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ANNUAL REPORT

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Report Of Independent Certified Public Accountants

Board of Directors and Shareholder
Molina Healthcare of Puerto Rico, Inc.

We have audited the accompanying balance sheets of Molina Healthcare of Puerto Rico, Inc., which comprise the balance sheets as of December 31, 2018, and 2017, and the related notes thereon.

Management's responsibility for the financial statements

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

Auditor's responsibility

Our responsibility is to express an opinion on these balance sheets based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

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Opinion

In our opinion, the balance sheets referred to above present fairly, in all material respects, the financial position of Molina Healthcare of Puerto Rico, Inc. as of December 31, 2018, and 2017, in accordance with accounting principles generally accepted in the United States of America.

Restriction on Use

This report is intended solely for the information and use of the Board of Directors, Shareholder and management of the Company and the Department of State of the Commonwealth of Puerto Rico and is not intended to be and should not be used by anyone other than these specified parties.

San Juan, Puerto Rico
May 29, 2019.

Kevane Grant Thornton LLP
by: [illegible]
Lic. # 4555

Molina Healthcare of Puerto Rico, Inc.
BALANCE SHEETS (Dollars in thousands)
December 31, 2018 and 2017

ASSETS	2018	2017
Cash	$ 199,245	$ 144,797
Receivables, net of allowance of $56 and $7,495, respectively	7,759	32,286
Income tax refundable	-	5,744
Prepaid expenses and other current assets	864	1,310
Total current assets	207,868	184,137
Property and equipment, net	2,680	3,778
Restricted cash and investments	10,113	10,109
Other assets	1,907	1,906
TOTAL ASSETS	$ 222,568	$ 199,930
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities		
Medical claims and benefits payable	$ 90,297	$ 100,792
Amounts due government agencies	10,506	-
Accounts payable and accrued expenses	4,270	2,996
Income taxes payable	4,663	-
Due to Parent	244	1,579
Total current liabilities	109,980	105,367
Other long-term liabilities	696	135
Total liabilities	110,676	105,502
SHAREHOLDER'S EQUITY		
Common stock, no par value; authorized 10,000 shares, 100 shares issued and outstanding	-	-
Additional paid-in capital	125,201	125,201
Accumulated deficit	(13,309)	(30,773)
Total shareholder's equity	111,892	94,428
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	$ 222,568	$ 199,930

The accompanying notes are an integral part of these statements.

Note A - Basis of Presentation

Organization and Operations

Molina Healthcare of Puerto Rico, Inc. (the Plan) was incorporated under the laws of the Commonwealth of Puerto Rico (the Commonwealth) on February 28, 2014. The Plan is a wholly-owned subsidiary of Molina Healthcare, Inc. (the Parent), a multi-state managed care organization that arranges for the delivery of health care services to persons eligible for Medicaid, Medicare and other government-sponsored programs for low-income families and individuals.

The Plan is a health maintenance organization licensed in the Commonwealth. The Plan has contracts with the Puerto Rico Health Insurance Administration (ASES by its Spanish acronym) to operate the Commonwealth's Medicaid-funded Government Health Plan (GHP) program covering the entire island. The Plan began serving members on April 1, 2015.

In July 2018, the Plan was selected by ASES to be one of the organizations to administer the Commonwealth's new Medicaid Managed Care contract. As of December 31, 2018, the Plan served approximately 252,000 members under the new contract, which represents a reduction in membership compared with 320,000 members served as of September 30, 2018. The new contract commenced on November 1, 2018 and has a three-year term with an optional one year extension.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. It also requires disclosure of contingent assets and liabilities which may be subject to estimation at the date of the financial statements and the reported amounts of revenue and expenses during the period. Such estimates and assumptions could change in the future as more information becomes known which could impact the amounts reported and disclosed herein. Principal areas requiring the use of estimates include:

- The determination of medical claims and benefits payable;
- Contractual provisions that may limit revenue recognition based upon the profits realized under a specific contract;
- Settlements under risk or savings sharing programs;
- The determination of reserves for potential absorption of claims unpaid by insolvent providers;
- The determination of reserves for the outcome of litigation; and
- The determination of valuation allowances for deferred tax assets.

Subsequent Events

The Plan evaluated its December 31, 2018, financial statements for subsequent events through May 29, 2019, the date that the financial statements were available to be issued. The Plan is not aware of any subsequent events that would require recognition or disclosure in these financial statements.

Note B - Summary of Significant Accounting Policies

Cash

The following table provides a reconciliation of cash and restricted cash reported within the accompanying balance sheets that sum to the total of the same such amounts presented in the accompanying statements of cash flows. The restricted cash presented below is included in non-current "Restricted investments" in the accompanying balance sheets.

	2018	2017
Cash	$ 199,245	$ 144,797
Restricted cash, non-current	9,505	9,504
Total cash and restricted cash presented in the statements of cash flows	$ 208,750	$ 154,301

Premium Revenue

Premium revenue is derived from Medicaid. Premium revenue is fixed in advance of the periods covered and, except as described below, is not generally subject to significant accounting estimates. The Plan is paid a per-member per-month (PMPM) fee for all contracted medical services based on the number of members the Plan has enrolled. Premium revenue is recognized in the month in which members are entitled to receive health care services. Premiums collected in advance are deferred. The Medicaid program periodically adjusts premium rates. A portion of the premiums are subject to possible retroactive adjustments for disenrollment, which have not been significant, although there can be no certainty that such adjustments will not be significant in the future.

Contractual provisions that may adjust or limit revenue or profit are as follows:

<u>Profit sharing</u> - The Plan's Medicaid contract with ASES contains a gain-sharing provision under which the Plan refunds amounts to ASES if the Plan generates a profit above 2.5%. A liability of $4.4 million was recorded at December 31, 2018 and no such liability was recorded at December 31, 2017.

<u>Quality incentive premiums</u> - Under the Plan's contract with ASES, up to 2% of revenue is withheld and is not earned until certain performance measures are met. These performance measures are generally linked to various administrative measures dictated by the Commonwealth.

Medical Care Costs

Medical care costs are recognized in the period in which services are provided and include amounts that have been paid by the Plan through the reporting date. Medical care costs include, among other items, fee-for-service claims, pharmacy benefits, capitation payments to providers, and various other medically-related costs.

Under fee-for-service claims arrangements, the Plan retains the financial responsibility for medical care provided and incurs costs based on actual utilization of hospital and physician services. Pharmacy benefits represent payments for members' prescription drug costs, net of rebates from drug manufacturers. The Plan estimates pharmacy rebates earned based on historical and current utilization of prescription drugs and contract terms. Capitation payments represent monthly contractual fees paid to physicians and other providers on a per-member, per-month basis, who are responsible for providing medical care to members, which could include medical or ancillary costs like dental, vision and other supplemental health benefits. Such capitation costs are fixed in advance of the periods covered and are not subject to significant accounting estimates. Due to

insolvency or other circumstances, such providers may be unable to pay claims they have incurred with third parties in connection with referral services provided to our members.

The Plan's medical care costs include amounts that have been paid by the Plan through the reporting date, as well as estimated liabilities for medical care costs incurred but not paid as of the reporting date. Such medical care cost liabilities include, among other items, unpaid fee for service claims, capitation payments owed providers, unpaid pharmacy invoices and various medically related administrative costs that have been incurred but not paid. The Plan uses judgment to determine the appropriate assumptions for determining the required estimates. See Note D, "Medical Claims and Benefits Payable," for further information.

Certain costs allocated by the Parent are included in medical care costs as discussed in Note C, "Transactions with Parent."

The following table provides the details of the Plan's medical care costs for the period indicated (dollars in thousands, except PMPM amounts):

	Year Ended December 31,					
	2018			2017		
	Amount	PMPM	Percentage of total	Amount	PMPM	Percentage of total
Fee-for-service	$ 344,791	$ 92.41	54.2%	$ 390,722	$ 101.54	56.6%
Pharmacy	173,937	46.62	27.4	175,456	45.60	25.4
Capitation	96,280	25.81	15.1	107,219	27.86	15.5
Other	20,941	5.61	3.3	17,466	4.54	2.5
	$ 635,949	$ 170.45	100.0%	$ 690,863	$ 179.54	100.0%

Premium Deficiency Reserves on Loss Contracts

The Plan assesses the profitability of its medical care policies to identify groups of contracts where current operating results or forecasts indicate probable future losses. If anticipated future variable costs exceed anticipated future premiums and investment income, a premium deficiency reserve is recognized. No premium deficiency reserves were recorded as of December 31, 2018 and 2017.

Receivables

Receivables consist primarily of amounts due from the Commonwealth, and are subject to potential retroactive adjustment. The amounts of all receivables are readily determinable, and because the Plan's primary creditor is the Commonwealth, the allowance for doubtful accounts is generally immaterial, except as described below. Any amounts determined to be uncollectible are charged to expense when such determination is made.

It is the practice of the Commonwealth to pay the Plan for eligible members only after those members have been assigned to the Plan, and the Plan has sent electronic confirmation of the receipt of eligibility. Particularly in the early stages of its contract with the Commonwealth, the Plan's confirmation of eligibility of certain members was not accepted as a result of various technical issues. The Plan has continued to pay for medical services for all members in question, but the Commonwealth is withholding payment of approximately $13.4 million of premium revenue related to those members. The Plan believes it has a valid claim to all of the premiums withheld, and is pursuing collection with the Commonwealth regarding this matter.

Property and Equipment

Property and equipment are stated at cost. Replacements and major improvements are capitalized, and repairs and maintenance are charged to expense as incurred. Furniture and equipment are depreciated using the straight-line method over estimated useful lives ranging from three to seven years. Software developed for internal use is capitalized. Software is generally amortized over its estimated useful life of three years. Leasehold improvements are amortized over the term of the lease or five to 10 years, whichever is shorter. A summary of property and equipment at December 31 as follows (in thousands):

	2018	2017
Leasehold improvements	$ 3,008	$ 3,008
Furniture and equipment	2,756	2,719
Capitalized software	2,848	2,848
	8,612	8,575
Less accumulated amortization, leasehold improvements	(1,050)	(749)
Less accumulated depreciation and amortization, furniture and equipment	(2,034)	(1,653)
Less accumulated amortization, capitalized software	(2,848)	(2,395)
	(5,932)	(4,797)
Property and equipment, net	$ 2,680	$ 3,778

Restricted Cash and Investments

The Plan's restricted cash and investments amounted to $10.1 million as of December 31, 2018 and 2017. This amount consists of three separate deposits as follows:

- A cash deposit of $4.5 million, pursuant to the regulations of Commonwealth law;
- A statutory deposit of $0.6 million, also required by Commonwealth law. This deposit is a U.S. Treasury note with a maturity date of less than one year at December 31, 2018. The use of these funds is limited to a specific purpose as required by the Commonwealth. Accordingly, it is designed as held-to-maturity and is carried at amortized cost, which approximates fair value. This restricted investment is classified as a Level 2 financial instrument (within the fair value hierarchy), because the fair value for this investment is based on quoted prices for similar securities on one or more securities exchanges; and
- A $5.0 million cash deposit held as collateral for automatic clearing house payments.

Fair Value of Financial Instruments

The carrying amounts of financial instruments included in current assets and liabilities approximate their fair value because of the relatively short period of time between the origination of these instruments and their expected realization.

Income Taxes

The Plan recognizes deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of its assets and liabilities, along with net operating loss and tax credit carryovers. For further discussion and disclosure, see Note E, "Income Tax Provision."

Concentrations of Credit Risk

The Plan has amounts deposited in financial institutions in which the balances exceed the Federal Deposit Insurance Corporation insured limit. The Plan has not experienced any losses in such accounts and management believes it is not exposed to any significant credit risk.

Risks and Uncertainties

The Plan's profitability depends in large part on accurately predicting and effectively managing medical care costs. The Plan continually reviews its premium and benefits structure as well as its underlying claims experience and revised actuarial data; however, several factors could adversely affect medical care costs. These factors, which include changes in health care practices, inflation, new technologies, major epidemics, natural disasters and malpractice litigation, are beyond the Plan's control and may adversely affect its ability to accurately predict and effectively control medical care costs. Costs in excess of those anticipated could have a material adverse effect on the Plan's financial condition, results of operations and cash flows.

The Plan's sole Medicaid customer is the Commonwealth. The loss of its contract with the Commonwealth would have a material adverse effect on the Plan's financial position, results of operations and cash flows.

The Plan is subject to thorough and extensive regulations by multiple Commonwealth agencies. Its failure to comply with various regulations and requirements could limit the Plan's revenue or increase costs. In certain circumstances, a failure to comply with regulations or the cost incurred in complying with regulations could have a material adverse effect on the Plan's financial position, results of operations, and cash flows.

Recent Accounting Pronouncement Adopted

Restricted Cash. In November 2016, the FASB issued ASU 2016-08, *Restricted Cash*, which requires the Plan to include in their statements of cash flows the changes in the balances of cash, cash equivalents, restricted cash and restricted cash equivalents. The Plan adopted ASU 2016-18 on January 1, 2019. The Plan applied the guidance restrospectively to all periods presented. Such retrospective adoption resulted in a $9.5 million reclassification of restricted cash from "Investing activities," to the beginning and ending balances of cash in the statements of cash flows for the year ended December 31, 2017. There was no impact to the statements of operations, balance sheets, or stockholders' equity. The reconciliation of cash to cash and restricted cash is presented at the beginning of this note.

Recent Accounting Pronouncement Not Yet Adopted

Software Licenses. In August 2018, the Financial Accounting Standards Board (FASB) issued ASU 2018-15, *Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*, which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. ASU 2018-15 is effective beginning January 1, 2020 and can be applied either

retrospectively or prospectively to all implementation costs incurred after the date of adoption; early adoption is permitted. The Plan early adopted this guidance prospectively on January 1, 2019.

Credit Losses. In June 2016, the FASB issued ASU 2016-13, *Measurement of Credit Losses on Financial Instruments.* Rather than generally recognizing credit losses when it is probable that the loss has been incurred, the revised guidance requires companies to recognize an allowance for credit losses for the difference between the amortized cost basis of a financial instrument and the amount of amortized cost that the Plan expects to collect over the instrument's contractual life. ASU 2016-13 is effective beginning January 1, 2020 and must be adopted as a cumulative effect adjustment to retained earnings; early adoption is permitted. The Plan is in the early stages of evaluating the effect of this guidance.

Leases. In February 2016, the FASB issued ASU 2016-02, *Leases* (Topic 842), as modified by:

- ASU 2017-03, *Transition and Open Effective Date Information*;
- ASU 2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842*;
- ASU 2018-10, *Codification Improvements to Topic 842, Leases*; and
- ASU 2018-11, *Lease (Topic 842): Targeted Improvements.*

Under Topic 842, an entity will be required to recognize assets and liabilities for the rights and obligations created by leases on the entity's balance sheet for both financing and operating leases. Topic 842 also requires new disclosures that depict the amount, timing, and uncertainty of cash flows pertaining to an entity's leases. The Plan will adopt Topic 842 effective January 1, 2019, using the modified retrospective method. Under this method, the Plan will recognize the cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings on January 1, 2019. In addition, the Plan elected the transition option provided under ASU 2018-11, which allows entities to continue to apply the legacy guidance in Topic 840, Leases, including its disclosure requirements, in the comparative periods presented in the year of adoption. Under Topic 842, the Plan will record right-of-use assets and liabilities relating primarily to leases of office space for administrative and health plan operations.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the American Institute of Certified Public Accountants, and the Securities and Exchange Commission (SEC) did not have, or are not believed by management to have, a significant impact on the present the future financial statements.

Note C - Transactions With Parent

Administrative Services and Net Worth Requirements

The Plan has various transactions with the Parent and the Parent's other subsidiaries recorded through inter-company accounts. Amounts due to, or due from, the Parent represent costs incurred in the ordinary course of business by, or on behalf of, the Plan. These amounts are not subject to interest charges in accordance with the Parent's policies.

The Plan has entered into an administrative services agreement with the Parent under which the Parent provides various administrative, financial, legal, information systems and human resources services to the Plan. Fees for such services are based on the estimated fair value of services rendered. Payment is subordinated to the Plan's ability to comply with minimum capital and other restrictive financial requirements of the Commonwealth.

Charges for these services amounted to $5.4 million and $14.2 million for the years ended December 31, 2018 and 2017, respectively.

As of December 31, 2018 and 2017, amounts due to Parent include payments due for claims processing and other administrative services provided by the Parent. Intercompany receivables and payables are generally settled monthly.

The Parent did not contribute capital to the Plan in the years ended December 31, 2018 and 2017. The Parent has agreed to provide future funding to the Plan, if necessary, to ensure the Plan's compliance with minimum net worth requirements.

Note D - Medical Claims and Benefits Payable

Medical care costs and medical claims and benefits payable are based on actual historical experience and estimates of medical expenses incurred but not paid (IBNP). The Plan estimates IBNP monthly based on a number of factors, including prior claims experience, health care service utilization data, cost trends, product mix, seasonality, prior authorization of medical services and other factors. The Plan also considers uncertainties related to fluctuations in provider billing patterns, claims payment patterns, membership and medical cost trends. Many of the Plan's medical contracts are complex in nature and may be subject to differing interpretations regarding amounts due for the provision of various services. Such differing interpretations may not come to light until a substantial period of time has passed following the contract implementation, leading to potential over or under estimation of some costs in the period in which they are first recorded. Estimates are adjusted as more information becomes available. Any adjustments to reserves are reflected in current operations. The Plan employs its own actuaries. The Plan believes that its process for estimating IBNP is adequate, but all estimates are subject to uncertainties. The Plan's estimate of IBNP may be inadequate in the future, which would negatively affect the Plan's results of operations.

The following table presents the components of the change in the Plan's medical claims and benefits payable for the years ended December 31 (in thousands):

	2018	2017
Balance at beginning of period	$ 100,792	$ 80,204
Components of medical care costs related to:		
Current period	665,960	680,978
Prior period	(30,011)	9,885
Total medical care costs	635,949	690,863
Payments for medical care costs related to:		
Current period	585,924	598,936
Prior period	60,520	71,339
Total paid	646,444	670,275
Balance at end of period	$ 90,297	$ 100,792

The liability for claims unpaid at January 1, 2018, developed favorably in 2018, primarily due to lower than anticipated medical claims related to prior years. The liability for claims unpaid at January 1, 2017, developed unfavorably in 2017, primarily due to higher than anticipated medical claims related to prior years.

The following tables provide information about incurred and paid claims development as of December 31, 2018, as well as cumulative claims frequency and the total of incurred but not paid claims liabilities. The cumulative claim frequency is measured by claim event, and includes claims covered under capitated arrangements (in thousands).

	Incurred claims and allocated claims adjustment expenses			Total	Cumulative number of
Benefit year	2016	2017	2018	IBNP	reported claims
2016	$ 701,411	$ 700,969	$ 693,893	$ 2,700	4,068
2017		680,978	661,368	6,276	7,733
2018			665,960	61,515	7,468
			$ 2,021,221	$ 70,491	

	Cumulative paid claims and allocate claims adjustment expenses		
Benefit year	2016	2017	2018
2016	$ 623,560	$ 689,045	$ 691,194
2017		598,936	655,091
2018			585,924
			$ 1,932,209

Incurred claims and allocated claims adjustment expenses	$ 2,021,221
Less: cumulative paid claims and allocated claims adjustment expenses	(1,932,209)
All outstanding liabilities before 2016	1,285
Medical claims and benefits payable	$ 90,297

Note E - Income Tax Provision

On December 22, 2017, the U.S. enacted the Tax Cuts and Jobs Act ("TCJA"). The TCJA, in part, reduced the U.S. federal corporate tax rate from 35% to 21% effective January 1, 2018. TCJA's change in the rate required that the Plan revalue deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future, which is generally the new 21% U.S. federal corporate tax rate. As of December 31, 2017, the Plan had not completed its accounting for all of the enactment-date income tax effects of the TCJA for the remeasurement of deferred tax assets and liabilities and recorded a provisional amount of $2.7 million. Upon further analysis of certain aspects of the TCJA and refinement of calculations during the 12 months ended December 31, 2018, the Plan adjusted the provisional amount downward by $0.6 million, which is included as a component of income tax expense from continuing operations. The Plan has now completed its accounting for all of the enactment-date income tax effects of the TCJA.

On December 10, 2018, the Commonwealth enacted Act 257-2018, which includes numerous amendments to the Puerto Rico Internal Revenue Code of 2011 (PR Code). Key aspects of the legislation which affect the Plan are:

- Reduction to the maximum corporate income tax rate from 39% to 37.5%.
- Elimination of the existing 51% disallowance of related party charges for taxpayers that submit a valid transfer pricing study prepared under Section 482 of the U.S. Internal Revenue Code.

The above changes are effective tax years beginning after December 31, 2018.

The Plan's provision for income tax (benefit) consisted of the following components for the year ended December 31 (in thousands):

	2018	2017
Current		
Domestic	$ 8,403	$ -
Foreign	(1,025)	(2,035)
Total current	7,378	(2,035)
Deferred		
Foreign	-	6,466
Total deferred	-	6,466
Provision for income tax (benefit)	$ 7,378	$ 4,431

The difference between the provision for income tax (benefit) and the amount computed by applying the Commonwealth's statutory income tax rate to income (loss) before income tax provision (benefit) is primarily related to non-deductible related party expenses, change in valuation allowance and the revaluation of deferred tax assets in connection with the TCJA.

Deferred tax assets and liabilities are classified as non-current. The components of the deferred tax assets were as follows (in thousands):

	2018	2017
Reserve liabilities	$ 96	$ 4,578
Depreciation and amortization	2,240	2,144
Net operating loss carryforward	-	1,138
Accrued expenses	1,226	869
Tax credit carryforward	1,000	582
Other, net	(34)	51
Valuation allowance	(4,528)	(9,362)
Deferred tax assets, net of valuation allowance	$ -	$ -

At December 31, 2018, the Plan had U.S. tax credit carryovers of approximately $1.0 million. The Plan had no net operating loss carryovers.

The Plan evaluates the need for a valuation allowance taking into consideration the ability to carry back and carry forward tax credits and losses, available tax planning strategies and future income, including reversal of temporary differences. The Plan has determined that as of December 31, 2018, $4.5 million of deferred tax

assets did not satisfy the recognition criteria due to uncertainty regarding realization. Therefore, the Plan decreased its valuation allowance by $4.9 million, from $9.4 million at December 31, 2017 to $4.5 million as of December 31, 2018.

The Plan is dually organized in both the Commonwealth and the state of Nevada. The Plan files a standalone Commonwealth income tax return which is considered its domestic return. Additionally, the Plan is included in the Parent's consolidated U.S. federal income tax return which is considered the Plan's foreign income tax return. U.S. income taxes are allocated to the Plan in accordance with a tax sharing agreement. The agreement allocates income taxes in an amount generally equivalent to the amount that would be expensed by the Plan as if it filed a separate U.S. tax return. In accordance with the tax sharing agreement, benefits to the Plan that arise from net operating losses will be refunded to the extent utilized on the consolidated tax return with any unused balance carried forward to offset taxable income in future periods. The Plan may be subject to tax examinations for tax years 2014 through 2018.

The roll forward of unrecognized tax benefits for the year ended December 31, 2018 is as follows (in thousands):

Gross unrecognized tax benefits at beginning of period	$	-
Increases in tax positions for current year		588
Gross unrecognized tax benefits at end of period	$	588

As of December 31, 2018 and 2017 the Plan had $0.6 million and $0, respectively of unrecognized tax benefits that if fully recognized would affect the Plan's effective tax rate. The Plan's continuing practice is to recognize interest and/or penalties related to unrecognized tax benefits in income tax expense. The Plan accrued no interest or penalties relating to unrecognized tax benefits for the years ended December 31, 2018 and 2017.

Note F - Statutory Capital Requirement

The Plan is subject to Commonwealth regulations that, among other things, require the maintenance of minimum levels of statutory capital and restrict the timing, payment and amount of dividends and other distributions that may be paid to the Parent as the sole shareholder. To the extent the Plan must comply with these regulations, the Plan may not have the financial flexibility to pay dividends. The Plan's net assets which may not be transferred in the form of loans, advances or cash dividends was $106.5 million and $78.9 million, respectively, in 2018 and 2017. At December 31, 2018 and 2017, no amounts were available for dividends.

Note G - Employee Benefit Plans

Defined Contribution Plan

The employees of the the Plan are eligible to participate in a defined contribution 401(k) plan sponsored by the Parent subject to the participation eligibility set forth in the plan. Eligible employees are allowed to contribute up to the maximum allowed by law. The Plan matches up to the first 4% of compensation contributed by employees subject to a one-year cliff vesting requirement. The Plan has no legal obligation to

provide benefits under the plan. The Plan's expense recognized in connection with the 401(k) plan was approximately $0.8 million for both 2018 and 2017.

Stock Plans

Under an equity incentive plan adopted by the Parent, the Plan's employees may be awarded Parent restricted stock or other equity incentives. Restricted stock awards generally vest in equal annual installments over periods up to four years from the date of grant.

The Parent has an employee stock purchase plan under which the eligible employees of the Plan may purchase common shares at 85% of the lower of the fair market value of the Parent's common stock on either the first or last trading day of each six-month offering period. Each participant is limited to a maximum purchase of $25,000 (as measured by the fair value of the stock acquired) per year through payroll deductions.

Note H - Commitments and Contingencies

Leases

The Plan leases office space, clinics and equipment, which expire at various dates through 2020. Certain leases contain annual escalation clauses and renewal provisions. Future minimum lease payments by year and in the aggregate under all noncancelable operating leases consist of the following approximate amounts (in thousands):

Years ended December 31,	
2019	$ 2,823
2020	866
Total	$ 3,689

Rental expense amounted to $3.0 million for both the years ended December 31, 2018 and 2017.

Legal Proceedings

The health care industry is subject to numerous laws and regulations of federal, state and local governments. Compliance with these laws and regulations can be subject to government review and interpretation, as well as regulatory actions unknown and unasserted at this time. Penalties associated with violations of these laws and regulations include significant fines and penalties, exclusion from participating in publicly funded programs, and the repayment of previously billed and collected revenues.

The Plan is involved in legal actions in the ordinary course of business, some of which seek monetary damages, including claims for punitive damages, which are not covered by insurance. The outcome of legal actions is inherently uncertain and such pending matters for which accruals have not been established have not progressed sufficiently through discovery and/or development of important factual information and legal issues to enable the Plan to estimate a range of possible loss, if any. While it is not possible to accurately predict or

determine the eventual outcomes of these items, an adverse determination in one or more of these pending matters could have a material adverse effect on the Plan's financial position, results of operations, or cash flows.

Professional Liability Insurance

The Parent carries claims-made managed care errors and omissions professional liability insurance for their health plan operations. No significant claims have been made against the Plan.

Medical Claims Reinsurance

The Plan maintains medical claims reinsurance with a deductible of $1.3 million for Medicaid. The reinsurance pays 90% of losses in excess of the deductible. The annual limit for Medicaid is $2.0 million per member per year. Reinsurance expense is reported as a deduction from net premium income, and amounted to $0.2 million and $0.3 million in 2018 and 2017, respectively. There were no reinsurance recoveries for the years ended December 31, 2018 and 2017, respectively. The Plan is liable for all benefits payable on a direct basis, whether or not claims are recovered under the reinsurance coverage.

Commonwealth Budget

The government of Puerto Rico continues to struggle with major fiscal and liquidity challenges. The extreme financial difficulties faced by the Commonwealth may make it very difficult for ASES to pay the Plan under the terms of the parties' Medicaid contract. A default by ASES on its payment obligations under the Plan's Medicaid contract, or a determination by ASES to terminate the Plan's contract based on insufficient funds available, could result in the Plan having paid, or in the Plan having to pay, provider claims in amounts for which the Plan is not paid reimbursement, and could make it unfeasible for the Plan to continue to operate. A default by ASES or termination of the Plan's Medicaid contract could have a material adverse effect on the business, financial condition, cash flows, or results of operations.

Note I – Restructuring

Following a management-initiated, broad operational assessment in early 2017, the Parent's board of directors approved, and the Parent committed to, a comprehensive restructuring and profitability improvement plan in June 2017 (the 2017 Restructuring Plan). Key activities under this plan to date have included:

- Streamlining the organizational structure to eliminate redundant layers of management, consolidate regional support services, and other staff reductions to improve efficiency and the speed and quality of decision-making;
- Re-design of core operating processes such as provider payment, utilization management, quality monitoring and improvement, and information technology, to achieve more effective and cost efficient outcomes;
- Remediation of high-cost provider contracts and enhancement of high quality, cost-effective networks;
- Restructuring, including selective exits, of direct delivery operations; and
- Partnering with the lowest-cost, most-effective vendors.

Costs Incurred

There were no Restructuring costs in 2018. Restructuring costs in 2017 consisted of one-time termination benefits. The Plan incurred substantially all costs relating to this plan in 2017, or approximately $0.5 million.

Restructuring costs are reported in "Restructuring costs" in the accompanying statements of operations. The Plan settled the restructuring costs requiring cash settlement by December 31, 2017; therefore, there were no restructuring costs accrued as of December 31, 2017.