AUDITED FINANCIAL STATEMENTS

University of Puerto Rico

Years Ended June 30, 2005 and 2004

University of Puerto Rico

Audited Financial Statements

Years Ended June 30, 2005 and 2004

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Report of Independent Auditors

Board of Trustees
University of Puerto Rico

We have audited the accompanying statement of net assets of the University of Puerto Rico (the University), a component unit of the Commonwealth of Puerto Rico, as of June 30, 2005 and 2004 and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Servicios Médicos Universitarios, Inc. (the Hospital) and Desarrollos Universitarios, Inc. (the Company), discretely presented component units, as of and for the years ended June 30, 2005 and 2004 and March 31, 2005 and 2004, respectively. Those financial statements were audited by other auditors whose report has been furnished to us. The Hospital's report included an explanatory paragraph stating that it has experienced recurring losses since it commenced operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Our opinion, insofar as it relates to data included for the Hospital and the Company is solely based on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of 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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Puerto Rico as of June 30, 2005 and 2004, and its changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 12 to the financial statements, the Hospital has experienced recurring losses since it commenced operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern.

In accordance with *Government Auditing Standards*, we have also issued our report, dated October 31, 2005, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

Management's Discussion and Analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the supplemental information. However, we did not audit the information and express no opinion on it.

Our audits were performed primarily for the purpose of forming an opinion on the financial statements of the University of Puerto Rico taken as a whole. The schedule of changes in sinking fund reserves included in page 49 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion is fairly stated in all material respects in relation to the financial statements taken as a whole.

As disclosed in Note 1 to the financial statements, the University adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, D*eposit and Investment Risk Disclosure and amendment of GASB3*, during 2005.

Ernst & Young LLP

October 31, 2005, except for
the third paragraph of
Note 15, as to which the
date is November 19, 2005

Stamp No. 2093888
affixed to original
of this report.

Introduction

The following discussion presents an overview of the financial position and financial activities of the University of Puerto Rico (the University) for the years ended June 30, 2005 and 2004. This discussion was prepared by University management and should be read in conjunction with the financial statements and notes thereto, which follow.

Financial Highlights

The financial position of the University remains strong at June 30, 2005, with total assets of $1,048,745,000 total liabilities of $741,092,000 and net assets of $307,654,000. University net assets increased $6,892,000 during the year ended June 30, 2005 when compared to $4,114,000 during June 30, 2004. This increase is explained in the section entitled "Analysis of Financial Position and Results of Operations." An overview of the statements is presented below along with a financial analysis of the transactions impacting the statements.

Condensed financial statements for the University as of and for the years ended June 30, 2005 and 2004 follow:

Condensed Statement of Net Assets

	June 30		
	2005	**2004**	**2003**
Assets			
Current assets	**$ 298,621,981**	$ 324,488,255	$ 343,492,432
Noncurrent assets:			
Due from Commonwealth of Puerto Rico	**71,570,127**	22,710,382	-
Capital	**629,903,127**	591,331,872	568,604,803
Other	**48,650,332**	41,365,027	33,678,864
Total assets	**$1,048,745,567**	$979,895,536	$ 945,776,099
Liabilities			
Current liabilities	**$ 188,106,410**	$ 135,275,117	$ 104,847,662
Noncurrent liabilities	**552,985,169**	543,858,433	544,280,641
Total liabilities	**$741,091,579**	$679,133,550	$ 649,128,303
Net assets			
Invested in capital assets net of related debt	**$ 183,741,045**	$ 164,188,965	$ 150,639,405
Restricted:			
Nonexpendable	**45,310,063**	38,902,830	31,906,293
Expendable	**85,968,022**	91,944,811	100,138,696
Unrestricted	**(7,365,142)**	5,725,380	13,963,402
Total net assets	**$307,653,988**	$300,761,986	$ 296,647,796

Condensed Statements of Revenues, Expenses and Changes in Net Assets

	2005	2004	2003
Operating revenues			
Tuition and fees	**$ 36,951,309**	$ 40,235,263	$ 38,844,683
Grants and contracts	**257,270,339**	251,075,661	246,523,874
Patient services	**43,589,157**	50,675,183	53,329,127
Other operating revenues	**38,852,582**	38,466,965	30,579,768
Total operating revenues	**376,663,387**	380,453,072	369,277,452
Operating expenses	**1,182,072,684**	1,120,598,736	1,040,994,779
Operating loss	**(805,409,297)**	(740,145,664)	(671,717,327)
Nonoperating revenues			
State appropriations	**796,568,502**	743,632,033	695,550,184
Other nonoperating expenses, including interest on indebteness	**(2,998,029)**	(6,852,732)	(9,243,174)
Net nonoperating revenues	**793,570,473**	736,779,301	686,307,010
Income before other revenues	**(11,838,824)**	($3,366,363)	14,589,683
Capital appropriations	**12,323,593**	2,243,129	691,592
Addition to permanent endowment	**6,407,233**	5,237,424	8,332,474
Total increase in net assets	**$ 6,892,002**	$ 4,114,190	$ 23,613,749

Condensed Statements of Cash Flows

Cash and cash equivalents (used in) provided by			
Operating activities	**$ (745,410,567)**	$ (711,317,046)	$ (658,450,757)
Noncapital financing activities	**811,364,868**	755,518,466	708,285,700
Capital and related financing activities	**(74,371,268)**	(79,302,909)	(88,222,791)
Investing activities	**(12,838,861)**	(13,331,357)	48,728,417
Net decrease in cash and cash equivalents	**(21,255,828)**	(48,432,846)	10,340,569
Cash and cash equivalents - beginning of year	**56,827,882**	105,260,728	94,920,159
Cash and cash equivalents - end of year	**$ 35,572,054**	$ 56,827,882	$ 105,260,728

Using the Financial Statements

The University's financial statements were prepared in accordance with standards issued by the Governmental Accounting Standards Board (GASB). In June 1999, the GASB issued Statement No. 34, Basic *Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. This was followed in November 1999 by GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities – an amendment of GASB Statement No. 34;* in June 2002 by GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus – an Amendment of GASB Statement No. 21 and No. 34;* in June 2002 by GASB Statement No. 38, *Certain Financial Statement Note Disclosures*; and also in May 2002 by GASB Statement No. 39, *Determining whether Certain Organizations on Components Units*.

These statements became effective for the years ended June 30, 2002 through 2004. The financial statement presentation required by GASB Statements No. 34 and 35 provides a comprehensive, entity-wide perspective of the University's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows.

Analysis of Financial Position and Results of Operations

Statement of Net Assets

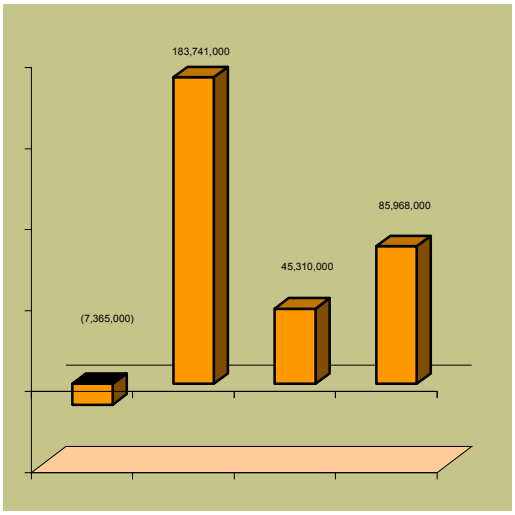
The statement of net assets presents the assets, liabilities and net assets of the University as of June 30, 2005 and 2004. The net assets are displayed in three parts, invested in capital assets net of related debt, restricted and unrestricted. Restricted net assets may either be expendable or nonexpendable and are those assets that are restricted by law or by an external donor. Unrestricted net assets, while they are generally designated for specific purposes, are available for use by the University to meet current expenses for any purposes. The statement of net assets, along with all of the University's basic financial statements, is prepared under the accrual basis of accounting, whereby revenues are recognized when the service is provided and expenses are recognized when others provide the service to the University, regardless of when cash is exchanged.

Assets included in the statement of net assets are classified as current or noncurrent. Current assets consist primarily of cash and cash equivalents, short-term investments and accounts receivable. Of these amounts, cash and cash equivalents, investments and accounts receivable comprise approximately 9.4%, 25% and 57%, respectively, of current assets as of June 30, 2005. Approximately 93% of noncurrent assets are capital assets.

University's cash, cash equivalents and investments decreased from $175,651,000 at June 30, 2004 to $170,383,000 at June 30, 2005. Current accounts receivable decreased from $161,078,000 to $142,189,000 for the same periods. The increase in Accounts Receivables net is due, basically by the increase in grants, contracts and appropriation with the Commonwealth of Puerto Rico and the Federal Government.

Current liabilities consist primarily of accounts payable and accrued liabilities and the current portion of long-term debt. Accounts payable and accrued liabilities increased from $81,097,000 to $101,262,000 between June 30, 2004 and 2005. The increase is due to an Annual Required Contribution to the University´s Retirement System and the employees, according of GASB Statement No. 16. Noncurrent liabilities consist primarily of bonded indebtedness and notes payable. Long-term debt decreased from $397,835,000 and to $382,261,000 for the same period as a result, mostly, of the repayment of principal.

Net assets represent the residual interest in the University's assets after liabilities are deducted and are classified into one of four categories as shown on the following illustration:



Unrestricted	(7,365,000)
Invested in Capital Assets	183,741,000
Restricted Nonexpendable	45,310,000
Restricted Expendable	85,968,000

Net assets invested in capital assets, net of related debt amounting to $183,741,000 represent the University's capital assets less accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

Restricted nonexpendable net assets, amounting to $45,310,000 consist primarily of the University's permanent endowment funds. The corpus of these funds may not be expended and must remain with the University in perpetuity. Only the earnings from these funds may be expended. Restricted expendable net assets, amounting to $85,968,000 are subject to externally imposed restrictions governing their use. The funds are restricted primarily for debt service, capital projects, student loans and scholarship purposes.

Unrestricted net assets amounting to $(7,365,000) represent those balances from operational activities that have not been restricted by parties external to the University such as donors or grant agencies. This includes funds that have been designated by the governing board for specific purposes as well as amounts that have been contractually committed for goods and services which have not yet been received. Approximately one half of the net assets relate to capital projects, which are in various stages of planning and completion.

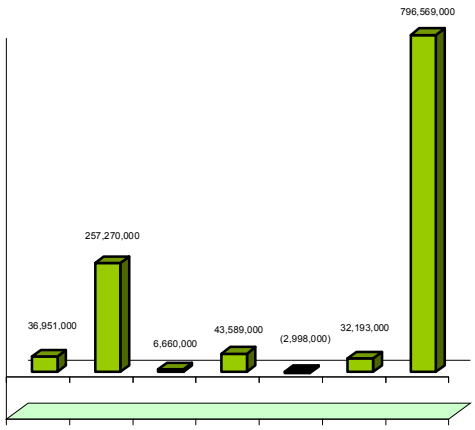
Statement of Revenues, Expenses and Changes in Net Assets

Changes in total University net assets as presented on the statement of net assets are based on the activity presented in the statement of revenues, expenses and changes in net assets. The purpose of the statement is to present the revenues received by the university, both operating and nonoperating, and the expenses paid by the University, operating and nonoperating, and any other revenues, expenses, gains and losses received or spent by the University.

Generally, operating revenues are received for providing goods and services to the various customers and constituencies of the University. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the University. Nonoperating revenues are revenues received for which goods and services are not provided. GASB Statement No. 34, as amended by GASB Statement No. 35 requires that statement appropriations be classified as nonoperating.

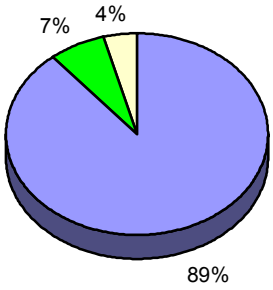
Approximately 91% of the operating revenues and non operating revenues of the University are federal and Commonwealth appropriations grants and contracts. The remainder consists primarily of tuition and fees and patient services.

The following illustration presents the major sources of University revenues (both operating and nonoperating) for the year ended June 30, 2005:



Tuitions & Fees	36,951,000
State and Federal Grants & Contracts	257,270,000
Auxiliary Enterprises	6,660,000
Patient services	43,589,000
Nonoperating Revenues	(2,998,000)
Other Operating Revenues	32,193,000
State Appropiations	796,569,000

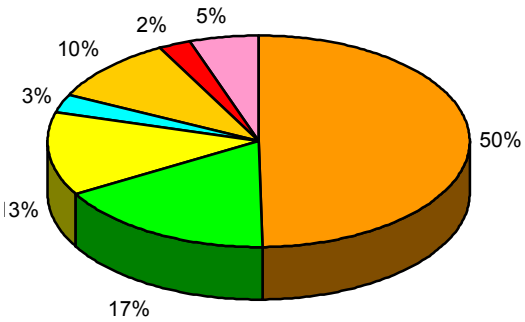
Analysis of Grants Revenues



Federal	238,302,090	89%
Commonwealth	18,968,249	7%
Other	10,852,762	4%

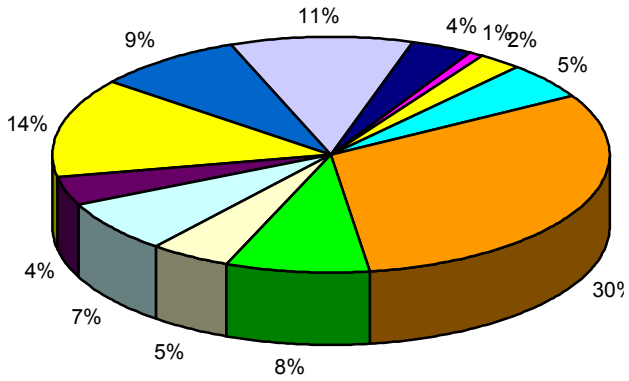
University expenses are presented using natural expense classifications. Salaries and benefits represent 67% of the University's operating expenses.

The following illustration presents the major University operating expenses, using natural classification for the year ended June 30, 2005:



Salaries	$ 588,045,000	50%
Benefits	199,436,000	17%
Scholarship and others services	151,106,000	13%
Utilites	33,152,000	3%
Supplies and others services	117,982,000	10%
Depreciation	29,354,000	2%
Others Expenditures	62,997,000	5%

Functional expense classification presents University expenses in the operational categories they benefit. The following illustration presents the major uses of University revenues (both operating and nonoperating) on a functional basis for the year ended June 30, 2005.



Instruction	367,702,000	30%
Research	98,034,000	8%
Public Service	56,022,000	5%
Academic Support	85,615,000	7%
Student Services	45,480,000	4%
Institutional Support	162,697,000	14%
Operation and Maintenance of Plant	101,530,000	9%
Scholarships and Fellowships	124,768,000	11%
Auxiliary Enterprises	42,391,000	4%
Patient service	10,609,000	1%
Depreciation	29,354,000	2%
Other	57,870,000	5%

For the year ended June 30, 2005, the University reported an operating loss of approximately $(805,409,000). After adding non-operating revenue and expenses, primarily state appropriations, the total increase in net assets for the year is approximately $6,892,000.

Statement of Cash Flows

The statements of cash flows present information related to cash flows of the University. The statement presents cash flows by category: operating activities, noncapital financing activities, capital and related financing activities and investing activities. The net cash provided to, or used by the University is presented by category.

Increases in cash and cash equivalents from noncapital financing activities were due primarily to the receipt of state appropriations and increases in cash and cash equivalents from investing activities resulted from maturities of short-term investments. Those increases were offset by decreases in cash and cash equivalents from capital and related financing activities and cash used in operating activities. Cash and cash equivalents decreased from capital and related debt activity due primarily to purchases of capital assets and payment of principal and interest on debt. The decrease in cash and cash equivalents from operating activities is consistent with the University's operating loss.

Capital Assets and Debt Administration

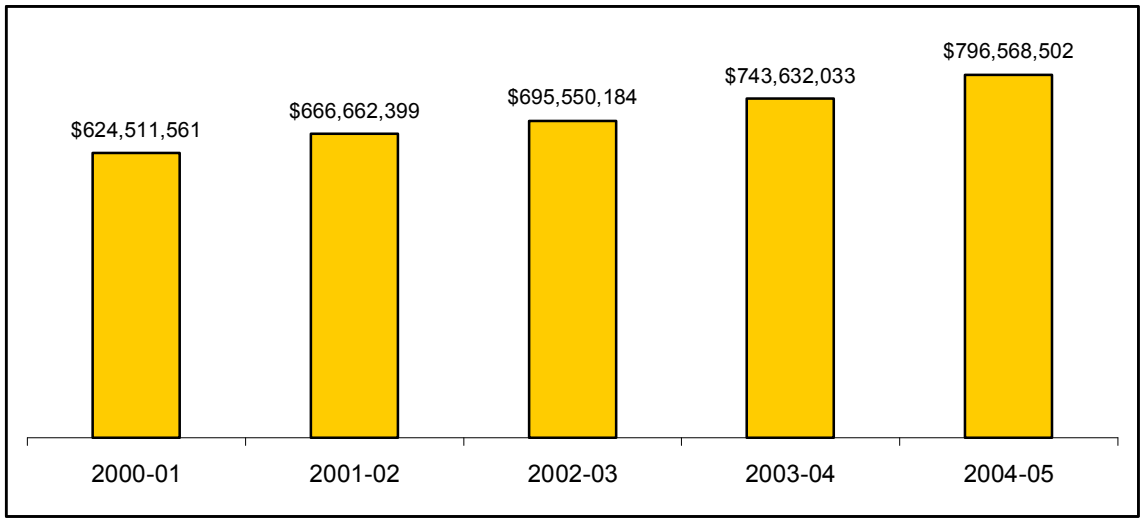
Significant capital assets additions for the year ended June 30, 2005 consist mainly of renovation and rehabilitation of existing facilities, restoration of historic buildings, and modifications of existing facilities in light of new technology, educational standards and the requirements of modern building codes.

During fiscal year 2005, the University borrowed $32,011,000 from the Governmental Development Bank, to finance new construction projects. Debt in the amount of approximately $17,486,000 was retired during the year.

Economic Outlook

The economy of Puerto Rico must be analyzed as a region within the U.S. economy, since it is part of the U.S. monetary and banking system, as well as within its territorial boundaries. The main driver of the Puerto Rico economy is a huge external sector closely tied to the flow of merchandise, tourists, and capital between Puerto Rico and the Mainland. Thus, historically, the real growth rates of the Puerto Rico economy have closely followed those of the U.S. economy. In fiscal year 2005, real GDP of Puerto Rico economy continued to expand at rate of 3.0%. The overall expansion of the economy of Puerto Rico was negatively affected by a decline in the U.S. real GDP growth rate.

The Commonwealth appropriations for the last five years are illustrated below:



The University administration is not aware of any currently known facts, decisions or conditions that are expected to have a significant effect on the University's financial position or results of operation during fiscal year 2005 beyond those unknown variations having a global effect on virtually all types of business operations. While the University's overall financial position is strong, various factors influence the University's ultimate financial success.

University of Puerto Rico

Statements of Net Assets

	June 30 2005	2004
Assets		
Current assets:		
Cash and cash equivalents	**$ 34,073,287**	$ 55,330,233
Investments at fair value	**51,044,877**	42,380,461
Investments with bond trustees at fair value	**39,093,146**	39,099,123
Accounts receivable (less allowances for doubtful accounts of $96,379,608 and $75,841,858 for 2005 and 2004, respectively)	**142,189,387**	161,077,900
Inventories	**8,000,211**	7,455,868
Prepaid expenses and other assets	**24,221,073**	19,144,670
Total current assets	**298,621,981**	324,488,255
Noncurrent assets:		
Restricted cash and cash equivalents	**1,498,767**	1,497,649
Investments at fair value	**44,672,823**	37,343,883
Due from Commonwealth of Puerto Rico	**71,570,127**	22,710,382
Notes receivable, net	**2,478,742**	2,523,495
Capital assets (net accumulated depreciation of $362,900,414 and $340,650,082 for 2005 and 2004, respectively)	**629,903,127**	591,331,872
Total noncurrent assets	**750,123,586**	655,407,281
Total assets	**$ 1,048,745,567**	$ 979,895,536
Liabilities		
Current liabilities:		
Accounts payable and accrued liabilities	**$ 101,261,852**	$ 81,097,273
Current portion of long-term debt	**63,901,010**	31,531,864
Other current liabilities	**22,943,548**	22,645,980
Total current liabilities	**188,106,410**	135,275,117
Noncurrent liabilities:		
Long-term debt, net of current portion	**382,261,072**	397,834,520
Other long-term liabilities	**170,724,097**	146,023,913
Total noncurrent liabilities	**552,985,169**	543,858,433
Total liabilities	**$ 741,091,579**	$ 679,133,550

See accompanying notes.

	June 30 2005	2004
Net assets		
Invested in capital assets, net of related debt	**$ 183,741,045**	$ 164,188,965
Restricted, nonexpendable		
Sholarship & fellowships	**23,837,318**	20,979,392
Research	**18,546,717**	13,292,145
Other	**2,926,028**	4,631,293
Restricted, expendable		
Research	**15,729,216**	13,180,651
Loans	**7,881,602**	7,996,322
Capital projects	**5,662,370**	6,679,951
Debt service	**37,501,622**	39,838,432
Other	**19,193,212**	24,249,455
Unrestricted	**(7,365,142)**	5,725,380
Total net assets	**$ 307,653,988**	$ 300,761,986

See accompanying notes.

University of Puerto Rico
Statements of Revenues, Expenses and Changes in Net Assets

	June 30	
	2005	**2004**
Revenues		
Operating revenues:		
Tuitions and fees (net of scholarship allowances of $28,822,302 and $30,100,834 for 2005 and 2004, respectively)	**$ 36,951,309**	$ 40,235,263
Net hospital patient services and other	**43,589,157**	50,675,183
Federal grants and contracts	**238,302,090**	238,477,529
Commonwealth grants and contracts (net of allowances of $4,893,254 and $9,895,867 for 2005 and 2004, respectively)	**18,968,249**	12,598,132
Nongovermental grants and contracts	**10,852,762**	11,366,647
Sales and services of educational departments	**5,935,971**	4,726,381
Auxiliary enterprises (net of scholarship allowances of $146,715 and $4,146 for 2005 and 2004, respectively)	**6,659,812**	6,748,690
Other operating revenues	**15,404,037**	15,625,247
Total operating revenues	**376,663,387**	380,453,072
Expenses		
Salaries:		
Faculty	**339,512,616**	323,245,761
Exempt staff	**246,050,912**	229,202,035
Nonexempt wages	**2,481,087**	2,808,706
Benefits	**199,435,760**	179,020,688
Scholarship and fellowship	**151,106,021**	154,139,641
Utilities	**33,152,547**	31,234,988
Supplies and other services	**117,982,519**	121,930,100
Depreciation	**29,353,945**	34,266,264
Other expenses	**62,997,277**	44,750,553
Total operating expenses	**1,182,072,684**	1,120,598,736
Operating loss	**(805,409,297)**	(740,145,664)
Nonoperating revenues (expenses):		
Commonwealth appropriations	**796,568,502**	743,632,033
Gifts	**7,284,899**	6,010,379
Net investment income	**3,154,496**	3,023,248
Interest on indebtedness	**(14,541,657)**	(16,524,989)
Other nonoperating revenues	**1,104,233**	638,630
Net nonoperating revenues	**793,570,473**	736,779,301
Loss before other revenues	**(11,838,824)**	(3,366,363)
Capital appropriations	**12,323,593**	2,243,129
Additions to term and permanent endowment	**6,407,233**	5,237,424
Increase in net assets	**6,892,002**	4,114,190
Net Assets		
Beginning of year	**300,761,986**	296,647,796
End of year	**$ 307,653,988**	$ 300,761,986

See accompanying notes.

University of Puerto Rico
Statements of Cash Flows

	Year Ended June 30	
	2005	**2004**
Cash flows from operating activities		
Tuition and fees	**$ 37,297,489**	$ 40,113,831
Grants and contracts	**255,755,608**	255,434,259
Patient services	**43,589,157**	50,675,184
Auxiliary enterprises	**6,349,042**	6,654,215
Sales and services educational depatrments	**10,203,787**	(3,624,511)
Payments to suppliers and vendors	**(117,067,834)**	(121,921,472)
Payments to employees	**(594,941,568)**	(548,196,193)
Payments for utilities	**(33,424,034)**	(31,216,778)
Payments for benefits	**(149,236,160)**	(154,604,323)
Payments for scholarships and fellowships	**(151,084,619)**	(154,140,705)
New loans issued to students	**(1,513,505)**	(2,435,729)
Student loan repayments	**1,558,255**	1,769,508
Other payments	**(52,896,185)**	(49,824,332)
Net cash used in operating activities	**(745,410,567)**	(711,317,046)
Cash flows from noncapital financing activities		
Commonwealth appropriations	**796,568,502**	743,632,033
Endowment gifts	**6,407,233**	5,237,424
Gifts and grants for other than capital purposes	**8,389,133**	6,649,009
Net cash provided by noncapital financing activities	**811,364,868**	755,518,466
Cash flows from capital and related financing activities		
Capital appropriations	**12,323,593**	2,243,129
Net purchases of capital assets	**(86,684,521)**	(61,085,487)
Principal paid on capital debt	**(17,485,773)**	(21,447,422)
Interest paid on capital debt	**(14,541,657)**	(16,524,989)
Deposit with trustee	**5,977**	1,560,404
Proceeds from capital debt	**32,011,113**	15,951,456
Net cash used in capital and related financing activities	**(74,371,268)**	(79,302,909)
Cash flows from investing activities		
Proceeds from sales and maturities of investments	**17,050,968**	16,534,604
Purchase of investments	**(33,044,325)**	(32,889,209)
Interest on investments	**3,154,496**	3,023,248
Net cash used in investing activities	**(12,838,861)**	(13,331,357)
Net change in cash and cash equivalents	**(21,255,828)**	(48,432,846)
Cash and cash equivalents:		
Beginning of period	**56,827,882**	105,260,728
End of period	**$ 35,572,054**	$ 56,827,882

University of Puerto Rico
Statement of Cash Flows (continued)

	Year Ended June 30 2005	2004
Reconciliation of net operating revenues (expenses) to net cash used in operating activities		
Operating loss	**$ (805,409,297)**	$ (740,145,664)
Adjustments to reconcile net loss to net cahs used in operating activities:		
Depreciation expense	**29,353,945**	34,266,264
Reduction of capital assets	**18,759,321**	4,092,154
Amortization on land premium, discount and future appreciated principal	**2,270,359**	2,069,141
Changes in assets and liabilities, net:		
Grants and contracts receivables	**(29,971,230)**	(36,920,674)
Other receivables		
Prepaid expenses, inventories and other	**(5,620,747)**	(7,444,118)
Accounts payable and accrued liabilities	**20,209,330**	17,617,019
Accrued salaries and wages and other liabilities	**24,997,752**	15,148,832
Net cash used in operating activities	**$ (745,410,567)**	$ (711,317,046)

See accompanying notes.

Discretely Presented Component Unit
(Servicios Médicos Universitarios, Inc.)
Balance Sheets

	Year Ended June 30	
	2005	**2004**
Assets		
Current assets:		
Cash	**$ 977,009**	$ 834,927
Patient accounts receivable, net of allowance for doubtful accounts of $29,174,559 in 2005 and $24,663,708 in 2004	**11,413,732**	10,468,354
Estimated third-party payor settlement - Medicare	**-**	410,347
Accounts receivable - other	**262,486**	217,514
Inventories of supplies	**1,835,051**	1,535,453
Prepaid expenses	**868,525**	877,233
Total current assets	**15,356,803**	14,343,828
Property and equipment, net	**3,283,246**	2,551,845
Total assets	**$ 18,640,049**	$ 16,895,673
Liabilities and deficiency in unrestricted net assets		
Current liabilities:		
Current portion of long term debt	**$ 15,367,611**	$ 15,367,611
Current portion of capital lease obligations	**278,984**	338,073
Accounts payable	**16,131,047**	14,147,967
Accrued interest	**2,762,252**	1,912,252
Estimated third-party payor settlements-Medicare	**1,454,393**	-
Accrued payroll taxes and employee benefits	**1,505,430**	1,577,899
Accrued expenses	**4,345,815**	4,266,459
Total current liabilities	**41,845,532**	37,610,261
Long-term debt, net of current portion	**1,632,389**	1,632,389
Capital lease obligations, net of current portion	**-**	32,004
Due to related parties	**26,587,565**	23,668,541
Total liabilities	**70,065,486**	62,943,195
Commitments and contingencies		
Deficiency in unrestricted net assets	**(51,425,437)**	(46,047,522)
Total liabilities and deficiency in unrestricted net assets	**$ 18,640,049**	$ 16,895,673

See accompanying notes.

Discretely Presented Component Unit
(Servicios Médicos Universitarios, Inc.)
Statements of Operations and Deficiency in Unrestricted Net Assets

	Year Ended June 30	
	2005	**2004**
Unrestriced revenues and other support:		
Net patient service revenue	**$ 37,700,670**	$ 35,011,804
Other revenue	**1,445,330**	1,385,018
Total revenues and other support	**39,146,000**	36,396,822
Expenses:		
Salaries and benefits	**17,222,514**	15,843,487
Contracted services	**2,378,480**	2,365,146
Professional services	**964,299**	942,119
Supplies	**12,029,608**	11,426,480
Utilities	**1,664,010**	1,816,464
Interest	**977,478**	996,509
Provision for bad debs	**6,292,064**	3,990,269
Depreciation and amortization	**586,230**	776,989
Other	**2,409,233**	1,928,903
Total expenses	**44,523,916**	40,086,366
Net loss	**(5,377,916)**	(3,689,544)
Deficiency in unrestricted net assets, at beginning of year	**(46,047,522)**	(42,357,978)
Deficiency in unrestricted net assets, at end of year	**$ (51,425,438)**	$ (46,047,522)

See accompanying notes.

Discretely Presented Component Unit
(Desarrollos Universitarios, Inc.)
Balance Sheet

	Year Ended March 31	
	2005	**2004**
Assets		
Current assets:		
Cash	**$ 202,802**	$ 77,805
Restricted funds held by trustee	**25,695,460**	32,331,302
Project in process	**80,755,423**	70,965,964
Bond issance costs, net of accumulated amortization of $290,391 and $210,412	**2,498,833**	2,578,812
Prepaid expenses	**5,275**	5,110
Total assets	**$ 109,157,793**	$ 105,958,993
Liabilities and deficiency in fund balance		
Current liabilities:		
Construction contract, project management fee and other payables, including retainege of $2,451,894 in both years	**$ 3,077,199**	$ 3,787,561
Accrued interest payable	**1,097,533**	1,113,722
Accrued expenses	**111,964**	115,876
Unearned revenue	**19,896,569**	14,670,562
Bonds payable, net of discount of $368,015 and $394,091	**85,071,985**	86,340,909
Total current liabilities	**109,255,250**	106,028,630
Contingencies		
Deficiency in fund balance	**(97,457)**	(69,637)
Total liabilities and deficiency in fund balance	**$ 109,157,793**	$ 105,958,993

See accompanying notes.

Discretely Presented Component Unit
(Desarrollos Universitarios, Inc.)
Statements of Operations and Deficiency in Fund Balance

	Year Ended March 31	
	2005	**2004**
Expenses:		
General and administrative	**$ (27,820)**	$ (31,716)
Total expenses and excess of expenses over revenues	**(27,820)**	(31,716)
Deficiency in fund balance, beginning of year	**(69,637)**	(37,921)
Deficiency in fund balance, end of year	**$ (97,457)**	$ (69,637)

See accompanying notes.

1. Reporting Entity and Summary of Significant Accounting Policies

Reporting Entity

The University of Puerto Rico (the University) is a public corporation of the Commonwealth of Puerto Rico (the Commonwealth) governed by a thirteen-member Board of Trustees, of which ten are appointed by the Governor of Puerto Rico and confirmed by the Senate of Puerto Rico. The remaining members of the Board consist of one full-time student and two term professors. The Governor appointed the original members for terms from four to eight years. Upon expiration of their terms, the new members will be appointed for a period of six years. The terms for the student and professors are for one year.

The University is exempt from the payment of taxes on its revenues and properties. The University is a component unit of the Commonwealth.

The financial reporting entity of the University consists principally of Río Piedras, Mayagüez, Medical Sciences, Cayey, Humacao, Ponce, Bayamón, Aguadilla, Arecibo, Carolina and Utuado; and the Central Administration.

Appropriations from the Commonwealth are the principal source of revenues of the University and are supported by Act No. 2 of January 20, 1966, as amended. Under the Act, the Commonwealth appropriates for the University an amount equal to 9.60% of the average total amount of annual revenues collected under the laws of the Commonwealth in the two fiscal years immediately proceeding the current fiscal year. In addition, the Commonwealth has appropriated amounts for general current obligations, for capital improvement programs, and for loans and financial assistance to students.

Discretely Presented Component Unit Disclosures: A discretely presented component unit is an entity whose operations are separate from the University's but over whom the University has significant accountability. The University has two discretely presented component units as follows:

Servicios Médicos Universitarios, Inc.

Servicios Médicos Universitarios, Inc. (the Hospital) is legally separated from the University and is governed by a separate board. The Company is a not-for-profit acute care corporation, organized under the Laws of the Commonwealth of Puerto Rico, on February 11, 1998. The principal objectives of the Company are to constitute it as the principal medical education, institution of the University and to offer care services to the residents of Puerto Rico.

1. Reporting Entity and Summary of Significant Accounting Policies (continued)

Servicios Médicos Universitarios Inc. (continued)

Desarrollos Universitarios, Inc.

Desarrollos Universitarios, Inc. (the Company) is legally separated from the University and is governed by a separate board. The Company was organized on January 22, 1997, under the laws of the Commonwealth of Puerto Rico as a not-for-profit organization. The Company was organized to develop, construct, and operate academic, residential, administrative, office, commercial, and maintenance facilities for the use of students and other persons or entities conducting business with the University of Puerto Rico (the University). Currently, the Company is in the process of developing the Plaza Universitaria (Plaza Universitaria) and the Central Air Condition System projects (the Projects), to be leased to the University. Plaza Universitaria will consist of a student housing facility, a multi-story parking building and an institutions building to house administrative, student service and support functions and to a lesser extent to lease commercial space. The financing for the Projects is being provided by the issuance of $86,735,000 in Educational Facilities Revenue Bonds through the Puerto Rico Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority (AFICA).

The following is a summary of the significant accounting policies followed by the University:

Financial Statement Presentation

In June 1999, the GASB issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. This was followed in November 1999 by GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities – an amendment of GASB Statement No. 34*; in June 2001 by GASB Statement No. 37, *Basic Financial Statements and Management's Discussion ad Analysis – for State and Local Governments: Omnibus – an Amendment of GASB Statement No. 21 and No. 34*; and, also in June 2004 by GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. These statements are effective for the year ended June 30, 2003. The financial statement presentation required by GASB Statement Nos. 34, 35, 37 and 38 provide a comprehensive, entity-wide perspective of the University's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows and replaces the fund group perspective previously required.

1. Reporting Entity and Summary of Significant Accounting Policies (continued)

Financial Statement Presentation (continued)

Significant accounting changes made in order to comply with the new requirements included the adoption of depreciation of capital assets, reporting tuition and fee revenue net of certain scholarship allowances and reporting revenue from auxiliary enterprises net of cost of goods sold and scholarships and allowances. Additionally, reclassifications of prior year balances have been made to conform to the current year presentation.

In March 2003, the GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures. This statement which amends GASB Statement No. 3, Deposits with Financial Institutions, Investments (Including Repurchase Agreements) and Reverse Repurchase Agreements*, is effective for the University for the year ending June 30, 2005.

The University will be required to address common deposit and investment risk to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. This statement also requires certain values that are highly sensitive to changes in interest rates. The University is also required to disclose its deposit and investment policies.

Measurement Focus and Basis of Accounting

For financial reporting purposes, the University is considered a special purpose governmental agency engaged only in business type activities, as defined by GASB Statement No. 34. Accordingly, the University's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. All significant transactions related to internal service activities such as publications, telecommunications and institutional computing have been eliminated where appropriate.

The University has the option to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB pronouncements conflict with GASB pronouncements. The University has elected to not apply FASB pronouncements issued after the applicable date.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 expenditures during the reporting period. Actual results could differ from those estimates.

1. Reporting Entity and Summary of Significant Accounting Policies (continued)

Cash Equivalents

The University considers all highly liquid debt instruments with maturities of three months or less when purchased to be cash equivalents.

Investments

Investments are reported at fair value in the statements of net assets. The changes in the fair value of investments are reported in the statements of revenues, expenses and changes in net assets as a component of net investment income.

Donated investments are recorded at their fair value at the date of donation. Investments of the Deferred Compensation Plan are valued at fair value in order to measure the current liability attributable to plan participants.

Restricted Funds Held by Trustee – Discretely Presented Component Unit

Restricted funds of Desarrollos Universitarios, Inc. held by trustee at March 31, 2005 and 2004 consist of money market funds and zero coupon bonds purchased with remaining maturities of six months or less.

Capital Assets

All capital expenditures of $1,000 or more and having a useful life of two or more years are capitalized at cost at the date of acquisition. Donated assets are recorded at estimated fair value at the date of donation. Depreciation is recorded using the straight-line method over the estimated useful lives of the assets, generally 25 to 50 years for buildings and infrastructure, 5 to 20 years for equipment and library materials, and 7 to 30 years for land improvements. Renovations to buildings and other assets that significantly increase the value or extend the useful life of the asset capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense was incurred.

Inventories

Inventories are valued at the lower of first-in, first-out cost or market and consist primarily of books.

1. Reporting Entity and Summary of Significant Accounting Policies (continued)

Classification of Net Assets

The University's net assets are classified as follows:

Invested in capital assets, net of related debt represents the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

Restricted, nonexpendable net assets consist of endowment and similar type funds which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to principal.

Restricted, expendable net assets include resources that the University is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, hospital revenues, sales and services of educational activities and auxiliary enterprises. Auxiliary enterprises are substantially self-supporting activities that provide services for students, faculty and staff. While unrestricted net assets may be designated for specific purposes by action of managements or the Board of Trustees, they are available for use, at the discretion of the governing board, to meet current expenses for any purpose. Substantially all unrestricted net assets are designated for academic and research programs and initiatives, and capital programs.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the University addresses each situation on a case-by-case basis prior to determining the resources to be used to satisfy the obligation.

1. Reporting Entity and Summary of Significant Accounting Policies (continued)

Scholarship Allowances and Student Financial Aid

Student tuition and fees, and certain other revenues from students, are expected net of scholarship discounts and allowances in the statement of revenues, expenses and changes in net assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the University and the amount that is paid by students and/or third parties making payments on the students' behalf. Certain governmental grants, such as Pell grants and other federal, state or nongovernmental programs, are recorded as either operating or nonoperating revenues in the University's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and certain other student charges, the University has recorded a scholarship discount and allowance.

Bond Premium/Discount and Deferred Issuance Costs

Bond premium and/or discount and deferred issuance costs are amortized using the effective interest method.

Deferred Compensation Plan

The University offers certain employees a non-qualified deferred compensation plan which was created pursuant to Certification No. 94 of the Council of Higher Education, dated February 13, 1984. The plan, managed by independent plan administrators, permits employees to defer a portion of their salary until future years. At the employee's election, such amounts may be invested in mutual funds, which represent varying levels of risk and return. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to these amounts, are (until paid or made available to the employee or other beneficiary) solely the property and rights of the University (without being restricted to the provisions of benefits under the plan), subject only to the claims of the University's general creditors. Participants' rights under the plan are equal to that of general creditors of the University in an amount equal to the fair market value of the deferred account for each participant. It is the opinion of the University's legal counsel that the University has no liability for the losses under the plan but does have the duty of care that would be required of an ordinary prudent investor. The University believes that it is unlikely that it will use the assets of the plan to satisfy the claims of general creditors in the future.

1. Reporting Entity and Summary of Significant Accounting Policies (continued)

Compensated Absences

The vacation policy of the University generally provides for the accumulation of 2.5 days per month. Unpaid vacation time accumulated is fully vested to the employees from the first day of work.

Employees accumulate sick leave generally at a rate of 1.5 days per month up to a maximum of 90 days. The University pays, annually, the excess of 90 days of accumulated sick leave to the employees. Upon retirement, an employee receives compensation for all accumulated unpaid sick leave at the then current rate, provided the employee has at least 10 years of service with the University. During the years ended June 30, 2005 and 2004, the cost of the excess of 90 days of the accumulated sick leave was $8,664,000 and $8,206,000, respectively.

Classification of Revenues

The University has classified its revenues as either operating or nonoperating revenues.

Operating revenues include activities that have the characteristics of exchange transactions such as student tuition and fees, net of scholarship discounts and allowances; sales and services of auxiliary enterprises, net of scholarship allowances; most federal, state and local grants and contracts; and, hospital patient service revenues, net of allowances for contractual adjustments and doubtful accounts.

Non operating revenues include activities that have the characteristics of non-exchange transactions, such as gifts and contributions, and other revenue sources that are defined as nonoperating revenues by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, and GASB Statement No. 34, such as state appropriations, investment income and gifts. Gifts to the endowment fund are classified as other nonoperating revenues.

Gifts and Pledges

Pledges of financial support from organizations and individuals representing and unconditional promise to give are recognized in the financial statements once all eligibility requirements, including time requirements, have been met. In the absence of such promise, revenue is recognized when the gift is received. Endowment pledges generally do not meet eligibility requirements, as defined by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, and are not recorded as assets until the related gift has been received.

Unconditional promises that are expected to be collected in future years are recorded at the present value of the estimated future cash flows.

1. Reporting Entity and Summary of Significant Accounting Policies (continued)

Gifts and Pledges (continued)

During the current year, the University received the third payment of $5,000,000 of an award from the National Center of Minority Health Disparities (NCMHD) amounting to $17,925,684, to establish a Health Services Research Center within the University of Puerto Rico's School of Medicine. The purpose of this Center is to strengthen and increase the diversity of the biomedical and behavioral workforce for the 21st century.

As part of the agreement, the University has to maintain the principal invested for at least five years; therefore, it was classified as a term endowment fund. The University received other miscellaneous endowment gifts during the year.

Grants and Contracts

The University has been awarded grants and contracts for which the funds have not been received or expenditures made for the purpose specified in the award. These awards have not been reflected in the financial statements, but represent commitments of sponsors to provide funds for specific research or training projects. For grants that have allowable cost provisions, the revenue will be recognized as the related expenditures are made. For grants with work completion requirements, the revenue is recognized as the work is completed and for grants without either of the above requirements, the revenue is recognized as it is received.

2. Cash and Cash Equivalents

As of June 30, 2005 and 2004, cash equivalents of approximately $25,757,000 and $65,898,000 respectively, consist of certificates of deposit and time deposits.

All the operating cash of the University and its Retirement System (the System) is pooled into one bank account. Cash balances by funds represent the cash that is allocated to each fund of the University.

The University is authorized to deposit only in institutions approved by the Department of the Treasury of the Commonwealth of Puerto Rico (Treasury) and such deposits are maintained in separate bank accounts in the name of the University. Such authorized depositories, except for the Government Development Bank for Puerto Rico (GDB) and the Economic Development Bank for Puerto Rico (EDB), collateralize the uninsured deposits with securities that are pledged with the Department of the Treasury.

No collateral is required to be maintained for deposits in the GDB and EDB, both public corporations of the Commonwealth of Puerto Rico.

2. Cash and Cash Equivalents (continued)

As of June 30, 2005 and 2004, the carrying value of cash and cash equivalents amounted to approximately $35,572,000 and $56,828,000 respectively, and the cash deposited in the banks amounted to $46,923,000 and $70,938,000 respectively.

3. Investments

The University's investments held at June 30, 2005 and 2004 are summarized in the following table:

	2005	2004
Certificates of deposit	**$ 7,457,224**	$ 4,536,924
Government agency securities	**56,456,176**	51,799,023
Corporate bonds and preferred stock	**11,104,374**	10,257,849
Common stock and convertibles	**59,793,072**	51,879,671
Other	**-**	350,000
	$ 134,810,846	$ 118,823,467

The custody of these investments is held by the trust treatment of a commercial bank in the name of the University and the portfolio is managed by a brokerage firm.

The University is authorized to invest a percentage of total assets, with certain limitations, in the following types of investments; not less than 20% and no more than 80% in fixed income securities, not less than 20% and no more than 80% in equity securities. No international equity, private equity and on non-U.S. income securities investments are held by the University.

Credit Risk

Issuer credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Investments issued or explicitly guaranteed by the United States government are excluded. As of June 30, 2005, the University's credit quality distribution for securities was as follows:

	Carrying Value	Moody's Ratings
U.S. Treasury Notes	$ 15,555,062	AAA
Corporate Bonds	11,104,384	AA

3. Investments (continued)

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value is to changes to market interest rates. As of June 30, 2005, the weighted average maturity by investment type in each fund follows:

Investment Type	Maturities	Amount
U.S. Treasury Notes	April 2008 - July 2032	$ 6,913,802
U.S. Treasury Notes	March 2007 - July 2032	422,114
U.S. Treasury Notes	November 2008 - July 2032	133,411
U.S. Treasury Notes	April 2008 - July 2032	6,969,055
U.S. Treasury Notes	November 2008 - April 2010	26,668
U.S. Treasury Notes	August 2008 - July 2032	1,090,012
Corporate Bonds	January 2006 - May 2033	4,694,744
Corporate Bonds	January 2006 - March 2033	315,522
Corporate Bonds	January 2006 - March 2033	130,577
Corporate Bonds	January 2006 - May 2033	4,757,751
Corporate Bonds	October 2013 - October 2030	11,963
Corporate Bonds	January 2006 - May 2033	1,193,827
		$ 26,659,446

4. Accounts Receivable

Accounts receivable as of June 30 are as follows:

	2005	2004
Commonwealth of Puerto Rico appropriations, grants and contracts	**$ 60,341,238**	$ 93,132,075
Due from Federal government	**40,857,570**	31,410,284
Due from Medical Plans	**45,203,075**	39,863,035
Due from Servicios Médicos Universitarios, Inc.	**24,646,756**	20,946,756
Other	**67,520,356**	51,567,608
	238,568,995	236,919,758
Less allowance for doubtful accounts	**96,379,608**	75,841,858
Accounts receivable, net	**$ 142,189,387**	$ 161,077,900

On September 7, 2004, the legislature of Puerto Rico approved a resolution to pay $94,710,382 to the University on behalf of the Puerto Rico Department of Health and the Commonwealth of Puerto Rico, over the course of ten years. As of June 30, 2005 the University has received $7,570,127 from this amount. The remaining balance is going to be received as follows:

Fiscal Year	Amount
2005-2006	$ 15,570,127
2006-2007	15,570,127
2007-2008	15,570,127
2008-2009	7,570,127
2009-2010	7,570,127
2010-2011	7,570,127
2011-2012	8,000,000
2012-2013	8,000,000
2013-2014	1,719,493
	$ 87,140,255

5. Capital Assets

Changes in capital assets for the year ended June 30, 2005 and 2004 are as follows:

	2005				
	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Capital assets not being depreciated:					
Land	$ 32,965,504	$ -	$ -	$ -	$ 32,965,504
Construction - in progress	117,183,191	50,431,777	(16,163,234)	(1,013,274)	150,438,460
	150,148,695	50,431,777	(16,163,234)	(1,013,274)	183,403,964
Other capital assets:					
Land improvements	30,514,724	-	-	-	30,514,724
Building, fixed equipment, improvements and infraestructure	566,661,328	-	15,285,066	-	581,946,394
Equipment and library materials	184,657,207	20,089,510	878,168	(8,686,426)	196,938,459
	781,833,259	20,089,510	16,163,234	(8,686,426)	809,399,577
Less accumulated drepreciation for:					
Land improvements	(10,211,382)	(1,252,099)	-	-	(11,463,481)
Buildings, fixed equipment, improvements and infraestructure	(196,029,115)	(14,690,372)	-	-	(210,719,487)
Equipment and library materials	(134,409,585)	(13,411,474)	-	7,103,613	(140,717,446)
	(340,650,082)	(29,353,945)	-	7,103,613	(362,900,414)
Other capital assets, net	441,183,177	(9,264,435)	16,163,234	(1,582,813)	446,499,163
Capital assets, net	$ 591,331,872	$ 41,167,342	$ -	$ (2,596,087)	$ 629,903,127

5. Capital Assets (continued)

	2004				
	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Capital assets not being depreciated:					
Land	$ 32,965,504	$ -	$ -	$ -	$ 32,965,504
Construction - in progress	147,986,260	41,812,751	(70,982,665)	(1,633,155)	117,183,191
	180,951,764	41,812,751	(70,982,665)	(1,633,155)	150,148,695
Other capital assets:					
Land improvements	29,140,159	-	1,374,565	-	30,514,724
Building, fixed equipment, improvements and infraestructure	495,434,471	1,834,631	69,419,494	(27,268)	566,661,328
Equipment and library materials	175,215,625	17,438,105	188,606	(8,185,129)	184,657,207
	699,790,255	19,272,736	70,982,665	(8,212,397)	781,833,259
Less accumulated drepreciation for:					
Land improvements	(9,495,235)	(716,147)	-	-	(10,211,382)
Buildings, fixed equipment, improvements and infraestructure	(183,283,414)	(12,745,701)	-	-	(196,029,115)
Equipment and library materials	(119,358,567)	(20,804,416)	-	5,753,398	(134,409,585)
	(312,137,216)	(34,266,264)	-	5,753,398	(340,650,082)
Other capital assets, net	387,653,039	(14,993,528)	70,982,665	(2,458,999)	441,183,177
Capital assets, net	$ 568,604,803	$ 26,819,223	$ -	$ (4,092,154)	$ 591,331,872

Project in Process – Discretely Presented Component Unit

Project in process of Desarrollos Universitarios, Inc. at March 31, 2005 and 2004 consist of:

	2005	2004
Construction, professional services and project management	**$ 71,492,429**	$ 65,558,257
Interest capitalized, net of interest and dividends earned from restricted funds of $9,122,543 and $8,514,412	**9,262,994**	5,407,707
Total	**$ 80,755,423**	$ 70,965,964

6. Lines of Credit

As of June 30, 2005, the University has available two line of credit agreements with GDB for the total authorized amounts of $100,000,000 and $60,000,000. Advances under these agreements, which bear a variable interest rates and are payable in a monthly and annual basis, respectively, amounted to $45,701,010 and $2,261,559 at June 30, 2005. The line of credit of $60,000,000 is guaranteed by the Commonwealth of Puerto Rico.

7. Noncurrent Liabilities

Changes in noncurrent liabilities for the year ended June 30, 2005 and 2004 are as follows:

2005

	Beginning Balance	Additions	Reductions	Other	Ending Balance	Less Due Within One Year	Noncurrent Liabilities
Long-term debt							
Notes payable	$ 16,182,231	$ 32,011,113	$ (230,775)	$ -	$ 47,962,569	$ 45,701,010	$ 2,261,559
Bonds payable	413,184,153	-	(17,255,000)	2,270,360	398,199,513	18,200,000	379,999,513
Total long-term	$ 429,366,384	$ 32,011,113	$ (17,485,775)	$ 2,270,360	$ 446,162,082	$ 63,901,010	$ 382,261,072
Other long-term liabilities							
Deferred compensation payable	$ 39,646,387	$ 5,928,913	$ -	$ -	$ 45,575,300	$ -	$ 45,575,300
Claims liability	13,598,042	7,000,000	(338,042)	-	20,260,000	2,000,000	18,260,000
Compensated absences	115,425,464	12,406,881	-	-	127,832,345	20,943,548	106,888,797
Total other long-term liabilities	$ 168,669,893	$ 25,335,794	$ (338,042)	$ -	$ 193,667,645	$ 22,943,548	$ 170,724,097

2004

	Beginning Balance	Additions	Reductions	Other	Ending Balance	Less Due Within One Year	Noncurrent Liabilities
Long-term debt							
Notes payable	$ 508,195	$ 15,951,456	$ (277,422)	$ -	$ 16,182,231	$ 14,276,864	$ 1,905,367
Bonds payable	432,285,012	-	(21,170,000)	2,069,142	413,184,153	17,255,000	395,929,153
Total long-term	$ 432,793,207	$ 15,951,456	$ (21,447,422)	$ 2,069,142	$ 429,366,384	$ 31,531,864	$ 397,834,520
Other long-term liabilities							
Deferred compensation payable	$ 32,767,691	$ 6,878,696	$ -	$ -	$ 39,646,387	$ -	$ 39,646,387
Claims liability	13,358,265	3,111,018	(2,871,241)	-	13,598,042	3,500,000	10,098,042
Compensated absences	107,395,105	8,030,359	-	-	115,425,464	19,145,980	96,279,484
Total other long-term liabilities	$ 153,521,061	$ 18,020,073	$ (2,871,241)	$ -	$ 168,669,893	$ 22,645,980	$ 146,023,913

Bonds payable are further disclosed in Note 8.

8. Bonds Payable

A. Bonds

The University has issued revenue bonds designated as "University System Revenue Bonds", the proceeds of which have been used mainly to finance new activities in connection with its educational facilities construction program and to cancel and refinance previous debts incurred. The following is the balance of bonds payable as of June 30, 2005:

Series	Balance as of June 30, 2005	Anual Interest Rate (%)	Due Date
C - Serial	$ 929,000	3.00%	1972-2011
D - Serial	1,208,000	3.75%	1972-2011
F - Term	12,225,000	5.50%	2012
M - Serial	18,305,000	4.35-5.45%	1996-2009
M - Term	127,215,000	5.25-5.45%	2015-2025
N - Serial	27,850,000	4.35-5.45%	1996-2008
N - Capital Appreciation Serial Bonds	51,980,000	5.6-5.75%	2009-2013
O - Serial	81,025,000	4.5-3.75%	2001-2020
O - Term	101,905,000	5.38%	2030
	422,642,000		
Less unamortized bond discount	(10,893,024)		
Plus unaccreted premium	1,213,158		
Less future appreciated principal	(14,762,621)		
	$ 398,199,513		

Capital Appreciation Serial Bonds interest accrues semi-annually and is added to the principal.

8. Bonds Payable (continued)

B. Debt Service Requirement

	Principal	Interest	Total
2006	$ 18,200,000	$ 19,864,180	$ 38,064,180
2007	19,210,000	18,854,332	38,064,332
2008	20,280,000	17,784,858	38,064,858
2009 to 2013	113,172,000	108,025,133	221,197,133
2014 to 2018	66,505,000	60,554,138	127,059,138
2019 to 2023	86,375,000	40,688,538	127,063,538
2024 to 2028	74,045,000	17,094,904	91,139,904
2029 to 2030	24,855,000	2,022,000	26,877,000
	$ 422,642,000	$ 284,888,083	$ 707,530,083

C. Pledged Revenues

The bonds are general obligations of the University and are collateralized by the pledge of, and a first charge on, all revenues derived or to be derived by the University, except for appropriations and contributions, as defined in the Trust Agreement governing the bonds issued. In the event that the pledged revenues are insufficient to pay the principal of and the interest on, the bonds, the University agrees to provide any additional required monies from other funds available to the University for such purposes, including funds appropriated by the Commonwealth of Puerto Rico. The revenues pledged were as follows for the year ended June 30, 2005:

Pledged Revenues:	June 30, 2005	June 30, 2004
Tuition and other fees collected	**$ 53,791,456**	$ 55,431,021
Student fees collected	**5,024,000**	5,109,364
Rental and other charges received for the right of use and occupancy of the facilities in the University system	**1,142,215**	1,209,430
Bookstore receipts (gross sales less cost of books and supplies sold)	**720,050**	456,461
Interest on investment of University funds, excluding funds invested pursuant to Article VI of the Trust Agreement	**957,054**	812,034
Funds paid to the University in respect to overhead allowance on federal research projects	**16,732,754**	15,317,430
Other income	**28,606,408**	28,501,876
	$ 106,973,937	$ 106,837,616

8. Bonds Payable (continued)

C. Pledged Revenues (continued)

Interest earned on investments in the sinking fund reserve account amounted to approximately $846,000 and $377,000 for the years ended June 30, 2005 and 2004, respectively.

The University is required to maintain a sinking fund and construction fund as described in the following paragraphs:

The funds for retirement of indebtedness consist of a sinking fund which includes three separate accounts designated Bond Service Account, Redemption Account and Reserve Account. The Trustee shall, upon the receipt of the pledged revenues, make deposits to the credit of the following accounts in the amounts specified and in the following order:

Bond Service Account - such amount thereof as may be required to make the amount then to its credit equal to the interest then due, or to become due, within the next ensuing six (6) months on the bonds of each series then outstanding, and the amount of principal of the serial bonds of each series then due, or to become due, within the next ensuing twelve (12) months.

Redemption Account - such amount, if any, after making the deposit to the Bond Service Account, as may be required to make the amount then to its credit equal to the amortization requirements, if any, for the fiscal year in which such deposit is made for the term bonds of each series then outstanding plus redemption premiums, if any.

Reserve Account - such amount, if any, after making the deposit to the above accounts as may be required to make the amount then to its credit equal to the maximum principal and interest (less any federal debt service grant payments) requirements for any year thereafter, on account of all bonds then outstanding.

Monies in the Bond Service Account and the Redemption Account shall, as nearly as may be practicable, be continuously invested and reinvested in direct obligations of, or obligations, the principal of and interest on which are unconditionally guaranteed by the United States Government. Monies in the Reserve Account may be invested in a broader range of investments including interest bearing bank accounts, federal agency obligations, repurchase agreements, commercial paper and other highly rated obligations.

D. Bonds Arbitrage

During fiscal year 2005 the Government Development Bank performed an arbitrage test. The preliminary results of the test showed a negative arbitrage.

8. Bonds Payable (continued)

E. Bonds Payable – Discretely Presented Component Unit

On December 21, 2000, AFICA issued, on behalf of Desarrollos Universitarios, Inc., Educational Facilities Revenue Bonds, 2000 Series A, in the amount of $86,735,000. The bonds were issued to (i) finance the development, construction and equipment of Plaza Universitaria Project (the Projects), (ii) repay a portion of certain advances made by the Government Development Bank for Puerto Rico under a line of credit facility for the purpose of paying certain costs of the development and construction of the Projects, (iii) make a deposit to the Debt Service Reserve fund and, (iv) pay the costs and expenses incurred in connection with the issuance and sale of bonds. The principal and interest on the bonds are insured by a financial guaranty insurance policy issued by MBIA Insurance Corporation, and by the assignment of the lease agreement with the University.

Bonds payable at March 31, 2005 and 2004 consist of:

Description	Interest Rate	Maturity	2005 Face Amount	2004 Face Amount
Serial Bonds	5.00%	July 1, 2004	**$ -**	$ 1,295,000
Serial Bonds	4.00%	July 1, 2005	**1,360,000**	1,360,000
Serial Bonds	5.00%	July 1, 2006	**1,415,000**	1,415,000
Serial Bonds	4.00%	July 1, 2007	**1,485,000**	1,485,000
Serial Bonds	5.00%	July 1, 2008	**1,545,000**	1,545,000
Serial Bonds	4.13%	July 1, 2009	**1,620,000**	1,620,000
Serial Bonds	4.25%	July 1, 2010	**1,685,000**	1,685,000
Serial Bonds	5.63%	July 1, 2011	**1,760,000**	1,760,000
Serial Bonds	5.63%	July 1, 2012	**1,860,000**	1,860,000
Serial Bonds	5.63%	July 1, 2013	**1,960,000**	1,960,000
Serial Bonds	5.63%	July 1, 2014	**2,075,000**	2,075,000
Serial Bonds	5.63%	July 1, 2015	**2,190,000**	2,190,000
Serial Bonds	5.63%	July 1, 2016	**2,315,000**	2,315,000
Serial Bonds	5.63%	July 1, 2017	**2,445,000**	2,445,000
Serial Bonds	5.63%	July 1, 2018	**2,580,000**	2,580,000
Serial Bonds	5.63%	July 1, 2019	**2,725,000**	2,725,000
Serial Bonds	5.00%	July 1, 2020	**2,880,000**	2,880,000
Serial Bonds	5.00%	July 1, 2021	**3,020,000**	3,020,000
Serial Bonds	5.00%	July 1, 2033	**50,520,000**	50,520,000
Total			**$ 85,440,000**	$ 86,735,000

8. Bonds Payable (continued)

E. Bonds Payable – Discretely Presented Component Unit (continued)

Interest on the bonds is payable each January 1 and July 1, commencing on July 1, 2001. Bonds maturing after July 1, 2010 may be redeemed, at the option of the University in whole or in part, at a redemption price equal to 100% of the principal amount plus accrued interest, without premium. In addition, term bonds are subject to mandatory redemption in part commencing on July 1, 2022 to the extent of the sinking fund requirement for said bonds set forth below at a redemption price equal to 100% of the principal amount thereof plus accrued interest.

Redemption Period	Amount
July 1, 2022	$ 3,175,000
July 1, 2023	3,330,000
July 1, 2024	3,500,000
July 1, 2025	3,675,000
July 1, 2026	3,855,000
July 1, 2027	4,050,000
July 1, 2028	4,255,000
July 1, 2029	4,465,000
July 1, 2030	4,690,000
July 1, 2031	4,925,000
July 1, 2032	5,170,000
July 1, 2033	5,430,000
	$ 50,520,000

9. Commitments and Contingent Liabilities

A. Insurance

The University is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Through January 1993 the University was insured under claims-made insurance policies with respect to medical malpractice risks for $250,000 per occurrence up to an annual aggregate of $500,000. Subsequent to such date, the University was unable to obtain insurance at a cost it considered to be economically justifiable, consequently, the University is now self-insured for such risks. Under Law Number 98 of August 24, 1994, the responsibility of the University is limited to a maximum amount of $75,000 per person, or $150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Self-insured risk liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend upon such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liabilities does not necessarily result in an exact amount. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. Changes in the claims liability amount in fiscal year 2005 were:

Claims payable - July 1	$	13,598,042
Incurred claims and changes in estimates		27,298,905
Payments for claims and adjustments expenses		(20,636,947)
Claims payable - June 30	$	20,260,000

The University continues to carry commercial insurance for all other risks of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

B. Federal Assistance Programs

The University participates in a number of federal financial assistance programs. These programs are subject to audits in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, or to compliance audits by grantor agencies. The resolution of certain previously identified questioned costs has not occurred. The amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time, although the University expects such amounts, if any, to be immaterial.

9. Commitments and Contingent Liabilities (continued)

C. Discretely Presented Component Units

Servicios Médicos Universitarios, Inc. (the Hospital) is a nonprofit corporation organized to operate and administer healthcare units located in Carolina. These facilities were acquired by the University and include land, building and medical equipment.

The Hospital entered into a loan agreement (the Agreement) with the Government Development Bank for Puerto Rico (GDB) for an aggregate principal amount not to exceed $17,000,000. As part of the Agreement, the University (the Guarantor) agreed to guaranty payment obligations.

On July 18, 2001, the Board of Trustees approved to amend the Working Capital Loan to $15,367,611 and to decrease the Improvement Loan to $1,632,389. The amendment was effective on August 1, 2001. In addition, the Guarantor will pay GDB, on the first day of July and January of each year, the balance of interest due and outstanding by the Hospital.

Scheduled principal repayments on long-term debt and capital lease obligations for the next five years and thereafter are as follows:

	Long-Term Debt	Capital Leases
2006	$ 15,367,611	$ 300,087
2007	-	-
2008	-	-
2009	-	-
2010	-	-
Thereafter	1,632,389	-
	17,000,000	300,087
Less: amount representing interest under capital lease obligations	-	21,103
	$ 17,000,000	$ 278,984

Total interest charged to operations under the aforementioned leases was approximately $29,500 and $30,000 in 2005 and 2004, respectively.

9. Commitments and Contingent Liabilities (continued)

C. Discretely Presented Component Units (continued)

Desarrollos Universitarios, Inc. (the Company) was incorporated on October 2, 1996. The Company is a non-profit corporation, with the sole purpose of developing, constructing and operating academic, residential, administrative, office, commercial and maintenance facilities (Plaza Universitaria) for use by students, faculty members, administrators, employees, visitors, invitees, and other members of or persons and entities related to or conducting business with the University community, or other activities conducted in such facility.

On May 11, 2000 the University's Board of Trustees ratified a Memorandum of Agreement (the Agreement) to establish a contractual agreement between the University and the Company. The Agreement, dated May 22, 1998, states among other things the following: (1) the University will lease to, or otherwise grant to, the Company the right for the long-term use of the land, for the sole purpose of developing, constructing and operating Plaza Universitaria, (2) the Company shall finance the development of Plaza Universitaria from AFICA Bond proceeds and/or line credit and/or any other structure or credit facility, (3) the Company will own the Plaza Universitaria improvements and will lease them exclusively to the University, during the life of the AFICA Bonds, (4) the University shall have the right to prepay or refinance the Bonds at any time, consistent with the restrictions on refinancing contained in the financing documents, (5) upon the payment or prepayment in full of all the AFICA Bonds, the lease on the land shall terminate and the University shall become, *ipso facto,* owner of all the Plaza Universitaria improvements, without the need or obligation to make any additional payment of any kind (other than any "bargain purchase" payment as may be required under the project documents), and (6) rental payments (lease payments) from the University shall have a fixed component and a variable component. The fixed component shall be in an amount sufficient to guarantee to bondholders the payment of principal and interest on the AFICA Bonds as may be established in the financing documents, and will be pledged to guarantee such payments. The variable component of the lease payments will be used to cover operating, maintenance, administrative, management, and other fees and costs, which will be established periodically and reviewed annually between the parties, as well as such amounts for reserves and special funds, which may be required under the financing documents related to the bond issue.

On December 21, 2000, the University entered into a lease agreement with the Company in which the University agreed to pay directly to a trustee for the account of the Company, the basic lease payments (denominated into components of principal and interest) on or before the twenty-fifth (25) day of each month. As of June 30, 2005 and 2004, the University had paid in advance a total of $21,322,000 and $16,096,000, respectively, for these purposes and such amounts have been recorded in the accompanying statements of net assets as prepaid expenses and other assets.

9. Commitments and Contingent Liabilities (continued)

C. Discretely Presented Component Units (continued)

Future minimum annual lease payments under this agreement at June 30, 2005 are: $5,702,000 in 2006; $5,701,000 in 2007; $5,701,000 in 2008; $5,700,000 in 2009; $5,698,000 in 2010; and $132,528,000 thereafter.

In October 2003, Plaza Universitaria Project's general contractor submitted a claim for extended overhead (field and main office) and subsequently a Proposal for Settlement for an amount exceeding $10 million. It is the Company's legal counsel's opinion that some of the allegations are invalid under the terms of the existing contract and that the general contractor has already been compensated for some of the claimed amounts by Company approved change orders. Management of the Company believes, based on the advice of counsel, that there is a minimal financial exposure to the Company in connection with this claim.

10. University of Puerto Rico Retirement System

General

The System is a single-employer defined benefit pension plan that covers all employees of the University of Puerto Rico (the University) with the exception of hourly, temporary, part-time, contract and substitute employees, and visiting professors. It is qualified and exempt from Puerto Rico and United States taxes.

Membership consisted of the following as of June 30, 2005 and 2004:

	2005	2004
Retirees and beneficiaries receiving benefits	**6,408**	6,317
Terminated plan members entitle to but no yet receiving benefits	**348**	324
Terminated non-vested plan members entitled to return on their contributions	**7,041**	6,945
Active plan members	**12,677**	12,484
Total	**26,474**	26,070

10. University of Puerto Rico Retirement System (continued)

Plan Amendments

Effective July 1, 1999, the Plan was amended by establishing Certification 128, to increase by 3% the pension benefits to those employees who retired due to age or disability and who have been retired for at least three years as of January 1, 1995, with a monthly minimum of $10.

Effective July 1, 1995, the Plan was amended by establishing Certification 194, to increase by 3% the pension benefits to those employees who retired due to age or disability and who have been retired for at least three years as of January 1, 1992, with a monthly minimum of $10.

Effective July 1, 2004, the Plan was amended by establishing Certification 130, to increase by 3% the pension benefits to those employees who retired due to age or disability and who have been retired for at least three years as of January 1, 2001, with a monthly minimum of $10.

Effective July 1, 2002, the Plan was amended, by establishing Certification 139, to offer participants an increase from $50,000 to $60,000 in the maximum salary subject to withholding contribution. The participants who elect this benefit may pay retroactively to their first day of employment the differences in withholding contributions for prior year salaries exceeding $50,000 and up to a maximum of $60,000 plus 8% interest. Also, effective July 1, 2002, maximum salary basis will increase automatically 3% every two years.

Effective July 1, 2001, the Plan was amended by establishing Certification 140, to increase by 3% the pension benefits to those employees who retired due to age or disability and who have been retired for at least three years as of January 1, 1998, with a monthly minimum of $10.

Effective July 1, 1998, the Plan was amended by establishing Certification 94, to offer participants an increase from $35,000 to $50,000 in the maximum salary subject to withholding contributions. The participants who elect this benefit may pay retroactively to their first day of employment the differences in withholding contributions for prior year salaries exceeding $35,000 and up to a maximum of $50,000 plus 8% interest. Effective July 1, 1998, all new participants contribute 9% of their salary up to $50,000.

In addition, the maximum annual compensation for those participants who had not completed 20 years of service by July 1, 1979 is $35,000. Also, the minimum pension is $250 a month. Finally, the reduction for commencement of pension benefits prior to age 65 is 1/3% per month for participants who had not completed 20 years of service by July 1, 1979 and elected Certification 55, and for participants hired on or after January 1, 1990.

10. University of Puerto Rico Retirement System (continued)

Contributions and Funding Policy

The contribution requirements of plan members and the University are established and may be amended by the Board of Trustees. Plan members are required to contribute as follows:

Members who elect Certification No. 139: 11% of monthly compensation up to $5,000

Members who have not completed 20 years of service by July 1, 1979:

- If full supplement is elected: 7% of monthly compensation up to $2,625
- If full supplement is not elected: 5% of monthly compensation up to $2,625
- If Certification 94 is elected: 9% of monthly compensation up to $4,500

Members who have completed 20 years of service by July 1, 1979:

- If full supplement is elected: 7% of monthly compensation
- If full supplement is not elected: 4% of monthly compensation up to $350, plus 6.5% of the excess

Members who have not completed 20 years of service by July 1, 1979 and elect Certification 55:

- If full supplement is elected: 7% of monthly compensation up to $2,625
- If full supplement is not elected: 4% of monthly compensation up to $350, plus 6.5% of the excess up to $2,625
- If Certification 94 is elected: 9% of monthly compensation up to $4,167

Members who are hired between January 1, 1990 and June 30, 1998:

- 8% of monthly compensation up to $2,625 or,
- If Certification 94 is elected: 9% of monthly compensation up to $4,167

Members who are hired on or after July 1, 1998:

- 9% of monthly compensation up to $4,167

The University is supposed to contribute at an actuarially determined rate; the rate as of June 30, 2005 and 2004 was 18.4% and 16.2% respectively, of annual covered payroll. The actuarially determined employer contribution rate takes into account payment of administrative expenses. Therefore, administrative expenses are paid out of the trust fund. The University contributed 15% and 14% of participants' payroll in 2005 and 2004, respectively.

10. University of Puerto Rico Retirement System (continued)

Contributions and Funding Policy

The contributions of the University were originally designed to fund, together with the contributions of the members, the current service cost on a current basis and the estimated accrued benefit cost attributable to qualifying service prior to the establishment of the System over a forty-year period, but as a result of increasing benefits without a correlative increase in employer's contributions, they fall short of accomplishing the necessary funding.

Retirement Benefits

The System provides retirement, disability and death benefits to plan members and beneficiaries. Cost-of-living adjustments are provided to members and beneficiaries at the discretion of the Board of Trustees of the University of Puerto Rico (Board of Trustees), formerly known as the Council on Higher Education of the University of Puerto Rico. Article XIII of the Rules and Regulations of the University of Puerto Rico Retirement System as amended effective July 1, 1973 assigns the authority to establish and amend benefit provisions to the Board of Trustees.

Participants who have completed 20 years of service by July 1, 1979 are entitled to annual retirement benefits at any age after 30 years of service. Otherwise, participants are entitled to annual retirement benefits at age 55 after 30 years of service. Participants may elect to receive their retirement benefits at age 58 after 10 years of service, or at age 55 after 25 years of service.

The amount of service retirement annuity is as follows:

- For all members except those who have completed 20 years of service by July 1, 1979:

    - Before age 65 - for members with at least 30 years of service: 75% of average compensation. Amount is reduced by ½% for each month the member is under age 58 (Certification 37) and 55 (Certification 55), at time annuity begins.

    - Before age 65 - for members with less than 30 years of service: 1.5% of average compensation per year of service for the member with 20 or fewer years. Percentage increases by .05% for each year in excess of 20 years up to a maximum of 1.95% per year. Amount is reduced by ½% for each month the member is under age 58 at time annuity begins.

    - After age 65 - if the member elected full supplement, the annuity is the same as before age 65. Otherwise, the annuity is reduced by ½% of average compensation not in excess of Social Security wage base in effect at retirement for each year of service. If the member had less than 30 years of service and was under age 58 at the beginning date, adjustment is made before application of ½% reduction per month under age 58.

10. University of Puerto Rico Retirement System (continued)

Retirement Benefits (continued)

- For those members who have completed 20 years of service by July 1, 1979:

    - Before age 65 - for members with at least 30 years of service: 75% of average compensation if age 55 at beginning date; 65% if under age 55. If the member completed 30 years of service before July 1973, the annuity is increased by 2% of average compensation for each year of service beyond 30 and before July 1973, but to not more than 85% of average compensation.

    - Before age 65 - for members with less than 30 years of service: 1.5% of average compensation per year of service for members with 20 or fewer years. Percentage increases by .05% for each year in excess of 20 years up to maximum of 1.95% per year. Amount is reduced by ½% for each month the member is under age 58 at the time the annuity begins.

    - At age 65 - if member elected full supplement, the annuity is the same as before age 65. Otherwise, the annuity is reduced by ½% of first $350 of average compensation for each year of service but not by more than primary Social Security benefit. If the member had less than 30 years of service and was under age 58 at beginning date, adjustment is made before application of ½% reduction per month under age 58.

- For all members who have not completed 20 years of service by July 1, 1979 and elect Certification 55, and for those hired on or after January 1, 1990:

    - Before age 65 - for members with less than 30 years of service: 1.5% of average compensation per year of service for members with 20 or fewer years. Percentage increases by .05% for each year in excess of 20 years up to a maximum of 1.95% per year.

    - Before age 65 - for members with at least 30 years of service: 75% of average compensation for participants with at least 55 years of age at retirement date. Amount reduced by ½% for each month the member is under age 55 at time annuity begins.

    - Age 65 - if member elected full supplement, annuity is the same as before age 65. Otherwise, annuity is reduced by ½% of average compensation at time of retirement multiplied by years of service.

        - Minimum Annuity - $250 per month - if a member terminates before rendering 10 years of service, the right to receive the portion of his accumulated plan benefits attributable to the University's contributions is forfeited. However, the employee is entitled to receive, in a lump-sum payment, the value of his accumulated contributions.

10. University of Puerto Rico Retirement System (continued)

Retirement Benefits (continued)

- If a member terminates after rendering 10 years of service, and does not withdraw his contributions, the member receives a retirement annuity payable beginning at age 60 based on the applicable benefit formula.

- Refund may also be obtained after 10 years of service, but the vested benefit is lost.

- **Disability Benefits** - employees who become disabled receive annual disability benefits regardless of service if disability is due to occupational causes or after 10 years of service if disability is due to non-occupational causes. If the employee is also eligible for a retirement annuity, the benefit payable is the higher of the two. Disability benefits are paid as follows:

  - Before age 65 - if service related, 50% of final salary. If not service related, 30% of average compensation plus additional 1% for each year of service over 10.

  - After age 65 - reduced to amount payable as retirement annuity, if that amount is less than disability retirement annuity, but reduced annuity plus primary Social Security benefit may not be less than original disability annuity.

Death Benefits:

- Pre-retirement death benefit - if the death of an employee is service related, a death benefit equal to 50% of the final annual salary plus $120 ($240 if widow not receiving benefit) per year for each child under age 18 (21 if at school) is paid to the employee's beneficiaries. Maximum family benefit is 75% of the employee's final annual salary. If death is non-service related, a lump-sum is paid equal to the employee's contributions plus one year's final salary, but not less than $6,000.

- Post retirement death benefits - employee's contributions are refunded to the extent that they exceed retirement payments already made, unless reversionary annuity was elected. Minimum payment is $600. In addition, 50% of retirement annuity is payable to surviving spouse until death or remarriage or until they become eligible for Social Security benefits. Minimum annuity, $75 per month, maximum annuity, $150 per month.

Christmas Bonus:

- A $400 annual bonus is given to all retiree plan members.

11. Post-Retirement Benefits

In addition to the pension benefits described in Note 10, the University provides post-retirement health care benefits and a Christmas bonus for its retired employees in accordance with law. Substantially all of the employees may become eligible for these benefits if they reach normal retirement age while working for the University. Health care benefits are provided through insurance companies whose premiums are paid by the retiree and by the University up to maximum of $125 per month for each retiree. During the years ended June 30, 2005, the payments of health care benefits amounted to $7,778,000. The Christmas bonus paid to the retired employees during the years ended June 30, 2005 and 2004 were $400 per retiree and the total amounts were $2,476,650 and $2,444,114, respectively. These benefits are recorded as expenses when granted and paid. The plan covers approximately 6,408 retirees.

12. Going Concern - Discretely Presented Component Unit

Since the Hospital commenced operations, it has experienced significant operating losses having an accumulated net assets deficiency of approximately $51,425,000 at June 30, 2005. The Hospital has received advances from the University to cover its cash needs from operations. Most of these accumulated losses are mainly related to the fact that, as a former public hospital operated by the Department of Health, it provides a significant amount of services to indigent population for which the Hospital does not obtain a payment. Most of these patients are indigent persons not subscribed to the Health Reform Program are aliens without medical insurance coverage, among others. The medical services provided to these persons were supposed to be paid to the Hospital by the Puerto Rico Department of Health. However, since the beginning of the operations of the Hospital, the Department of Health has been unable to pay for such services. As shown in the accompanying financial statements, the Hospital has accumulated losses for uncollectible accounts receivable in the approximate amount of $29,174,000.

The Hospital's management believes that all these factors had a material impact in the Hospital's results of operations during its years of operations and consequently in the accumulated deficit at June 30, 2005.

The Hospital's management with the assistance of the University of Puerto Rico's administration continues implementing a management plan toward its operational activities as well as the Hospital's ability to get cash to comply with its current obligations.

Among the matters included in such management plan are the following:

- Extension of the medical privileges in the Hospital to faculty members within the Hospital's primary and secondary market area.
- Development of new business within the Hospital's building, for example space rentals for physicians and others.
- Marketing of the Ob Gyn and pediatrics services.

12. Going Concern - Discretely Presented Component Unit (continued)

- Marketing of the ophthalmology services, including a new physician that has a specialization in cornea diagnosis and treatment.
- Revaluation of the contract agreements with the anesthesiologists and radiologists, to share the costs of those services.
- More aggressive negotiation with medical insurance to increase the per diem rates.

Among the alternatives, the Hospital has to deal with its fiscal difficulties and has publicly discussing the possibility to sell the Hospital's facilities.

The accompanying financial statements do not include any adjustments relating to the recoverability and classification of recorded assets amounts or the amounts and classifications of liabilities that might be necessary, should the Hospital be unable to continue as a going concern or in the event of any disposition of the Hospital's assets through a sale or by other means.

13. Functional Information

The University's operating expenses by functional classification were as follows:

Functional classification	Salaries and Benefits	Supplies and Other Services	Scholarship and Fellowship	Utilities	Depreciation	Other Expenditures	Total
Instruction	$ 334,968,365	$ 19,067,166	$ 12,307,580	$ 1,185,011	$ -	$ 173,392	$ **367,701,513**
Research	62,412,211	22,049,800	9,067,252	502,357	-	4,002,415	**98,034,034**
Public service	43,852,678	9,534,958	2,392,871	169,833	-	72,001	**56,022,340**
Academic support	67,299,111	14,547,307	3,672,593	60,474	-	36,000	**85,615,486**
Student service	37,379,622	7,383,156	649,844	1,435	-	66,241	**45,480,298**
Institutional support	128,855,178	30,374,022	369,132	2,519,873	-	578,693	**162,696,899**
Oper & Maintenance	65,920,485	7,001,842	26,942	28,396,986	-	183,732	**101,529,987**
Student Aid	1,569,980	643,967	122,554,307	-	-	-	**124,768,254**
Patient Service	40,686,479	1,649,465	33,565	6,515	-	15,023	**42,391,047**
Auxiliary Enterprises	4,536,267	5,730,835	31,935	310,062	-	-	**10,609,100**
Depreciation	-	-	-	-	29,353,945	-	**29,353,945**
Other	-	-	-	-	-	57,869,781	**57,869,781**
	$ 787,480,375	**$ 117,982,519**	**$ 151,106,021**	**$ 33,152,547**	**$ 29,353,945**	**$ 62,997,277**	**$ 1,182,072,684**

14. Significant New Accounting Pronouncements

In November 2003 the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This Statement establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This Statement also clarifies and establishes accounting requirements for insurance recoveries. This statement will be effective for the University for fiscal year ending June 30, 2006.

In April 2004 the GASB issued Statement No. 43, *Financial Reporting for Post employment Benefit Plans Other Than Pension Plans*. This Statement establishes uniform financial reporting standards for OPEB plans and supersedes the interim guidance included in Statement No. 26, *Financial Reporting for Post employment Healthcare Plans Administered by Defined Benefit Pension Plans*. The approach followed in this Statement generally is consistent with the approach adopted in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, with modifications to reflect differences between pension plans and OPEB plans. This statement will be effective as follows:

The requirements of this Statement for OPEB plan reporting are effective one year prior to the effective date of Statement 45 for the employer (single-employer plan) or for the largest participating employer in the plan (multiple-employer plan). The requirements of this Statement are effective in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999:

- Plans in which the sole or largest employer is a phase 1 government—with annual revenues of $100 million or more—are required to implement this Statement in financial statements for periods beginning after December 15, 2005.

- Plans in which the sole or largest employer is a phase 2 government—with total annual revenues of $10 million or more but less than $100 million—are required to implement this Statement in financial statements for periods beginning after December 15, 2006.

- Plans in which the sole or largest employer is a phase 3 government—with total annual revenues of less than $10 million—are required to implement this Statement in financial statements for periods beginning after December 15, 2007.

If comparative financial statements are presented, restatement of prior-period financial statements is required. Early implementation is encouraged.

14. Significant New Accounting Pronouncement (continued)

In May 2004, the GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section - an amendment of NCGA Statement 1*. This Statement amends the portions of NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*, that guide the preparation of the statistical section. The statistical section presents detailed information, typically in ten-year trends, that assists users in utilizing the basic financial statements, notes to basic financial statements, and required supplementary information to assess the economic condition of a government. This statement is effective for Statistical sections prepared for periods beginning after June 15, 2005.

In July 2004 the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions*. This Statement improves the relevance and usefulness of financial reporting by (a)requiring systematic, accrual-basis measurement and recognition of OPEB cost (expense) over a period that approximates employees' years of service and (b)providing information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan. This statement will be effective as follows:

The requirements of this Statement are effective in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999:

- Governments that were phase 1 governments for the purpose of implementation of Statement 34—those with annual revenues of $100 million or more—are required to implement this Statement in financial statements for periods beginning after December 15, 2006.

- Governments that were phase 2 governments for the purpose of implementation of Statement 34—those with total annual revenues of $10 million or more but less than $100 million—are required to implement this Statement in financial statements for periods beginning after December 15, 2007.

- Governments that were phase 3 governments for the purpose of implementation of Statement 34—those with total annual revenues of less than $10 million—are required to implement this Statement in financial statements for periods beginning after December 15, 2008.

Earlier application of this Statement is encouraged. All component units should implement the requirements of this Statement no later than the same year as their primary government.

14. Significant New Accounting Pronouncement (continued)

In December 2004, the GASB issued Statement No. 46, *Net Assets Restricted by Legislation - an amendment of GASB Statement No. 34*. This Statement clarifies that a legally enforceable enabling legislation restriction is one that a party external to a government—such as citizens, public interest groups, or the judiciary—can compel a government to honor. The Statement states that the legal enforceability of an enabling legislation restriction should be reevaluated if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling legislation or if a government has other cause for reconsideration. Although the determination that a particular restriction is not legally enforceable may cause a government to review the enforceability of other restrictions, it should not necessarily lead a government to the same conclusion for all enabling legislation restrictions. This statement is effective for periods beginning after June 15, 2005. Earlier application is encouraged.

15. Subsequent Events

On July 29, 2005, the Legislative Assembly of Puerto Rico approved Law 36 which amended Law Act 139 of 1999, reinstating the funds to the University corresponding to the Slot Machines Revenue.

On September 26, 2005, the Medical Science Campus was granted a Public Health Grant of $15 million development of research infrastructure and capacity for the conduct, collaboration and promotion of scientifically meritorious research. The University will receive this during the next three years, for a total award of $15 million.

On November 19, 2005, the Board of Trustees of the University approved a Resolution (Certification No. 43 2005-2006) authorizing the execution and delivery of separate Master Agreements, refunding a portion of its bonds and also simultaneously issuing bonds (New Money) to defray the cost of certain necessary capital improvements at the University of Puerto Rico.

Other Financial Information

University of Puerto Rico

Schedule of Changes in Sinking Fund Reserve

	2005			2004		
	Bond Service Account	Bond Reserve Account	Total	Bond Service Account	Bond Reserve Account	Total
Additions:						
Transfer from Reserve Account	**$ 4,834,555**	**$ -**	**$ 4,834,555**	$ 3,607,039	$ -	$ 3,607,039
Transfer from unrestricted current funds	**33,039,508**	**1,677,432**	**34,716,940**	39,508,764	4,084,757	43,593,520
Net increase in fair marker value of investments	**47,519**	**41,939**	**89,458**	1	160,694	160,694
Interest Earned on Investments	**148,874**	**697,944**	**846,818**	102,704	274,648	377,352
Total receipts	**38,070,456**	**2,417,315**	**40,487,771**	43,218,507	4,520,098	47,738,605
Deductions:						
Payments of bond interest	**20,815,446**	**-**	**20,815,446**	22,048,516	-	22,048,516
Payments of bond principal	**17,255,000**	**-**	**17,255,000**	21,170,000	-	21,170,000
Transfer to Reserve Account	**-**	**4,834,555**	**4,834,555**	-	3,607,039	3,607,039
Total disbursements	**38,070,446**	**4,834,555**	**42,905,001**	43,218,516	3,607,039	46,825,555
Net increase/(decrease) for the year	**10**	**(2,417,240)**	**(2,417,230)**	(9)	913,059	913,050
Balances at beginning of year	**0**	**41,573,018**	**41,573,018**	10	40,659,959	40,659,969
Balance at end of year	**$ 10**	**$ 39,155,778**	**$ 39,155,788**	$ 1	$ 41,573,018	$ 41,573,019

Report on Independent Auditors on Compliance and Internal Control Over Financial Reporting in Accordance with Government Auditing Standards

Board of Trustees
University of Puerto Rico

We have audited the financial statements of the University of Puerto Rico (the University) as of and for the year ended June 30, 2005, and have issued our report thereon dated October 31, 2005. We conducted our audit in accordance with generally accepted auditing standards 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 University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control and its operation that we consider to be a material weakness. However, we noted other matters involving the internal control over financial reporting that we have reported to management of the University in a separate letter dated November 29, 2004.

Compliance

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial instances of noncompliance that we have reported to management of the University in a separate letter dated October 31, 2005.

This report is intended for the information of the board of trustees, management and Federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Ernst & Young LLP

October 31, 2005

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of this report.