounts advanced under these agreements generally represent short–term loans and are reflected as an asset. The securities underlying these agreements are usually held by the broker or his/her agent, with whom the agreement is transacted.

Investments-Investments in equity securities with readily determinable fair values and all investments in debt securities are carried at fair value. Money market investments with a remaining maturity at time of purchase of one year or less are carried at cost. Investment positions in 2a–7 like external investment pools are carried at the pools' share price. Fair value is determined based on quoted market prices and quotations received from independent broker/dealers or pricing service organizations. The Corporation has private equity investments, such as the Guayacán funds, whose fair values have been estimated in the absence of readily determinable fair values. This estimate is based on information provided by the underlying fund managers.

Securities transactions are accounted for on the trade date. Realized gains and losses from the sale of securities and unrealized changes in the fair value of outstanding securities are included in net increase (decrease) in fair value of investments. Realized gains and losses are computed as the difference between the proceeds of the sale and the original cost of the investment sold. Gains and losses on the sale of securities are determined based on the specific identification method.

Securities Lending Transactions-The Corporation accounts for and reports its security lending transactions in accordance with the provisions of GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions,* as amended. This statement establishes standards of accounting and financial reporting for securities lending transactions in which governmental entities (lenders) transfer their securities to broker–dealers and other entities (borrowers) for collateral and simultaneously agree to return the collateral for the same securities in the future.

Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets. Securities received as collateral are reported as assets if the Corporation has the ability to pledge or sell them without a borrower default. Liabilities resulting from these securities lending transactions also are reported in the statement of net assets. Securities lending transactions collateralized by letters of credit or by securities that the Corporation does not have the ability to pledge or sell unless the borrower defaults are not reported as assets and liabilities in the statement of net assets.

Allowance for Doubtful Accounts-The allowance for uncollectible insurance premiums and other receivables is an amount that management believes will be adequate to absorb possible losses on existing receivables that may become uncollectible based on evaluations of the collectability of the receivables and prior credit loss experience. Because of uncertainties inherent in the estimation process, the related allowance may change in the future.

Inventories- Inventories are stated at cost (first–in, first–out method).

Capital Assets-Capital assets are stated at cost. Depreciation and amortization expense is computed using the straight–line method over the estimated useful lives of the assets, or in the case of assets under capital lease, over the term of the lease, whichever is shorter. The Corporation records as capital expenditures, assets with an individual cost of more than $100. The useful lives of these assets are as follow:

Description	Useful Life
Building and improvements	3–50 years
Medical and office equipment	3–10 years
Information systems	3 years
Motor vehicles	5 years
Assets under capital leases	Lease–term

Expenditures for repairs and maintenance, which do not extend the useful lives of the assets, are charged to operations in the year incurred. At the time capital assets are sold or otherwise disposed, the cost and related accumulated depreciation are removed from the books and the resulting gain or loss, if any, is credited or charged to operations.

Compensated Absences-Compensated absences, such as unpaid vacation and sick leave pay, are accrued when incurred using the pay or salary rates in effect at the statement of net assets' date. The employees of the Corporation are granted 30 days of vacation and 18 days of sick leave annually. An additional amount is accrued for certain salary related benefits associated with the payment of compensated absences. In the event of employee resignation, an employee is reimbursed for accumulated vacation and sick leave days.

Pensions-The Corporation accounts for pension costs under the provisions of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers*. This statement establishes standards for the measurement, recognition and display of pension expense and related liabilities in financial statements of state and local governmental employers.

Postemployment Benefits Other Than Pensions-The Corporation accounts for postemployment benefits other than pensions ("OPEB") under the provisions of the GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This statement requires a systematic, accrual–basis measurement and recognition of OPEB cost (expense) over a period that approximates employees' years of service and provides information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan. GASB No. 45 allows employers to amortize the portion of the cost attributed to past service over a period not to exceed thirty (30) years.

Income Taxes-The Corporation, as a governmental corporation of the Commonwealth, is exempt from the payment of income taxes.

Statement of Cash Flows-The accompanying statement of cash flows is presented in accordance with the provisions of GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities that Use Proprietary Fund Accounting*. The provisions of GASB No. 34 require that the direct method be used to present the funds inflows and outflows of the Corporation. For purposes of the statement of cash flows, the Corporation considers all highly liquid debt instruments with maturities of three months or less when purchased to be cash equivalents.

Future Adoption of Accounting Pronouncements-The GASB has issued the following Statements:

- GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employers Plans*, which is effective for periods beginning after June 15, 2011.
- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which is effective for periods beginning after December 15, 2011.
- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus an amendment of GASB Statements No. 14 and No. 34*, which is effective for periods beginning after June 15, 2012.
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is effective for periods beginning after December 15, 2011.
- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which is effective for periods beginning after December 15, 2011.
- GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions-an amendment of GASB Statement No. 53*, which is effective for periods beginning after June 15, 2011.

Management is evaluating the impact that these statements will have on the Corporation's basic financial statements.

2. CASH AND CASH EQUIVALENTS

The Corporation's cash and cash equivalents as of June 30, 2011 are comprised of the following:

Description	Amount
Cash on hand	$ 209,814
Due from commercial banks	28,988,908
Total cash and due from banks	29,198,722
Interest bearing deposit accounts ("IBA's") with GDB:	
Due on demand	32,422,646
Certificates of deposit	25,842,792
Cash equivalents- IBA's	58,265,438
Cash equivalents- investments (see Note 3)	320,620,437
Total	$ 408,084,597

Custodial credit risk related to deposits is the risk that in the event of a financial institution failure, the Corporation's deposits might not be recovered. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance ($250,000 at June 30, 2011). At June 30, 2011, all securities pledged by depository institutions as collateral are held by a trustee of the Treasury Department of the Commonwealth. As of June 30, 2011, the Corporation had approximately $28,989,000 in depository balance with a financial institution, which was insured and/or collateralized.

Interest bearing deposits with GDB are uninsured and uncollateralized. These deposits are exposed to custodial credit risk.

Foreign currency risk is the risk that changes in exchange rates will adversely affect the value of a deposit. Cash in foreign currency amounted to $505,628 at June 30, 2011. Cash in foreign currency present minimal foreign currency risk at June 30, 2011.

See Note 3 for additional information related to credit risk, foreign currency risk and custodial credit risk on cash equivalent investments.

3. INVESTMENTS

The Board of Directors ("BOD") of the Corporation has enacted the Statement of Investment Policy, Guidelines and Objectives (the "SIPGO") with the objective of providing general and specific guidance for the maximization of resources available for the payment of benefits to injured workers as the pervasive goal of the workers' compensation coverage of its insurance program. SIPGO sets as the primary objective for the available funds, to maximize the yield of invested assets, while having the adequate liquidity to pay obligations as they become due. The strategic objective is accomplished through a proper mix of adequate time horizon, risk tolerance and return expectation, and is achieved through strategic assets allocation. SIPGO provides guidance for the strategic assets allocation including the internally managed short term funds, securities selection and related restrictions; sets the responsibilities of the BOD, the Corporation's management, investment consultants, portfolio managers, and custodians. The SIPGO establishes standards for review and communication of compliance with the prevailing policies and procedures. The SIPGO also provides that the Finance Committee of the BOD (the "Finance Committee") is responsible for implementing and monitoring the investment program of the Corporation. The Finance Committee meets on a quarterly basis.

The SIPGO allows management to purchase or enter into the following investment instruments:

- United States Government and agencies obligations
- Obligations of the Commonwealth, its agencies, municipalities, public corporations and instrumentalities
- Government National Mortgage Association (GNMA)
- Mortgage pass–through guaranteed by United States Government agencies other than GNMA, such as Federal Home Loan Mortgage Corporation (FHLMC) and Federal National Mortgage Association (FNMA), among others
- Mortgage and asset–backed securities
- Common and preferred stocks
- Corporate bonds and notes (convertible or non–convertible)
- Money market funds and bank–sponsored short–term investment fund
- Resell agreements
- Commercial paper
- Options, futures and interest–rate swap agreements for hedging and risk control purposes, as well as for the creation of synthetic products, which qualify under any of the foregoing investment categories
- Open–end mutual funds with acceptable underlying assets and rated AAA by Standard & Poor's or AAA by Moody's
- Puerto Rico Government Investment Trust Fund (PRGITF)
- Securities lending transactions

The SIPGO establishes limitations and other guidelines on amounts to be invested in the aforementioned investment categories and by issuer/counterparty and on exposure by country. In addition, such policy provides guidelines on the institutions with which investment transactions can be entered into. The BOD of the Corporation will determine, from time to time, other transactions that the Corporation may enter into. Certain investment transactions that are generally considered to carry a greater than normal risk require the prior approval of Government Development Bank for Puerto Rico ("GDB"), a component unit of the Commonwealth, before being executed.

The following table summarizes the type and maturity of investments held by the Corporation at June 30, 2011. Expected maturities will differ from contractual maturities, because counter parties may have the right to call or prepay obligations with or without call or prepayment penalties. No investment in any one issuer other than the U.S. government and its agencies and the Commonwealth and its agencies and instrumentalities, represented 5% or more of total investment portfolio at June 30, 2011.

Investment Type	Within One Year	After One to Five Years	After Five to Ten Years	After Ten Years	Total
U.S. Treasuries	$ 45,509,023	$ 71,458,128	$ 16,981,507	$ 28,031,171	$ 161,979,829
U.S. sponsored agencies bonds and notes:					
Federal Home Loan Bank (FHLB)	509,025	8,799,934	3,623,530		12,932,489
Federal Home Loan Mortgage Corporation (FHLMC)		2,443,894	2,468,566	1,331,856	6,244,316
Federal National Mortgage Association (FNMA)		2,327,336	343,158	1,301,777	3,972,271
Federal Farm Credit Bank (FFCB)		8,444,622	1,033,550		9,478,172
Other	3,468,195	1,578,315			5,046,510
Mortgage–backed securities:					
Government National Mortgage Association (GNMA)		30,278		6,926,286	6,956,564
FNMA		1,660,606	6,062,221	27,406,513	35,129,340
FHLMC		28,650,103	3,614,236	8,696,458	40,960,797
Collateralized mortgage obligations (CMO's) issued and/or guaranteed by:					
GNMA				24,324,414	24,324,414
FNMA			134,561	15,255	149,816
FHLMC			21,400	1,486,245	1,507,645
Commercial mortgages				35,501,664	35,501,664
Other					-
Asset–backed securities	513,627	35,000,275	786,650	3,854,666	40,155,218
Corporate bonds and notes	28,394,524	157,479,974	114,260,109	26,486,111	326,620,718
Foreign government bonds and notes	2,340,720	2,663,025	710,602		5,714,347
U.S. municipal notes	3,175,768	5,740,002	4,797,734	22,941,089	36,654,593
Commonwealth agency bonds		563,496	4,413,674	1,108,057	6,085,227
Money market funds	257,222,844				257,222,844
Indexed certificates of deposit	104,544,754				104,544,754
External investments pool-fixed-income securities	1,037,531				1,037,531
Investments held under securities lending transactions:					
Interest bearing deposits	18,000,000				18,000,000
Resell agreements	40,202,846				40,202,846
Commercial paper	14,036,938				14,036,938
Corporate bonds and notes	12,044,090				12,044,090
Total debt securities and fixed–income external investment pools	$ 530,999,885	$ 326,839,988	$ 159,251,498	$ 189,411,562	1,206,502,933
Equity securities					280,124,893
External investment pools — equity securities:					
Russell 1000 Growth Index Fund					2,066,064
Guayacan Private Equity Fund L.P. II					6,939,330
Guayacan Fund of Funds III, L.P.					10,734,409
Total					$ 1,506,367,629

As of June 30, 2011, investments were classified as current and non–current in the accompanying statement of net assets as follows:

Description	Amount
Current assets:	
Cash equivalents	$ 320,620,437
Investments in debt and equity securities	510,244,144
Total current assets	830,864,581
Non–current assets	675,503,048
Total	$ 1,506,367,629

The Corporation's investments presented as cash equivalents as of June 30, 2011 are comprised of the following:

Description	Amount
Interest bearing deposits held under securities lending transactions:	
Foreign certificates of deposit with other banks, due within three months	$ 3,000,000
Investments in debt securities held under securities lending transactions:	
Resell agreements, due overnight	25,202,846
Investments in:	
Money market funds	257,222,844
US Treasuries- US Treasury bills	35,194,747
	292,417,591
Total	$ 320,620,437

Investments in fixed–income external investment pools include $1,037,531 invested with the Puerto Rico Government Investment Trust Fund (the "PRGITF"), a government–sponsored pool, which is administered by the GDB. The PRGITF may purchase only high quality securities denominated in U.S. dollars that the investment advisors believe present minimal credit risk. The PRGITF had an average maturity of less than 60 days; accordingly, they were presented as investments with maturity of less than one year. The Corporation was exposed to custodial credit risk. This pool is subject to regulatory oversight by the Commissioner of Financial Institutions of Puerto Rico. The fair value of the pool is the same as the fair value of the pool shares.

The fair value of investments in limited partnerships as of June 30, 2011, amounted to approximately $17.7 million. The allocations of net gain and net loss to limited partners are based on certain percentages, as established in the limited partnership agreements. The investments in limited partnerships were as follows:

- During the fiscal year 2010, an additional investment of $1,000,000 was made in the Guayacán Private Equity Fund L.P. II, a Delaware limited partnership created by Grupo Guayacán, Inc., as General Partner, bringing the amount invested at June 30, 2011 to $6,897,516. The Corporation has a total commitment of $10.0 million. This fund seeks to provide investors with a superior investment return and extensive diversification by investing in nineteen (19) private equity investment partnerships in the United States and Europe. This fund also invests a portion of its assets in a Puerto Rico based private equity investment entity.

- During the fiscal year 2011, an additional investment of approximately $4,156,000 was made in the Guayacán Fund of Funds III, L.P., a limited partnership organized in April 2007, pursuant to the laws of the State of Delaware, bringing the amount invested at June 30, 2011 to $11,727,273. The Corporation has a total commitment of $40.0 million. This partnership intends to seek out, invest in, and add value to companies, which will be based or operating in Puerto Rico or in companies whose products or services are targeted at the U.S. Hispanic market, with specific interest in those companies where Advent-Morro's Equity Partners, Inc. Puerto Rico contact, know–how and track record can be leveraged to enhance investment selection and post–investment value-add. Guayacán Private Fund of Funds III, L.P. will strive to have a balanced mix of portfolio investments primarily focusing on later stage opportunities such as: expansion financing, leveraged buyouts, management buyouts, and recapitalizations. This partnership may invest in de–novo companies that are being set up to enter established industries via market consolidation opportunities and/or internal growth.

At June 30, 2011, the Corporation has variable-rate interest investments, which reset in the frequency shown below, at 100% of an interest rate index plus a spread, as follows:

Investment Type	Reset	Amount
Mortgage–backed securities:		
FNMA	Monthly	$ 3,360,504
FHLMC	Monthly	2,840,860
CMO's issued and/or guaranteed by:		
GNMA	Monthly	4,091,064
FHLMC	Monthly	1,048,376
Commercial mortgage	Monthly	1,135,259
Corporate bonds and notes	Semiannually	2,264,258
Asset backed securities	Monthly	5,723,782
Asset backed securities	Quarterly	424,099
Commercial mortgage bonds	Monthly	12,072,688
US Treasury Bonds	Semiannually	4,290,663
Investments held under securities lending transactions:		
Interest bearing deposits	Quarterly	5,000,000
Commercial paper	Semiannually	8,999,418
Resell agreements	Daily	15,000,000
Corporate bonds and notes	Quarterly	5,000,000
Total		$ 71,250,971

The credit risk related to investments is the risk that debt securities in the Corporation's portfolio will decline in price or fail to make principal and interest payments when due because the issuer of the security experiences a decline in the financial condition. The Corporation limits its credit risk by investing principally in high quality investments (rated BBB or better, according to Standard and Poor's or other equivalent rating agencies when maturities are longer than a year). In addition, the Corporation restricts investment in certain securities to avoid concentration and/or increase duration.

All of the Corporation's investments in U.S. Treasury securities and mortgage–backed securities guaranteed by GNMA carry the explicit guarantee of the U.S. government. The credit quality ratings for investments in debt securities, excluding U.S. Treasury securities and mortgage–backed securities guaranteed by GNMA, at June 30, 2011 are as follows:

Investment Type	Credit Risk Rating AAA to A-	BBB+	BBB	BBB-	BB+	Not Rated	Total
U.S. sponsored agencies							
bonds and notes:							
FHLB	$ 12,932,489	$ -	$ -	$ -	$ -	$ -	$ 12,932,489
FHLMC	6,244,316	-	-	-	-	-	6,244,316
FNMA	3,972,271	-	-	-	-	-	3,972,271
FFCB	9,478,172	-	-	-	-	-	9,478,172
Other	5,046,510	-	-	-	-		5,046,510
Mortgage–backed securities:							
FNMA	-	-	-	-	-	35,129,340	35,129,340
FHLMC	26,107,150	-	-	-	-	14,853,647	40,960,797
CMO's issued and/or guaranteed by:							
FNMA	-	-	-	-	-	149,816	149,816
FHLMC	-	-	-	-	-	1,507,645	1,507,645
Commercial mortgage	34,981,421	-	-	520,243	-	-	35,501,664
Other	-	-	-	-	-		-
Asset–backed securities	39,264,649	890,569	-	-	-	-	40,155,218
Corporate bonds and notes	231,735,463	48,250,162	29,369,659	16,739,639	525,795	-	326,620,718
Foreign government bonds and notes	5,714,347	-	-	-	-	-	5,714,347
U.S. municipal notes	36,654,593	-	-	-	-	-	36,654,593
Commonwealth agency bonds	-	2,196,848	2,464,199	1,424,180	-	-	6,085,227
Money market funds	-	-	-	-	-	257,222,844	257,222,844
Indexed certificates of deposit	-	-	-	-	-	104,544,754	104,544,754
Investments held under securities loans:							
Interest bearing deposits	18,000,000	-	-	-	-	-	18,000,000
Resell agreements	40,202,846	-	-	-	-	-	40,202,846
Commercial paper	14,036,938	-	-	-	-	-	14,036,938
Corporate bonds and notes	12,044,090	-	-	-	-	-	12,044,090
Total	$ 496,415,256	$ 51,337,579	$ 31,833,858	$ 18,684,062	$ 525,795	$ 413,408,046	$ 1,012,204,595

Interest bearing deposits with other banks held under securities lending transactions (see Note 10) are uninsured and uncollateralized. These deposits are exposed to custodial credit risk.

Negotiable indexed certificates of deposit were entered with Puerto Rico commercial banks and are insured and collateralized with securities pledged by the banks and held by a trustee of the Treasury Department of the Commonwealth. The term of these indexed certificates of deposit is five years and the return on each instrument is linked to an underlying basket of the following five indexes: S&P Index Fund, S&P Small Cap 600 Index, S&P Mid Cap 400 Index, MSCIEAFE Index Fund and MSCI Emerging Markets Index Fund.

In accordance with its investment policy, the Corporation manages its exposure to declines in fair values by structuring the investment portfolio so that securities mature to meet cash requirements for compensation and medical benefit payments, thereby avoiding the need to sell securities on the open market prior to maturity. Investments in equity securities are not subject to the maximum maturity policy since they do not carry a maturity date. The Corporation is expected to achieve capital preservation and income generation by investing in a diversified portfolio of marketable, investment grade core fixed–income securities.

As of June 30, 2011, investment maturities as a percentage of total debt securities and fixed–income external investment pools are as follows:

Maturity	Maximum Maturity
Within one year	44%
After one to five years	27%
After five years to ten years	13%
After ten years	16%

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The Corporation's investment policy permits investing in international stocks to diversify the risks of the investment portfolio. The Corporation limits its exposure to foreign currency risk by limiting the total amount invested to a 5% of the portfolio.

As of June 30, 2011, the Corporation had the following investments denominated in foreign currency:

Description	Currency	Fair value
Common stock	Australian Dollar	$ 4,406,803
	British Pound	6,585,640
	Canadian Dollar	4,975,142
	DKK	833,822
	Euro	16,106,016
	Hong Kong Dollar	4,486,283
	Japanese Yen	17,637,755
	Norwegian Krone	2,862,044
	Singapore Dollar	1,192,314
	Swedish Krona	540,012
	Swiss Franc	7,393,942
Preferred stock	Euro	2,301,402
Total		$ 69,321,175

Custodial credit risk related to investments is the risk that, in the event of failure of the counterparty to a transaction, the Corporation may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. At June 30, 2011, all securities held in portfolio were registered in the name of the Corporation and were held in the possession of the Corporation's custodian banks, JP Morgan Chase Bank, N.A. and the Bank of New York Mellon, except for securities lent (see Note 10).

Interest and dividend income for the year ended June 30, 2011, consist of the following:

Description	Amount
Interest income on interest bearing deposits with GDB	$ 1,232,030
Interest income on investments	37,814,191
Dividend income on investments	5,848,674
Dividend income on investment in PRGITF	1,033
Interest income on investments in cash and non-cash collateral received on securities lending transactions	589,908
Other interest income	304,349
	45,790,185
Less investment managers' fees	(5,041,800)
Total interest and dividend income-net	$ 40,748,385

Net increase in the fair value of investments for the year ended June 30, 2011, consists of the following:

Description	Investments	Derivative Instruments	Total
Gross realized gains	$ 96,747,681	$ 4,629,934	$ 101,377,615
Gross realized losses	(19,017,050)	(358,613)	(19,375,663)
Net increase in fair value	18,038,339	300,110	18,338,449
Total	$ 95,768,970	$ 4,571,431	$ 100,340,401

4. ACCOUNTS RECEIVABLE-NET

Accounts receivable as of June 30, 2011, consist of:

Description	Amount
Insurance premiums receivable, including estimated additional premiums-net of allowance for uncollectible insurance premiums of $302,420,585	$ 69,956,978
Interest and dividends receivable	7,633,494
Securities sold but not yet delivered	100,956,099
Employees' accounts receivable, collateralized with motor vehicles-net of allowance for uncollectible accounts of $995,933	6,669,783
Other accounts receivable-net of allowance for uncollectible accounts of $142,810,654	2,371,468
Total	$ 187,587,822

Insurance premiums receivable include an estimate for additional premiums of $90,520,613. The Corporation follows a policy of not charging–off uncollectible insurance premiums against the related allowance for uncollectible accounts. Other accounts receivable mainly include the portion of insurance premiums of previously uninsured employers considered to be collectible.

5. INVENTORIES

Inventories as of June 30, 2011, consist of:

Description	Amount
Medicines and medical supplies	$ 5,899,339
Office materials and supplies	501,818
Total	$ 6,401,157

6. CAPITAL ASSETS — NET

The activity of capital assets for the year ended June 30, 2011 is as follows:

Description	Balance June 30, 2010	Increase	Decrease	Balance June 30, 2011
Capital assets not subject to depreciation and amortization:				
Land	$ 5,860,166	$ -	$ -	$ 5,860,166
Land–under capital lease	7,150,000	-	-	7,150,000
	13,010,166	-	-	13,010,166
Capital assets subject to depreciation and amortization:				
Buildings and improvements	97,439,058	8,750,852	-	106,189,910
Medical and office equipment	43,021,433	1,308,653	(204,157)	44,125,929
Software	12,114,892	91,163	-	12,206,055
Motor vehicles	784,116	158,805	-	942,921
Assets under capital leases:				
Building and improvements	27,850,000	-	-	27,850,000
Office equipment	-	-	-	-
	181,209,499	10,309,473	(204,157)	191,314,815
Less accumulated depreciation and amortization:				
Buildings and improvements	(41,317,529)	(2,496,612)	-	(43,814,141)
Medical and office equipment	(38,147,078)	(1,095,971)	204,157	(39,038,892)
Software	(11,873,675)	(110,778)	-	(11,984,453)
Motor vehicles	(768,547)	(27,417)	-	(795,964)
Assets under capital leases:				
Building and improvements	(9,283,333)	(928,333)	-	(10,211,666)
Office equipment	-	-	-	-
	(101,390,162)	(4,659,111)	204,157	(105,845,116)
Capital assets being depreciated and amortized — net	79,819,337	5,650,362	-	85,469,699
Capital assets — net	$ 92,829,503	$ 5,650,362	$ -	$ 98,479,865

As of June 30, 2011, the net carrying value of assets under capital leases amounted to $24,788,334. Amortization of assets under capital leases amounted to $928,333 for the year ended June 30, 2011.

7. LIABILITY FOR INCURRED BUT UNPAID BENEFITS AND BENEFIT ADJUSTMENT EXPENSES

The liability for incurred but unpaid benefits and benefit adjustment expenses is based on historical claims experience data, assumptions, and projections as to future events, including claims frequency, severity, persistency and inflationary trends determined by an independent actuarial study. This liability has been discounted at 4.20% in 2011. The actuarial study considered the experience of the Corporation from fiscal years 1996–1997 to 2010–2011, and included estimates for cases reported that have not been adjudged and cases incurred but not reported. The assumptions used in estimating and establishing the liability is reviewed annually based on current circumstances and trends. Any resulting adjustments are considered to be a change in an accounting estimate and accounted for as an increase (decrease) to expenses of the Corporation during the current period.

The Corporation has established a liability for both, reported and unreported insured events, which includes estimates of future payment of benefits and related benefit adjustment expenses. The liability for incurred but unpaid benefits and benefit adjustment expenses as of June 30, 2011, consists of:

Compensation benefits:	
Cases adjudged:	
Long–term partial disability	$ 24,331,406
Long–term total disability	207,852,534
Death	35,384,947
	267,568,887
Cases reported not adjudged and cases incurred but not reported:	
Short-term disability (per diem)	110,772,698
Long–term partial disability	143,510,222
Long–term total disability	75,104,060
Death	(389,872)
	328,997,108
Total compensation benefits	596,565,995
Medical benefits	118,922,242
Loss adjustment expense, including legal fees	68,529,426
Total	$ 784,017,663

The following provides a reconciliation of the beginning and ending balance for the liability for incurred but unpaid benefits and benefits adjustment expenses for the year ended June 30, 2011:

Description	Amount
Liability for incurred but unpaid benefits and benefit adjustment expenses — beginning of year	$ 778,243,075
Incurred benefits related to:	
Insured events of the current year	487,090,381
Insured events of the prior years	38,477,670
Total incurred benefits	525,568,051
Benefit payments related to:	
Insured events of the current year	(319,011,522)
Insured events of the prior years	(200,781,941)
Total benefit payments	(519,793,463)
Liability for incurred but unpaid benefits and benefit adjustment expenses — end of year	$ 784,017,663

8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2011, consist of:

Description	Amount
Accounts payable:	
Securities purchased but not yet received	$ 26,160,308
Due to employers	16,113,888
Suppliers, professional services and others	48,077,520
Total accounts payable	90,351,716
Accrued liabilities:	
Compensated absences–vacations and sick leaves	42,798,083
Accruals for Christmas bonus, salary increases, compensatory time and other fringe benefits	13,269,976
Early retirement plan and other retirement benefits	2,586,206
Net pension obligation (see Note 16)	7,248,462
Postemployment benefits other than pensions (see Note 17)	9,552,605
Accruals for claims and contingencies (see Note 20)	4,650,367
Accrued interest payable	837,835
Total accued liabilities	80,943,534
Total	$ 171,295,250

9. ACCRUAL FOR REIMBURSEMENT OF PREMIUMS

As of June 30, 2011, the accrual for reimbursement of premiums as determined by the independent actuary was classified as current and non-current in the accompanying statement of net assets as follows:

Description	Amount
Due within one year	$ 60,889,772
Due in more than one year	67,210,228
Total	$ 128,100,000

The reimbursement of insurance premiums for the year ended June 30, 2011 amounted approximately to $62,419,000, which includes a current year credit of $5,559,000 to reflect changes in the accrual for reimbursement of premiums determined by an independent actuary. A discount rate of 4.62% was used to determine present value.

10. SECURITIES LENDING OBLIGATIONS

The Commonwealth statutes and the Corporation's BOD policies permit the Corporation to use its investments to enter into securities lending transactions, whereby securities are transferred to an independent broker or dealer in exchange for collateral in the form of cash, securities and/or irrevocable bank letters of credit.

The Corporation's securities custodian, JP Morgan Chase Bank, N.A., as agent of the Corporation, manages the securities lending program and receives cash collateral, securities or irrevocable bank letters of credit as collateral. The collateral securities cannot be pledged or sold by the Corporation unless the borrower defaults. The collateral requirement is equal to 102 percent for securities issued in the United States and 105 percent for securities issued outside of the United States, of the fair value of the security lent. Additional collateral has to be provided by the next business day if the collateral fair value falls below the fair value of the securities lent. All security loans can be terminated on demand by either the Corporation or the borrower. In lending securities, the term to maturity of the securities loans is matched with the term to maturity of the investment made with the cash collateral. Such matching existed at year–end.

At year–end, the Corporation has no credit risk exposure to borrowers because the amounts the Corporation owes the borrowers exceed the amounts the borrowers owe the Corporation. Contracts with the lending agents require them to indemnify the Corporation if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the Corporation for income distributions by the securities' issuers while the securities are on loan.

Securities lent as of June 30, 2011 had a fair value of $150,068,510 and were secured with collateral received with a fair value of $152,576,418.

Securities lent for which cash was received as collateral as of June 30, 2011, consist of:

Description	Amount
U.S. Treasury notes and bonds	$ 33,697,412
U.S. sponsored agencies bonds and notes	10,616,335
Corporate bonds and notes	24,340,097
Equity securities	14,485,488
Total	$ 83,139,332

Cash collateral received as of June 30, 2011 amounted to $84,283,874 (see Note 3) and was invested as follows:

Description	Amount
Commercial paper	$ 14,036,938
Corporate bonds and notes	12,044,090
Resell agreements	40,202,846
Interest bearing deposits:	
Certificates of deposit with other banks	10,000,000
Foreign certificates of deposit with other banks, denominated in US dollars	8,000,000
Total	$ 84,283,874

In addition, the Corporation had the following lending obligations as of June 30, 2011 for which securities were received as collateral:

	Fair Value	
Description	Securities Lent	Collateral Received
U.S. Treasury notes and bonds	$61,594,076	$62,848,998
U.S. sponsored agencies bonds and notes	5,335,102	5,443,546
Total	$66,929,178	$68,292,544

Cost of securities lending transactions for the year ended June 30, 2011 consist of the following:

Description	Amount
Borrower rebates	$ 123,134
Agent fees	186,704
Total	$ 309,838

11. NOTE PAYABLE

Note payable activity for the year ended June 30, 2011, is as follows:

June 30, 2010	Advances	Payments	June 30, 2011
$ 220,000,000	$ 242,000,000	$ 220,000,000	$ 242,000,000

On May 11, 2011, the Corporation entered into a loan agreement ("the Loan") with a private financial institution for the amount of $242,000,000. The Loan matures on May 1, 2028 and carries a variable interest rate of 30 day LIBOR plus a 2.25% spread. This loan requires the Corporation to comply with certain restrictive covenants, which, in the event of non–compliance, provide the financial institution the right to declare the outstanding debt as due and payable in cancellation of the loan agreement. One of the covenants requires the Corporation to pledge 130% of the outstanding principal on the loan in securities in its investment portfolio. Proceeds of the loan were used to repay a note payable and interest payable to the Government Development Bank for Puerto Rico($220,000,000 principal and $3,273,000 in interest), purchase of two buildings ($8,490,000 for building purchased before June 30, 2011 and $10,100,000 for building purchased after June 30, 2011) and other purposes ($137,000).

The annual debt service requirements to maturity, including principal and interest, for the note payable are as follows:

Fiscal Year Ending June 30,	Principal	Interest
2012	$ -	$ 5,894,152
2013	-	5,894,152
2014	12,099,999	5,714,053
2015	16,133,332	5,321,109
2016	16,133,332	4,928,166
2017-2021	80,666,660	18,746,679
2022-2026	80,666,660	8,923,093
2027-2028	36,300,017	818,633
Total	$ 242,000,000	$ 56,240,037

Debt service requirements of this variable-rate debt assume that the interest rate effective at June 30, 2011 remains the same throughout the term of the debt.

12. OTHER NOTES PAYABLE

During 1999, the Corporation acquired the facilities where four regional offices are located. In consideration for the facilities acquired, the Corporation entered into non–interest bearing financing agreements with the sellers, payable on an installment basis and collateralized with first mortgages over the underlying facilities. The original terms of these notes payable are as follows:

Note	Description	Original Balance
1	Non–interest bearing note, due in September 2018, payable in 40 semiannual installments, effective interest rate of 6.54%	$ 35,001,060
2	Non–interest bearing note, due in September 2018, payable in 40 semiannual installments, effective interest rate of 6.54%	21,419,834
3	Non–interest bearing note, due in October 2018, payable in 40 semiannual installments, effective interest rate of 6.31%	16,619,468
4	Non–interest bearing note, due in March 2019, payable in 40 semiannual installments, effective interest rate of 6.84%	53,285,454
	Total payments	126,325,816
	Less imputed interest at the inception of the notes	(54,957,702)
	Total original balance	$ 71,368,114

The activity of these notes payable for the year ended June 30, 2011, is as follows:

Description	Balance June 30, 2010	Advances	Payments	Balance June 30, 2011
Note payable (gross):				
Note 1	$ 16,514,676	$ -	$ (1,857,180)	$ 14,657,496
Note 2	8,877,466	-	(965,536)	7,911,930
Note 3	6,256,322	-	(661,648)	5,594,674
Note 4	25,141,876	-	(1,410,682)	23,731,194
Total	$ 56,790,340	$ -	$ (4,895,046)	$ 51,895,294
Portion representing interest:				
Note 1	$ (3,529,177)	$ -	$ 771,409	$ (2,757,768)
Note 2	(1,917,700)	-	414,928	(1,502,772)
Note 3	(1,322,226)	-	281,564	(1,040,662)
Note 4	(6,218,294)	-	1,267,498	(4,950,796)
Total	$ (12,987,397)	$ -	$ 2,735,399	$ (10,251,998)
Principal of note payable:				
Note 1	$ 12,985,499	$ -	$ (1,085,771)	$ 11,899,728
Note 2	6,959,766	-	(550,608)	6,409,158
Note 3	4,934,096	-	(380,084)	4,554,012
Note 4	18,923,582	-	(143,184)	18,780,398
Total	$ 43,802,943	$ -	$ (2,159,647)	$ 41,643,296

The schedule of payments of these notes payable as of June 30, 2011, is as follows:

Fiscal Year Ending June 30	Principal	Interest	Total
2012	$ 3,991,864	$ 2,489,240	$ 6,481,104
2013	4,489,202	2,208,771	6,697,973
2014	5,026,926	1,894,419	6,921,345
2015	5,607,970	1,543,449	7,151,419
2016	6,235,471	1,152,927	7,388,398
2017-2019	16,291,863	963,192	17,255,055
	41,643,296	10,251,998	51,895,294
Less current portion	(3,991,864)	(2,489,240)	(6,481,104)
Non-current portion	$ 37,651,432	$ 7,762,758	$ 45,414,190

13. OBLIGATION UNDER CAPITAL LEASE

In fiscal year 2000, the Corporation acquired under a capital lease agreement the facility where a regional office is located. The agreement requires the Corporation to make total payments of approximately $111.7 million over 30 years. The effective interest rate was determined at 10.23%. The activity of the obligation under capital lease for the year ended June 30, 2011, is as follows:

Description	Balance June 30, 2010	Advances	Payments	Balance June 30, 2011
Future payments on assets under capital lease	$ 74,497,500	$ -	$ (3,724,875)	$ 70,772,625
Portion representing interest	(42,828,140)	-	3,215,568	(39,612,572)
Present value minimum lease payments	$ 31,669,360	$ -	$ (509,307)	$ 31,160,053

The schedule of future minimum lease payments under this lease agreement, together with the present value of such minimum lease payments for the year ended as of June 30, 2011, is as follows:

Fiscal Years Ending June 30,	Present Value Capital Lease	Interest	Total
2012	$ 563,908	$ 3,160,966	$ 3,724,874
2013	624,365	3,100,510	3,724,875
2014	691,302	3,033,573	3,724,875
2015	765,416	2,959,459	3,724,875
2016	847,475	2,877,400	3,724,875
2017-2021	5,811,390	12,812,985	18,624,375
2022–2026	9,670,025	8,954,350	18,624,375
2027–2030	12,186,172	2,713,329	14,899,501
	31,160,053	39,612,572	70,772,625
Less current portion	(563,908)	(3,160,966)	(3,724,874)
Non–current portion	$ 30,596,145	$ 36,451,606	$ 67,047,751

14. TRANSFERS TO OTHER GOVERNMENTAL AGENCIES

Transfers to other governmental agencies during the year ended June 30, 2011, are as follows:

Description	Amount
Industrial Commission of Puerto Rico	$ 23,913,453
Department of Labor and Human Resources:	
Occupational Safety and Health Office	8,108,374
Job Training Program for PR's New Workforce	7,500,000
Labor Standards Offices	10,916,626
Department of the Family — Vocational Rehabilitation Program	600,000
Labor Affairs Office	140,000
Total	$ 51,178,453

The expenses incurred by the Industrial Commission of Puerto Rico are covered by the Corporation under the provisions of Law No. 45. These expenses shall not exceed 4% of the total of insurance premiums collected during the previous fiscal year.

The transfers to the Department of Labor and Human Resources, Occupational Safety and Health and Labor Standards Offices, are in accordance with the applicable legislation as of July 20, 1990, which authorizes the Corporation to transfer certain amounts as prescribed by law to cover operational expenses of the above mentioned offices.

The transfers to the Department of Labor and Human Resources, Job Training Program for Puerto Rico's New Workforce, are in accordance with Executive Order OE-2011-016, which requires the Corporation to transfer $7,500,000 for fiscal years 2011 and 2012.

The transfer to the Department of the Family is made under the provisions of Law No. 243, of July 23, 1974, which requires the Corporation to transfer to the Vocational Rehabilitation Program an amount not to exceed $600,000 each year for the vocational rehabilitation of injured workers. As of June 30, 2011, the amount due under this Program amounted to $600,000.

15. INVESTMENT DERIVATIVE INSTRUMENTS

The Corporation entered into derivative instruments not designated as hedge transactions to the extent and in a manner consistent with the Corporation's SIPGO, to establish an asset class exposure or in order to affect a change in the overall allocation strategy of the investment portfolio or to affect currency hedging for non–US dollar positions. These investment derivative instruments consist of spot currency contracts, forward currency contracts and future contracts. The financial exposure is managed through an independent money manager in accordance with the Corporation's investment policies. The Corporation is exposed to foreign currency risk and market interest risk as a result of the changes in the fair value of the derivative.

For the year ended June 30, 2011, the Corporation recorded within net increase in fair value of investment in the statement of activities, a net gain on investment derivative instrument transactions amounting to approximately $4,571,000. At June 30, 2011, there were no significant outstanding investment derivative instruments.

16. EMPLOYEES' RETIREMENT PLAN

Defined Benefit Pension Plan-The Employees' Retirement System of the Commonwealth of Puerto Rico 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 Corporation hired before January 1, 2000 and under 55 years of age at the date of employment became members of the Retirement System as a condition of their employment. No benefits are payable if the participant receives a refund of their accumulated contributions.

The Retirement System provides retirement, death, and disability benefits pursuant to legislation enacted by the Legislature. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after 10 years of plan participation. Disability benefits are available to members for occupational and non-occupational disabilities. However, a member must have at least 10 years of service to receive non-occupational disability benefits.

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

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

Commonwealth Legislation requires employees to contribute 5.775% of the first $550 of their monthly gross salary and 8.275% for the excess over $550 of monthly gross salary. The Corporation is required by the same statute to contribute 9.275% of each participant's gross salary.

Defined Contribution Plan-The Legislature enacted Act No. 305 on September 24, 1999, which amended Act No. 447 to establish, among other things, a defined contribution savings plan program (the "Program") to be administered by the Retirement System. All regular employees hired for the first time on or after January 1, 2000, and former employees who participated in the defined benefit pension plan, received a refund of their contributions, and were 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 individual accounts established under the Program. Participants have three options to invest their contributions to the Program. Investment income is credited to the participant's account semiannually.

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

Upon retirement, the balance in each participant's account will be used to purchase an annuity contract, which will provide for a monthly benefit during the participant's life and 50% of such 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 each participant's account will be paid in a lump sum to the participant's beneficiaries. Participants have the option of receiving a lump sum or purchasing an annuity contract in case of permanent disability.

Total employee contributions for the defined benefit pension plan and the defined contribution plan during the year ended June 30, 2011 amounted to approximately $17,544,000 and $2,226,000 respectively. The Corporation's total contributions during the years ended June 30, 2011, 2010, and 2009 amounted to approximately $19,726,000, $20,436,000, and $20,095,000, respectively. These amounts represented 100% of the required contribution for the corresponding year. Individual information for each option is not available since the allocation is performed by the Retirement System itself.

Additional information on the Retirement System is provided in its stand-alone financial statements for the year ended June 30, 2011, a copy of which can be obtained from the Employees' Retirement System of the Commonwealth of Puerto Rico and its instrumentalities. P.O. Box 42004, San Juan PR 00940-2004.

Other Retirement Benefits

In addition to the Defined Benefit Plan and to the Defined Contribution Plan, the Corporation provides the following retirement benefits:

- Life insurance benefit — Life insurance coverage is provided to retirees for a period of one year following retirement. It is covered through the Corporation's health plan ($20,000 of life coverage for retiree only).
- Christmas bonus benefit — Same eligibility as for the health benefits but retirement must occur after March 31. The benefit is a one–time payment in the year of retirement equal to 9.5% of salary up to a maximum of $3,325, except for unionized lawyers who receive 8.5% of salary up to a maximum of $2,720. Employees retired pursuant to various special incentive programs may receive up to five years of such Christmas bonuses.
- Retirement payment benefit — Eligibility required at least 15 years of service at the Corporation and at least 30 years of credited service at the Retirement System and the retiree must provide a letter of resignation at least 90 days prior to retirement. Benefit is a lump sum of $8,100.
- Retirement bonus benefit — Same eligibility as for the health benefits. Trust employees receive 21% of final salary as a lump sum and all other employees receive 30% of final salary as a lump sum.
- Disability benefit — To be eligible for disability benefits, the employee must be a permanent full–time employee. A totally disabled employee who meets the disability requirements of the Social Security Administration, the Worker Compensation or the Retirement System receives a lump sum of $5,000. A totally disabled employee who resigns and is not eligible for the disability requirements mentioned above, receives a lump sum of 55% of the last year salary and up to $5,000 for rehabilitation costs ($4,800 for trust employees).

Funding Policy and Annual Pension Cost — The required contribution is based on projected pay–as–you–go financing requirements. Benefits are actuarially calculated by an independent actuary.

The Annual Pension Cost is calculated based on the annual required contribution of the employer (the "ARC"). The ARC is determined in accordance with plan provisions, demographic participant data, actuarial assumptions, actuarial cost method, and other actuarial methods prescribed by GASB Statement No. 27. While pre–funding is not required, the ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty years. The ARC will generally increase with benefit cost increases and participant growth; in addition, gains/losses resulting from demographic and/or assumption changes will also impact the ARC.

The following tables show the components of the Corporation's annual pension cost for the fiscal year ended June 30, 2011, the amount actually contributed to the Pension Program, the change in the Corporation's net obligation and the funded status of the Pension Program:

Net Pension Obligation Movement:	For the Year Ended June 30, 2011
Annual Required Contribution	$ 5,755,513
Interest on the net pension obligation	303,544
Adjustments to the ARC	(669,768)
Annual pension cost (expense)	5,389,289
Employer contribution	(6,025,098)
Increase in the net pension obligation	(635,809)
Net pension obligation — beginning of year	7,884,271
Net pension obligation — end of year	$ 7,248,462
Percentage of annual pension cost contributed	111.80 %
Funded Status:	
Actuarial valuation date	July 1, 2009
Actuarial accrued liability (AAL)	$ 37,872,366
Unfunded AAL	$ 37,872,366
Funded ratio	0 %
Annual covered payroll	$ 202,224,106

Pension Actuarial Valuation — The following table shows the most significant actuarial methods and assumptions used to estimate the net pension obligation. As permitted by GASB Statement No. 27, the actuarial valuation is performed every two years.

Actuarial Methods and Assumptions:

Valuation year	July 1, 2009
Actuarial cost method	Projected Unit Credit
Amortization method	Level percentage of projected payroll on a closed basis over 15 years
Asset valuation method	N/A
Discount rate	3.85 %
Projected salary increase	4.00 %
Mortality rate	RP–2000 Generational Healthy Mortality Table for blended healthy active employee/retiree RP-2000 Combined Disability Mortality Table for disabled participants

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future, and actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the basic financial statements, presents multiyear trend information about the actuarial value of program assets relative to the actuarial accrued liability for benefits.

Calculations are based on the types of benefits provided at the time of each valuation and on the pattern of sharing of costs between the employer and members to that point. The projections of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future.

The actuarial calculations reflect a long–term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short–term volatility in actuarial accrued liabilities and actuarial value of assets.

17. POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS

Program Description and Membership — The Corporation's Postemployment Benefits Other Than Pensions Program (the "OPEB Program") provides postemployment benefits other than pensions ("OPEB") to all employees who meet certain age and years of service requirements. These benefits were agreed by the Corporation and employees in the collective bargain agreements and similar agreements. The benefits are funded from the Corporation's assets.

The Corporation provides the following OPEB:

- Health and other health related benefits: medical, prescription drugs, dental, and vision benefits are provided together in a fully–insured health plan. Upon retirement, an eligible employee receives two years of non–contributory healthcare benefits from the Corporation and through its healthcare plan. The Corporation's healthcare plan covers medical, prescription drugs, vision, dental, and life insurance (see Note 16). After the two years, the retiree can continue participation in the Corporation's plan (for lifetime) by contributing the difference between the plan premium and the Corporation's contribution of $35/month ($40/month for members of the "Union de Empleados de la Corporación del Fondo del Seguro de Estado") per retiree (including dependents, if any). The $35/month and $40/month contributions end when the retiree reaches 65 years of age and, thereafter, the retiree must contribute the full plan premium. Some retirees who retired under special incentive programs have the two-years extended (ranging from 5 to 7 years total). After the two–year period (or the special retirement program period), the retiree can continue the spouse or family coverage for the lifetime of the retiree.

At June 30, 2011, membership in the Corporation's OPEB Program consisted of the following:

Retirees and beneficiaries currently receiving benefits	414
Current participating employees	3,824
Total membership	4,238

Funding Policy and Annual OPEB Cost — The required contribution is based on projected pay–as–you–go financing requirements. Benefits are actuarially calculated by an independent actuary.

The Annual OPEB Cost is calculated based on the annual required contribution of the employer (the "ARC"). The ARC is determined in accordance with plan provisions, demographic participant data, actuarial assumptions, actuarial cost method, and other actuarial methods prescribed by GASB Statement No. 45. While pre–funding is not required, the ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty years. The ARC will generally increase with benefit cost increases and participant growth; in addition, gains/losses resulting from demographic and/or assumption changes will also impact the ARC.

The following tables show the components of the Corporation's annual OPEB cost for the fiscal year ended June 30, 2011, the amount actually contributed to the OPEB Program, the change in the Corporation's net obligation and the funded status of the OPEB Program.

Net OPEB Obligation Movement:	**For the Year Ended June 30, 2011**
ARC	$ 5,706,997
Interest on the net OPEB obligation	371,200
Adjustments to the ARC	(522,548)
Annual OPEB cost (expense)	5,555,649
Employer contribution	(5,644,614)
Increase in the net OPEB obligation	(88,965)
Net OPEB obligation — beginning of year	9,641,570
Net OPEB obligation — end of year	$ 9,552,605
Percentage of annual OPEB cost contributed	101.60 %

Funded Status:	
Actuarial valuation date	July 1, 2009
Actuarial accrued liability (AAL)	$ 59,884,898
Unfunded AAL	$ 59,884,898
Funded ratio	0 %
Annual covered payroll	$ 202,224,106

OPEB Actuarial Valuation — The following table shows the most significant actuarial methods and assumptions used to estimate the net OPEB obligation. As permitted by GASB Statement No. 45, the actuarial valuation is performed every two years.

Actuarial Methods and Assumptions:

Valuation year	July 1, 2009
Actuarial cost method	Projected Unit Credit, level dollar
Amortization method	Level percentage of projected payroll on a closed basis over 30 years
Asset valuation method	N/A
Discount rate	3.85 %
Projected salary increase	4.00 %
Mortality rate	RP–2000 Generational Healthy Mortality Table for blended healthy active employee/retiree RP-2000 Combined Disability Mortality Table for disabled participants
Heath care cost trend rate for medical and prescription drugs	10.5% in fiscal 2011, grading to 5% for fiscal year 2019

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future, and actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the basic financial statements, presents multiyear trend information about the actuarial value of program assets relative to the actuarial accrued liability for benefits.

Calculations are based on the types of benefits provided at the time of each valuation and on the pattern of sharing of costs between the employer and members to that point. The projections of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future.

The actuarial calculations reflect a long–term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short–term volatility in actuarial accrued liabilities and actuarial value of assets.

18. SEGREGATION OF FUND

The Corporation is required to maintain an adequate accounting system and to segregate the financial resources by funds, as defined by the Act, as amended. The provisions of the Act establish the segregation of the funds be based on their purposes, as defined.

As of June 30, 2011, the Corporation was required to account for the Death and Total Disability Fund (the "DTDF") and for the Reserve for Catastrophic Fund (the "RCF"). The DTDF recognizes the claims awarded to the workers (injured employees or its beneficiaries). The Corporation maintains a separate account to record the inventory of claims adjudicated, which is part of the liabilities for incurred but unpaid benefits and benefit adjustment expenses, reflected in the accompanying financial statements. As of June 30, 2011, the DTDF (adjudged cases) amounted to approximately $162,961,000 and the investments portfolio serves to fund the obligation incurred.

The RCF is required by the Article 23 of the Act, which serves to provide funds in an event of catastrophic situation. The provisions of Article 23 allow the Corporation to use the funds in the RCF to reduce any deficit incurred by the Corporation. As of June 30, 2011, the RCF amounted to approximately $14,138,000.

19. COMMITMENTS

Operating Lease Agreements — The Corporation rents certain of its administrative offices and clinics under non–cancelable long–term operating lease agreements. Certain leases contain escalation clauses providing for increased rental. Rent charged to operations in fiscal year 2011 amounted to approximately $23.4 million. At June 30, 2011, the minimum annual future rentals under non–cancelable leases, without considering renewal options, are approximately as follows:

Fiscal Year Ending June 30,	Amount
2011	$ 21,293,516
2012	15,434,031
2013	13,316,794
2014	5,784,665
2015	3,761,504
2016-2019	5,223,360
Total	$ 64,813,870

See Note 14 for commitments with other governmental agencies.

20. CONTINGENCIES

The Corporation is included as defendant in various lawsuits from 232 current and former employees as a result of the Corporation's decision to declare null and void certain administrative personnel transactions which occurred in prior years. Plaintiffs' claims include damages and requests for reinstatements. On November 17, 2011, as part of one of the cases being litigated, the State Court of Appeals ratified a previous ruling in favor of plaintiffs on the subject related to nullification of personnel transactions. Management believes, based on the opinion of legal counsel, that their actions were appropriate and these adverse rulings were appealed to the State Supreme Court. The Corporation's management does not have an assessment of any potential exposure. The effect, if any, resulting from an adverse resolution is not recorded in the financial statements.

Also, the Corporation is included as defendant or co–defendant in several other claims and lawsuits pending final resolution. The Corporation had medical malpractice insurance coverage through June 3, 1991, and for the period from December 31, 1996 to April 1, 2007. During the periods from June 4, 1991 to December 30, 1996 and from April 2, 2007 to present, the Corporation had no medical malpractice coverage. Management has recorded an accrual of approximately $4.7 million to cover claims and lawsuits that may be assessed against the Corporation, including malpractice cases not covered by the related policy.

In the opinion of management, any loss to be sustained as a result of an unfavorable outcome for the above mentioned cases has been provided for in the reserve estimates accrued and should not materially affect the Corporation's financial statements.

21. TRANSACTIONS WITH GOVERNMENTAL ENTITIES

During the year ended June 30, 2011, insurance premiums earned by the Corporation from the governmental sector are approximately as follows: $109.6 million from the Commonwealth and its agencies and public corporations and $44.5 million from the municipalities for a total amount of $154.1million from the governmental sector. These amounts represent approximately 23% of the total of premiums earned.

Interest bearing deposits with GDB, and its accrued interest receivable amounted to $58,265,437 and $131,534, respectively, as of June 30, 2011. Interest income earned on these deposits amounted to $1,232,030 for the year ended June 30, 2011.

The Corporation has invested $6,085,227 in the Commonwealth's agency bonds as of June 30, 2011. Accrued interest receivable on the Commonwealth's agency bonds amounted to $70,361 as of June 30, 2011. Investment with the PRGITF amounted to $1,037,531 as of June 30, 2011. Dividend income earned on this investment amounted to $1,033 for the year ended June 30, 2011.

Accounts receivable from and payable to the Commonwealth's agencies and public corporations amounted to $29.1 million and $2.8 million, respectively, as of June 30, 2011. Medical and administrative expenses paid to the Commonwealth's agencies and public corporations amounted to approximately $9.5 million for the year ended June 30, 2011.

Interest expense on the note payable to GDB amounted to $4,528,952 for the year ended June 30, 2011.

Investment manager fees paid to GDB amounted to $1,345,113 for the year ended June 30, 2011.

For transfers to (from) other governmental agencies, see Note 14. For transactions with the Retirement System, see Note 16.

22. SUBSEQUENT EVENTS

On July, 2011, the Corporation purchased a building for approximately $10,100,000.

* * * * * *

REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)

STATE INSURANCE FUND CORPORATION

(A Component Unit of the Commonwealth of Puerto Rico)

TEN–YEAR CLAIMS DEVELOPMENT INFORMATION (AMOUNTS IN THOUSANDS)
REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)
FISCAL YEAR ENDED JUNE 30

Description	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
1) Projected gross earned premiums	$602,732	$651,436	$690,711	$722,761	$725,616	$731,975	$737,520	$718,133	$679,088	$693,271
2) Unallocated expense	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
3) Estimated ultimate awards at end of policy year	487,800	455,200	438,250	496,100	494,000	477,598	478,404	476,369	496,427	462,174
4) Awarded as of:										
12 months	205,937	204,587	220,232	245,159	260,638	266,889	269,569	276,197	292,341	268,231
24 months	269,097	271,467	287,801	317,854	330,546	336,490	337,774	350,117	377,569	
36 months	298,340	297,224	313,454	347,332	358,867	367,869	372,665	387,556		
48 months	312,038	310,119	325,917	361,764	374,105	386,247	392,282			
60 months	320,059	317,793	333,515	371,092	385,132	398,828				
72 months	325,512	325,229	338,640	379,397	393,448					
84 months	329,281	329,221	343,373	386,084						
96 months	332,358	332,804	347,059							
108 months	335,234	335,857								
120 months	337,412									
5) Re–estimated ultimate incurred:										
12 months	487,800	455,200	438,250	496,100	494,000	477,598	478,404	476,369	496,427	462,174
24 months	414,575	395,400	400,900	441,800	449,171	460,651	462,871	467,551	501,982	
36 months	377,025	367,250	374,500	428,502	446,943	456,440	454,667	474,334		
48 months	359,383	350,642	366,466	429,045	444,532	455,030	459,509			
60 months	352,393	350,550	366,579	429,753	443,561	458,392				
72 months	352,927	352,563	365,676	431,112	443,877					
84 months	351,956	352,536	366,790	433,140						
96 months	352,773	353,748	368,154							
108 months	353,300	354,390								
120 months	353,195									

NA = Not available

STATE INSURANCE FUND CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)

SCHEDULES OF FUNDING PROGRESS AND EMPLOYER CONTRIBUTIONS FOR PENSION COSTS
REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)
FISCAL YEAR ENDED JUNE 30, 2011

Schedule of Funding Progress:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded/ (Overfunded) ALL (UAAL) (b) – (a)	Funded Ratio (a) / (b)	Covered Payroll (2) (c)	UAAL as a Percentage of Covered Payroll [(b) – (a)/(c)]
July 1, 2009	$ -	$ 37,872,366	$ 37,872,366	0 %	$ 202,224,106	18.7 %
July 1, 2007	$ -	$ 46,403,413	$ 46,403,413	0 %	$ 218,896,766	21.2 %

Schedule of Employer Contributions:

Fiscal Year Ended	Annual Required Contribution (ARC)	Employer Contributions (1)	Percentage Contributed	Net Pension Obligation
June 30, 2011	$ 5,389,289	$ 6,025,098	111.8 %	$ 7,248,462
June 30, 2010	$ 5,406,659	$ 4,932,242	91.2 %	$ 7,844,271
June 30, 2009	$ 6,587,551	$ 2,621,547	39.8 %	$ 7,409,854
June 30, 2008	$ 6,464,149	$ 3,020,299	46.7 %	$ 3,443,850

(1) Since there is no funding, these are estimated cash plan premiums and other payments less estimated participant contributions.
(2) Estimated plan participant payroll, includes only plan participants.

SCHEDULES OF FUNDING PROGRESS AND EMPLOYER CONTRIBUTIONS FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED) FISCAL YEAR ENDED JUNE 30, 2011

Schedule of Funding Progress:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded/ (Overfunded) ALL (UAAL) (b) – (a)	Funded Ratio (a) / (b)	Covered Payroll (2) (c)	UAAL as a Percentage of Covered Payroll [(b) – (a)/(c)]
July 1, 2009	$ -	$ 59,884,898	$ 59,884,898	0 %	$ 202,224,106	29.6 %
July 1, 2007	$ -	$ 63,329,510	$ 63,329,510	0 %	$ 218,896,766	28.9 %

Fiscal Year Ended	Annual Required Contribution (ARC)	Employer Contributions (1)	Percentage Contributed	Net OPEB Obligation
June 30, 2011	$ 5,555,649	$ 5,644,614	101.6 %	$ 9,552,605
June 30, 2010	$ 5,212,977	$ 3,824,400	73.4 %	$ 9,641,570
June 30, 2009	$ 6,611,429	$ 2,195,089	33.2 %	$ 8,252,993
June 30, 2008	$ 6,365,627	$ 2,528,974	39.7 %	$ 3,836,653

(1) Since there is no funding, these are estimated cash plan premiums and other payments less estimated participant contributions.
(2) Estimated plan participant payroll, includes only plan participants.

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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
the State Insurance Fund Corporation

We have audited the financial statements of the State Insurance Fund Corporation (a component unit of the Commonwealth of Puerto Rico) as of and for the year ended June 30, 2011, and have issued our report thereon dated January17, 2012. 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 Corporation'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 Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies, or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies. Significant deficiencies and material weaknesses are listed in a separate letter dated January 17, 2012.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. Material Weaknesses are listed in a separate letter dated January 17, 2012.

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. Significant deficiencies are listed in a separate letter dated January 17, 2012.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

We noted certain matters that we reported to the Corporation's management in a separate letter dated January 17, 2012.

This report is intended solely for the information and use of the audit committee, management, and the Legislature and the Comptroller of the Commonwealth of Puerto Rico, and is not intended to be and should not be used by anyone other than these specified parties.

Schuman Henriquez & Co.

San Juan, Puerto Rico

January 17, 2012

Certified Public Accountants
(of Puerto Rico)
License No. 53 expires December 1, 2012
Stamp 2619554 of the P.R. Society of
Certified Public Accountants has been
affixed to the file copy of this report