# AUDITED FINANCIAL STATEMENTS

University of Puerto Rico
Year Ended June 30, 2007
With Report of Independent Auditors

University of Puerto Rico

Audited Financial Statements

Years Ended June 30, 2007 and 2006

## Contents

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# Report of Independent Auditors

Board of Trustees
University of Puerto Rico

We have audited the accompanying financial statements of the business-type activities and the aggregate discretely presented component units of the University of Puerto Rico (the University), a component unit of the Commonwealth of Puerto Rico, as of and for the years ended June 30, 2007 and 2006, which collectively comprise the University's financial statements, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions 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), which represent 100% of the aggregate discretely presented component units, as of and for the years ended June 30, 2007 and 2006 and March 31, 2007 and 2006, respectively. Those financial statements were audited by other auditors whose reports thereon have 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 amounts included for the Hospital and the Company, is solely based on the reports 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the University's internal control over financial reporting. Our audit included 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 the other auditors provide a reasonable basis for our opinions.

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 respective financial position of the University of Puerto Rico and the aggregate discretely presented component units of the University of Puerto Rico as of June 30, 2007 and 2006, and the respective changes in financial position and cash flows thereon for the years then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 13 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 April 29, 2008, 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

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

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the University of Puerto Rico financial statements. The schedule of changes in sinking fund reserves included in page 56 is presented for purposes of additional analysis and is not a required part of the financial statements. Such schedule 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.

Ernst & Young LLP

April 29, 2008

Stamp No. 2328011
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, 2007 and 2006. This discussion and analysis was prepared by University management and should be read in conjunction with the financial statements and notes thereto, which follow.

The financial operations and position of two not-for-profit organizations, Servicios Médicos Universitarios, Inc. and Desarrollos Universitarios, Inc. are considered component units of the University and are discretely presented in the University's financial statements. An annual audit of each organization's financial statement is conducted by independent certified public accountants. Financial statements and information relating to the component units may be obtained from their respective administrative officers.

## Financial Highlights

The financial position of the University remains strong at June 30, 2007, with total assets of \$1,483,229,447 total liabilities of \$1,056,509,575 and net assets of \$426,719,873. The University's net assets increased \$40,590,712 during the year ended June 30, 2007, when compared to \$78,475,171 during the year ended June 30, 2006 and to \$6,892,002 during the year ended June 30, 2005. These increases are explained in the section entitled "Analysis of Financial Position and Changes in Financial Position." 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, 2007, 2006 and 2005 follow:

**Condensed Statements of Net Assets**

| | June 30 | | |
|---|---|---|---|
| | **2007** | **2006** | **2005** |
| **Assets** | | | |
| Current assets | **$ 344,095,972** | $ 341,443,766 | $ 277,300,121 |
| Noncurrent assets: | | | |
| Due from Commonwealth of Puerto Rico | **84,232,509** | 56,000,001 | 71,570,127 |
| Capital | **796,685,602** | 659,326,528 | 629,903,127 |
| Other | **258,215,364** | 81,705,901 | 69,972,192 |
| Total assets | **1,483,229,447** | 1,138,476,196 | 1,048,745,567 |
| **Liabilities** | | | |
| Current liabilities | **133,037,509** | 199,479,385 | 188,106,410 |
| Noncurrent liabilities | **923,472,066** | 552,867,652 | 552,985,169 |
| Total liabilities | **1,056,509,575** | 752,347,037 | 741,091,579 |
| **Net assets** | | | |
| Invested in capital assets net of related debt | **231,026,259** | 207,167,597 | 183,741,045 |
| Restricted: | | | |
| Nonexpendable | **62,406,256** | 52,247,594 | 45,310,063 |
| Expendable | **120,847,524** | 113,179,703 | 85,968,022 |
| Unrestricted | **12,439,834** | 13,534,265 | (7,365,142) |
| Total net assets | **$ 426,719,873** | $ 386,129,159 | $ 307,653,988 |

**Condensed Statements of Revenues, Expenses and Changes in Net Assets**

| | Year Ended June 30 | | |
|---|---|---|---|
| | **2007** | **2006** | **2005** |
| **Operating revenues** | | | |
| Tuition and fees (net of scholarship) | $ 49,269,042 | $ 51,115,866 | $ 36,951,309 |
| Grants and contracts | 148,409,147 | 133,858,642 | 142,165,395 |
| Patient services | 48,669,981 | 49,667,252 | 43,589,157 |
| Other operating revenues | 39,919,317 | 45,743,758 | 38,852,582 |
| Total operating revenues | 286,267,487 | 280,385,518 | 261,558,443 |
| **Operating expenses** | 1,266,523,365 | 1,196,233,066 | 1,182,072,684 |
| **Operating loss** | (980,255,878) | (915,847,548) | (920,514,241) |
| **Nonoperating revenues and expenses** | | | |
| State appropriations | 896,492,596 | 854,981,674 | 796,568,502 |
| Other nonoperating revenues and expenses, including interest on indebness | 104,908,125 | 125,315,363 | 112,106,915 |
| Net nonoperating revenues | 1,001,400,721 | 980,297,037 | 908,675,417 |
| Income (loss) before other revenues | 21,144,843 | 64,449,489 | (11,838,824) |
| Capital appropriations | 12,607,556 | 10,160,608 | 12,323,593 |
| Addition to permanent endowment | 6,838,313 | 3,865,074 | 6,407,233 |
| Total increase in net assets | $ 40,590,712 | $ 78,475,171 | $ 6,892,002 |

## 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.* 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 Changes in Financial Position**

*Statements of Net Asset*

The statements of net assets present the assets, liabilities and net assets of the University as of June 30, 2007 and 2006. 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 statements of net assets, along with all of the University's basic financial statements, are prepared under the accrual basis of accounting, whereby revenues are recognized when the service is provided by and expenses are recognized when others provide the service to the University, regardless of when cash is exchanged.

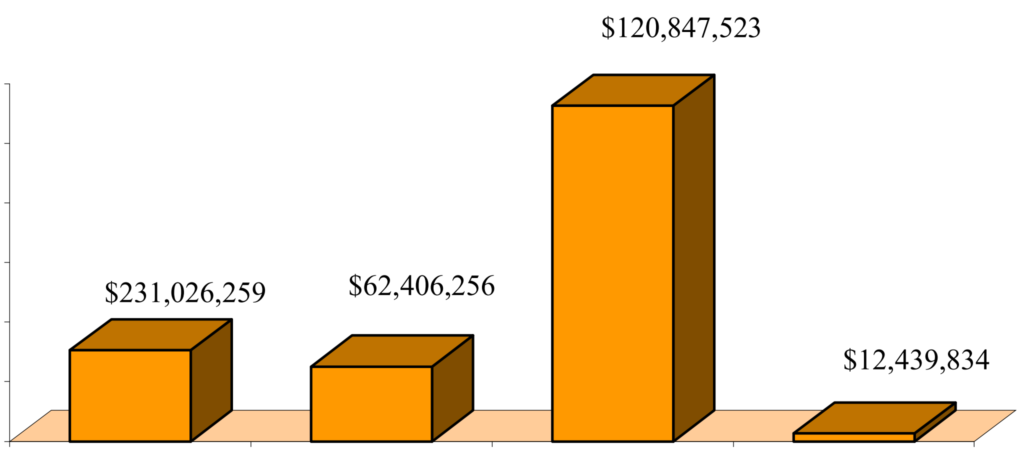
Assets included in the statements of net assets are classified as current or noncurrent. Current assets consist primarily of cash and cash equivalents, short-term investments and accounts receivable. Of these amounts, cash and cash equivalents, investments and accounts receivable comprise approximately 14%, 35% and 46%, respectively, of current assets and 70% of noncurrent assets are capital assets as of June 30, 2007. As of June 30, 2006, these amounts comprise approximately 26%, 29% and 42% of current assets and 83% of noncurrent assets are capital assets. As of June 30, 2005, these amounts comprise approximately 9.4%, 25% and 57% of current assets and 93% of noncurrent assets are capital assets.

University's cash, cash equivalents and investments increased from $170,383,000 at June 30, 2005 to $239,586,325 at June 30, 2006 and increased to $414,403,362 at June 30, 2007. The increase in investments at fair value is because the University invested a portion of the cash received from the bond issuance. Currents accounts receivable increased from $142,189,307 to $144,925,202 and increased to $159,522,765 for the same periods. The increase in accounts receivable between June 30, 2006 and 2007, is mainly due to increase in slot machines revenue allocations from the Commonwealth of Puerto Rico.

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 $84,849,240 to $85,079,562 between June 30, 2006 and 2007. Non-current liabilities consist primarily of bonded indebtedness. Long-term debt increases from $371,470,852 to $656,019,072 between June 30, 2007 and 2006. The increase is due to new bonds issued in December 2006.

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

**Table 1 - Net Assets - June 30, 2007**




| | | |
|---|---|---|
| Invested in Capital Assets | $ | 231,026,259 |
| Restricted Nonexpendable | | 62,406,256 |
| Restricted Expendable | | 120,847,523 |
| Unrestricted | | 12,439,834 |

Net assets invested in capital assets, net of related debt amounting to $231,026,259 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 $62,406,256, 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 $120,847,523, 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 $12,439,834 represent those balances from operational activities that have not been restricted by parties external to the University such as donors or grant agencies.

*Statements of Revenues, Expenses and Changes in Net Assets*

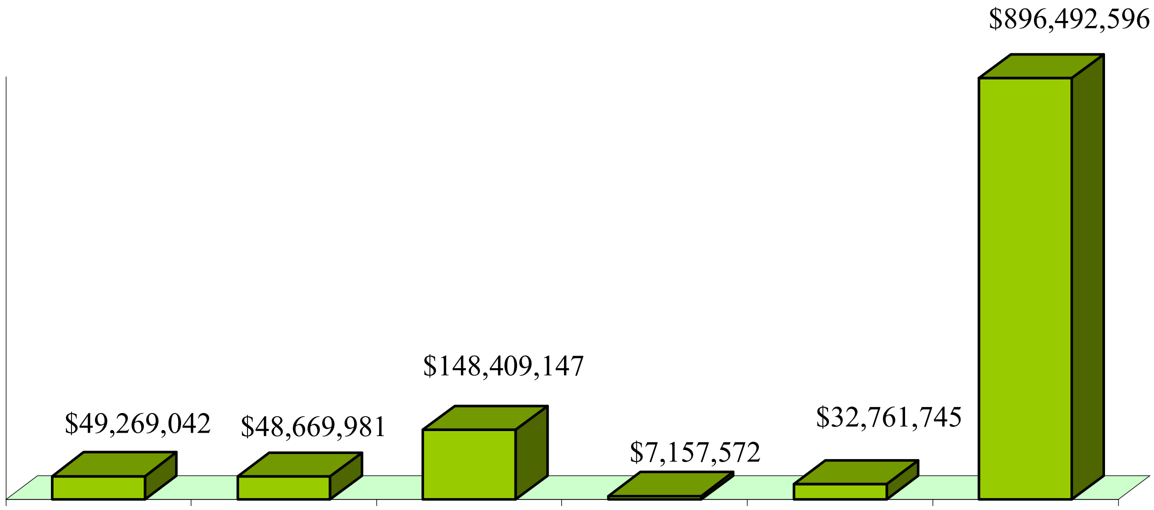
Changes in total University net assets as presented in the statements of net assets are based on the activity presented in the statements of revenues, expenses and changes in net assets. The purpose of these statements are to present the revenues earned by the University, both operating and nonoperating, and the expenses paid and accrued by the University 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.

Approximately 89% 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 the University revenues (both operating and nonoperating) for the year ended June 30, 2007:

**Table 2 - Revenues - Year Ended June 30, 2007**

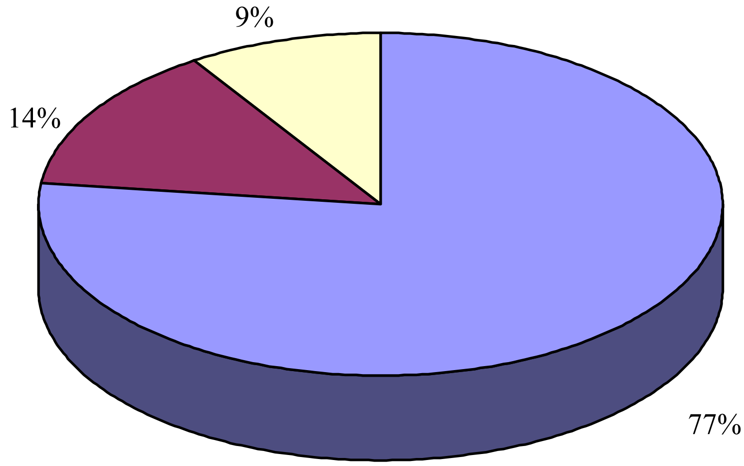



**Operating and Nonoperating Revenues**

| | | |
|---|---|---|
| Tuitions & Fees (net of scholarship) | $ | 49,269,042 |
| Patient services | | 48,669,981 |
| State and Federal Grants & Contracts | | 148,409,147 |
| Auxiliary Enterprises | | 7,157,572 |
| Other Operating Revenues | | 32,761,745 |
| State Appropriations | | 896,492,596 |

Federal Grants represent 77% of the University grants revenues. The following illustration presents the grants revenues of the University of Puerto Rico:

**Table 3 - Anaysis of Grants Revenues**
**Year Ended June 30, 2007**

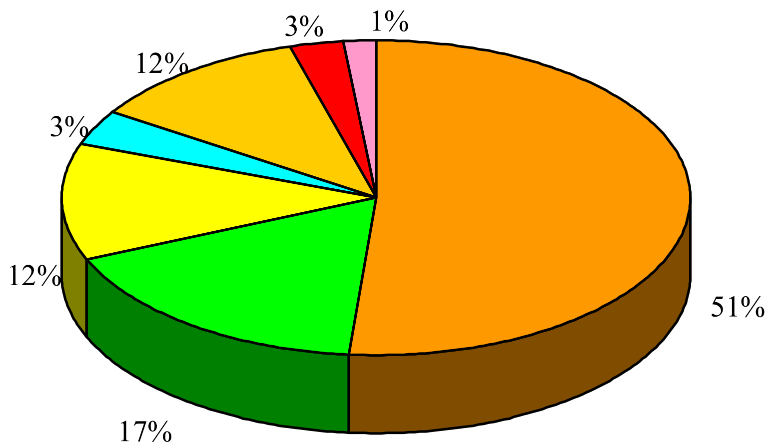



| | | | |
|---|---|---|---|
| Federal | $ | 125,667,791 | 77% |
| Commonwealth | | 22,741,356 | 14% |
| Other | | 14,753,879 | 9% |

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, 2007:

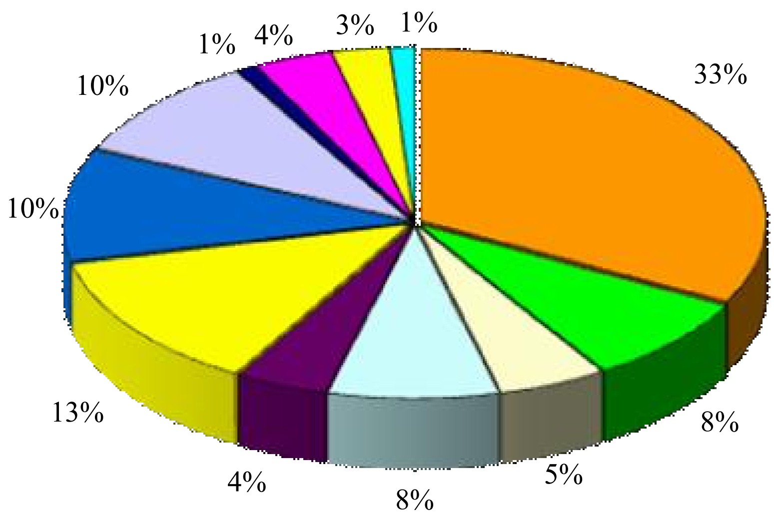
**Table 4 - Operating Expenses**




| | | | |
|---|---|---|---|
| Salaries | $ | 652,018,299 | 51% |
| Benefits | | 218,195,408 | 17% |
| Scholarship and others services | | 150,573,298 | 12% |
| Utilites | | 44,530,281 | 3% |
| Supplies and others services | | 149,551,732 | 12% |
| Depreciation | | 33,774,910 | 3% |
| Others Expenditures | | 17,879,437 | 1% |

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, 2007:

**Table 5 - Expenses by Function**




| | | | |
|---|---|---|---|
| Instruction | $ | 414,325,677 | 33% |
| Research | | 105,401,003 | 8% |
| Public Service | | 63,920,992 | 5% |
| Academic Support | | 101,008,992 | 8% |
| Student Services | | 54,467,642 | 4% |
| Institutional Support | | 164,648,897 | 13% |
| Operation and Maintenance of Plant | | 134,230,580 | 10% |
| Scholarships and Fellowships | | 122,671,693 | 10% |
| Auxiliary Enterprises | | 11,473,059 | 1% |
| Patient service | | 46,102,702 | 4% |
| Depreciation | | 33,774,910 | 3% |
| Other | | 14,496,756 | 1% |

For the year ended June 30, 2007, the University reported an operating loss of $(980,255,878). After adding nonoperating revenues and expenses, primarily state appropriations and Federal Pell Grant, the total increase in net assets for the year amounted to $40,590,712.

*Statements of Cash Flow*

The Statements of Cash Flows present information related to cash flows of the University by the following categories: operating activities, noncapital financing activities, capital and related financing activities and investing activities.

Increases in cash and cash equivalents from noncapital financing activities were due primarily to the receipt of state appropriations. This increase was offset by decreases in cash and cash equivalents from investing activities resulting from purchases of short-term investments, decreases in cash and cash equivalents used for capital and related financing activities and cash used in operating activities. Cash and cash equivalents decrease from capital and related financing activities was due primarily to purchases of capital assets and payments 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, 2007 and 2006, 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 2007, the University issued bond $546,150,000 to refund a portion of Revenue Bonds and finance costs of projects included in the Capital Improvements Programs.

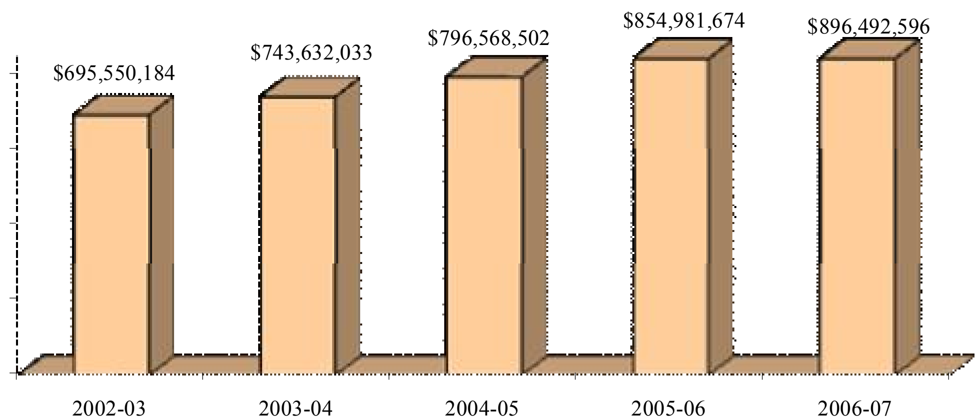
In addition, during the year ended June 30, 2007, the University recorded as capital lease the building, furniture and equipment of the Plaza Universitaria Project. Assets under the capital lease agreement amounted to approximately $99 million.

**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 drive of the Puerto Rican 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 2007, real GDP of Puerto Rico economy continued to expand at rate of 3.6%. 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:

**Table 6 - Commonwealth Appropriations**




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 2007 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.

## Request for Information

This financial report is designed to provide a general overview of the University's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Finance Director. The executive offices of the University are located at 1187 Flamboyan Street, Jardín Botánico Sur, San Juan, Puerto Rico 00926.

## University of Puerto Rico
## Statements of Net Assets

| | June 30 | |
|---|---|---|
| | **2007** | **2006** |
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | **$ 49,595,830** | $ 89,824,861 |
| Investments at fair value | **64,851,571** | 58,431,799 |
| Investments with bond trustees at fair value | **58,233,345** | 39,116,255 |
| Accounts receivable (less allowances for doubtful accounts of $106,514,050 and $112,752,800 for 2007 and 2006, respectively) | **159,522,765** | 144,925,202 |
| Inventories | **4,882,571** | 6,397,837 |
| Prepaid expenses and other assets | **7,009,890** | 2,747,812 |
| Total current assets | **344,095,972** | 341,443,766 |
| Noncurrent assets: | | |
| Restricted cash and cash equivalents | **4,544,892** | 1,299,879 |
| Investments at fair value | **237,177,724** | 50,913,531 |
| Due from Commonwealth of Puerto Rico | **84,232,509** | 56,000,001 |
| Prepaid expenses and other assets | **13,772,652** | 27,023,624 |
| Notes receivable, net | **2,720,096** | 2,468,867 |
| Capital assets (net accumulated depreciation of $411,324,335 and $384,397,167 for 2007 and 2006, respectively) | **796,685,602** | 659,326,528 |
| Total noncurrent assets | **1,139,133,475** | 797,032,430 |
| Total assets | **1,483,229,447** | 1,138,476,196 |
| **Liabilities** | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | **85,079,562** | 84,849,240 |
| Current portion of long-term debt | **19,760,000** | 90,624,037 |
| Obligation under capital lease, current portion | **2,178,105** | – |
| Other current liabilities | **26,019,842** | 24,006,108 |
| Total current liabilities | **133,037,509** | 199,479,385 |
| Noncurrent liabilities: | | |
| Long-term debt, net of current portion | **656,019,072** | 371,470,852 |
| Obligation under capital lease, noncurrent portion | **68,597,825** | – |
| Other long-term liabilities | **198,855,169** | 181,396,800 |
| Total noncurrent liabilities | **923,472,066** | 552,867,652 |
| Total liabilities | **1,056,509,575** | 752,347,037 |

*(Continues)*

## University of Puerto Rico
## Statements of Net Assets (continued)

| | June 30 | |
|---|---|---|
| | **2007** | **2006** |
| **Net assets** | | |
| Invested in capital assets, net of related debt | **231,026,259** | 207,167,597 |
| Restricted, nonexpendable: | | |
| Scholarship and fellowships | **39,560,872** | 30,028,944 |
| Research | **19,080,230** | 18,541,039 |
| Other | **3,765,154** | 3,677,611 |
| Restricted, expendable: | | |
| Research | **20,946,073** | 23,325,933 |
| Loans | **7,685,906** | 7,866,623 |
| Capital projects | **24,791,044** | 35,235,157 |
| Debt service | **56,233,963** | 37,557,804 |
| Other | **11,190,537** | 9,194,186 |
| Unrestricted | **12,439,834** | 13,534,265 |
| Total net assets | **$ 426,719,872** | $ 386,129,159 |

*See accompanying notes.*

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

| | June 30 2007 | June 30 2006 |
|---|---|---|
| **Revenues** | | |
| Operating revenues: | | |
| Tuitions and fees (net of scholarship allowances of $37,277,970 and $36,576,974 for 2007 and 2006, respectively) | **$ 49,269,042** | $ 51,115,866 |
| Net hospital patient services and other | **48,669,981** | 49,667,252 |
| Federal grants and contracts | **125,667,791** | 117,372,972 |
| Commonwealth grants and contracts (net of allowances of $4,985,386 and $6,423,178 for 2007 and 2006, respectively) | **22,741,356** | 16,485,670 |
| Nongovermental grants and contracts | **14,753,879** | 14,203,931 |
| Sales and services of educational departments | **4,316,666** | 6,812,491 |
| Auxiliary enterprises (net of scholarship allowances of $162,750 and $181,659 for 2007 and 2006, respectively) | **7,157,572** | 6,808,430 |
| Other operating revenues | **13,691,200** | 17,918,906 |
| Total operating revenues | **286,267,487** | 280,385,518 |
| | | |
| **Expenses** | | |
| Salaries: | | |
| Faculty | **377,460,983** | 358,229,060 |
| Exempt staff | **272,900,601** | 260,520,104 |
| Nonexempt wages | **1,656,715** | 2,408,761 |
| Benefits | **218,195,408** | 208,781,874 |
| Scholarship and fellowship | **150,573,298** | 137,445,350 |
| Utilities | **44,530,281** | 44,166,848 |
| Supplies and other services | **149,551,732** | 128,758,460 |
| Depreciation | **33,774,910** | 29,216,968 |
| Other expenses | **17,879,437** | 26,705,641 |
| Total operating expenses | **1,266,523,365** | 1,196,233,066 |
| Operating loss | **(980,255,878)** | (915,847,548) |
| | | |
| Nonoperating revenues (expenses): | | |
| Commonwealth appropriations | **896,492,596** | 854,981,674 |
| Federal Pell Grant program | **109,492,991** | 106,572,086 |
| Gifts | **6,461,769** | 5,438,676 |
| Net investment income | **9,116,461** | 5,802,197 |
| Interest on indebtedness | **(20,812,346)** | (11,813,450) |
| Other nonoperating revenues | **649,250** | 19,315,854 |
| Net nonoperating revenues | **1,001,400,721** | 980,297,037 |
| Income before other revenues | **21,144,843** | 64,449,489 |
| | | |
| Capital appropriations | **12,607,556** | 10,160,608 |
| Additions to term and permanent endowment | **6,838,313** | 3,865,074 |
| Increase in net assets | **40,590,712** | 78,475,171 |
| | | |
| **Net Assets** | | |
| Beginning of year | **386,129,159** | 307,653,988 |
| End of year | **$ 426,719,871** | $ 386,129,159 |

*See accompanying notes.*

## University of Puerto Rico
## Statements of Cash Flows

| | Year Ended June 30 | |
|---|---|---|
| | **2007** | 2006 |
| **Cash flows from operating activities** | | |
| Tuition and fees | **$ 49,253,880** | $ 49,889,882 |
| Grants and contracts | **157,423,396** | 165,314,646 |
| Pell grants | **109,492,991** | 106,572,086 |
| Patient services | **48,669,981** | 49,667,252 |
| Auxiliary enterprises | **6,857,754** | 6,472,420 |
| Sales and services educational depatrments | **4,358,816** | 3,666,463 |
| Payments to suppliers and vendors | **(63,480,929)** | (133,018,328) |
| Payments to employees | **(651,271,784)** | (621,731,261) |
| Payments for utilities | **(44,044,748)** | (44,268,477) |
| Payments for benefits | **(140,576,178)** | (207,579,734) |
| Payments for scholarships and fellowships | **(150,677,612)** | (137,406,365) |
| New loans issued to students | **(1,297,397)** | (1,215,509) |
| Student loan repayments | **1,046,166** | 1,225,385 |
| Other payments | **(30,361,913)** | (6,879,415) |
| Net cash used in operating activities | **(704,607,577)** | (769,290,954) |
| **Cash flows from noncapital financing activities** | | |
| Commonwealth appropriations | **896,492,595** | 854,981,674 |
| Endowment gifts | **6,838,313** | 3,865,074 |
| Gifts and grants for other than capital purposes | **7,111,019** | 24,754,529 |
| Net cash provided by noncapital financing activities | **910,441,927** | 883,601,277 |
| **Cash flows from capital and related financing activities** | | |
| Capital appropriations | **12,607,555** | 10,160,608 |
| Additions of capital assets | **(172,561,024)** | (62,738,861) |
| Principal paid on indebtness | **(292,474,805)** | (19,210,000) |
| Interest paid on capital indebtness | **(20,812,346)** | (11,813,450) |
| Deposit with trustee | **(19,117,090)** | (23,109) |
| Capital lease | **(70,775,930)** | – |
| Proceeds from capital debt | **503,882,775** | 32,692,605 |
| Net cash used in capital and related financing activities | **(59,250,866)** | (50,932,206) |
| **Cash flows from investing activities** | | |
| Proceeds from sales and maturities of investments | **36,058,961** | 34,860,593 |
| Purchase of investments | **(228,742,925)** | (48,488,221) |
| Interest on investments | **9,116,461** | 5,802,197 |
| Net cash used in investing activities | **(183,567,503)** | (7,825,431) |
| Net change in cash and cash equivalents | **(36,984,018)** | 55,552,686 |
| Cash and cash equivalents: | | |
| Beginning of period | **91,124,740** | 35,572,054 |
| End of period | **$ 54,140,722** | $ 91,124,740 |

*(Continues)*

# University of Puerto Rico
## Statements of Cash Flows (continued)

| | Year Ended June 30 | |
|---|---|---|
| | **2007** | 2006 |
| **Reconciliation of operating loss to net cash used in operating activities** | | |
| Operating loss | **$ (980,255,878)** | $ (915,847,548) |
| Adjustments to reconcile operating loss to net cash used in operating activities: | | |
| Depreciation expense | **33,774,910** | 29,216,968 |
| Reduction of capital assets | **1,427,039** | 4,098,492 |
| Amortization on bond premium, discount and future appreciated principal | **2,276,213** | 2,450,202 |
| Changes in assets and liabilities, net: | | |
| Grants and contracts receivables | **66,662,920** | 119,406,397 |
| Prepaid expenses, inventories and other | **10,504,164** | (3,947,991) |
| Accounts payable, accrued liabilities and capital lease | **70,755,022** | (16,402,736) |
| Accrued salaries and wages and other liabilities | **90,248,033** | 11,735,262 |
| Net cash used in operating activities | **$ (704,607,577)** | $ (769,290,954) |

*See accompanying notes.*

**Discretely Presented Component Unit**
**Servicios Médicos Universitarios, Inc.**
**(A Not-for Profit Organization)**
**Balance Sheets**

| | June 30 | |
|---|---|---|
| | **2007** | **2006** |
| **Assets** | | |
| Current assets: | | |
| Cash | **$ 32,062** | $ 580,620 |
| Patient accounts receivable, net of allowance for doubtful accounts of $41,822,363 in 2007 and $33,333,901 in 2006 | **14,367,224** | 14,000,380 |
| Accounts receivable - other | **275,841** | 182,043 |
| Inventories of supplies | **1,556,395** | 1,820,927 |
| Prepaid expenses | **252,272** | 717,755 |
| Total current assets | **16,483,794** | 17,301,725 |
| Property and equipment, net | **3,660,070** | 3,867,915 |
| Total assets | **$ 20,143,864** | $ 21,169,640 |
| | | |
| **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 |
| Accounts payable | **22,788,522** | 19,467,543 |
| Accrued interest | **4,767,455** | 3,681,155 |
| Estimated third-party payor settlements-medicare | **1,047,750** | 1,825,260 |
| Accrued payroll taxes and employee benefits | **1,460,488** | 1,128,678 |
| Accrued expenses | **1,717,360** | 2,058,496 |
| Total current liabilities | **47,149,186** | 43,807,727 |
| | | |
| Long-term debt, net of current portion | **1,632,389** | 1,632,389 |
| Due to related party | **34,896,147** | 31,372,171 |
| Accrued claim losses | **480,000** | – |
| Total liabilities | **84,157,722** | 76,812,287 |
| | | |
| Deficiency in unrestricted net assets | **(64,013,858)** | (55,642,647) |
| Total liabilities and deficiency in unrestricted net assets | **$ 20,143,864** | $ 21,169,640 |

*See accompanying notes.*

**Discretely Presented Component Unit**
**Servicios Médicos Universitarios, Inc.**
**(A Not-for-Profit Organization)**
**Statements of Operations and Deficiency in Unrestricted Net Assets**

| | Year Ended June 30 | |
|---|---|---|
| | **2007** | **2006** |
| **Unrestriced revenues and other support** | | |
| Net patient service revenue | **$ 39,888,022** | $ 37,319,625 |
| Other revenue | **1,705,766** | 1,671,181 |
| Total revenues and other support | **41,593,788** | 38,990,806 |
| **Expenses** | | |
| Salaries and benefits | **17,379,152** | 18,549,982 |
| Contracted services | **3,238,090** | 2,229,824 |
| Professional services | **1,123,287** | 1,135,842 |
| Supplies | **12,853,696** | 12,574,931 |
| Utilities | **2,509,198** | 2,194,597 |
| Interest | **1,254,105** | 1,200,213 |
| Provision for bad debs | **8,434,671** | 5,290,454 |
| Provision for claim losses | **480,000** | – |
| Depreciation and amortization | **865,812** | 757,957 |
| Other | **1,826,988** | 2,143,487 |
| Total expenses | **49,964,999** | 46,077,287 |
| Excess of expenses over revenue before extraordinary gain | **(8,371,211)** | (7,086,481) |
| Extraordinary gain | **–** | 2,869,272 |
| Change in unrestricted net assets | **(8,371,211)** | (4,217,209) |
| Deficiency in unrestricted net assets, at beginning of year | **(55,642,647)** | (51,425,438) |
| Deficiency in unrestricted net assets, at end of year | **$ (64,013,858)** | $ (55,642,647) |

*See accompanying notes.*

## Discretely Presented Component Unit
## Servicios Médicos Universitarios, Inc.
## (A Not-for-Profit Organization)
## Statements of Cash Flows

| | Year Ended June 30 2007 | Year Ended June 30 2006 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Change in unrestricted net assets | $ (8,371,211) | $ (4,217,209) |
| Adjustments to reconcile change in unrestricted net assets to net cash (used in) operating activities: | | |
| Depreciation and amortization | 865,812 | 757,957 |
| Provision for bad debts | 8,434,671 | 5,290,454 |
| Provision for claim losses | 480,000 | |
| Extraordinary gain | – | (2,869,272) |
| (Increase) in patient accounts receivable | (8,801,514) | (7,877,102) |
| Decrease (increase) in inventory of supplies | 264,532 | 14,124 |
| Decrease in prepaid expenses | 465,483 | 150,769 |
| Decrease (increase) in accounts receivable-other | (292,386) | 6,743 |
| Increase in accounts payable | 3,041,995 | 611,726 |
| Increase in estimated third-party payor settlements-Medicare | (777,510) | 370,867 |
| Increase in accrued expenses, payroll taxes and employee benefits | 1,563,238 | 205,200 |
| Increase in accrued interest | 1,086,300 | 918,903 |
| Total adjustments | 6,330,621 | (2,419,631) |
| Net cash used in operating activities | (2,040,590) | (6,636,840) |
| | | |
| **Cash flows from investing actitivies** | | |
| Purchase of property and equipment | (657,968) | (1,342,625) |
| | | |
| **Cash flows from financing activities** | | |
| Payments on long-term debt and capital lease obligations | – | – |
| Net advances from University of Puerto Rico and other related parties | 2,150,000 | 7,583,076 |
| Net cash provided by financing activities | 2,150,000 | 7,583,076 |
| Net decrease in cash | (548,558) | (396,389) |
| | | |
| Cash and cash equivalents, at beginning of year | 580,620 | 977,009 |
| Cash and cash equivalents, at end of year | $ 32,062 | $ 580,620 |
| | | |
| **Supplemental disclosures of cash flows information** | | |
| Cash paid for interest | $ 78,762 | $ 116,693 |

*See accompanying notes.*

## Discretely Presented Component Unit
## Desarrollos Universitarios, Inc.
## (A Not-for-Profit Organization)
## Statements of Financial Position

| | Year Ended March 31 2007 | | Year Ended March 31 2006 | |
|---|---|---|---|---|
| **Assets** | | | | |
| Current assets: | | | | |
| Cash | **$** | **2,013,630** | $ | 2,433,407 |
| Restricted cash | | **65,805** | | |
| Restricted funds held by trustee | | **10,369,384** | | 14,466,518 |
| Net investment in direct financing lease | | **71,030,863** | | – |
| Due from the University of Puerto Rico | | **1,558,351** | | – |
| Prepaid expenses | | **95,579** | | 94,992 |
| Project in process | | **–** | | 94,383,247 |
| Bond issuance costs, net of accumulated amortization of $451,765 and $371,161 | | **2,337,459** | | 2,418,063 |
| Other assets | | **60,224** | | – |
| Total assets | **$** | **87,531,295** | $ | 113,796,227 |
| | | | | |
| **Liabilities and deficiency in net assets** | | | | |
| Liabilities: | | | | |
| Construction contract, project management fee and other payables, including retaineage of $1,448,317 and $2,154,231 | **$** | **2,539,396** | $ | 3,244,985 |
| Accrued interest payable | | **1,066,245** | | 1,083,933 |
| Accrued expenses | | **823,207** | | 404,636 |
| Unearned student dormitories rental income | | **6,970** | | – |
| Student dormitories security deposits | | **29,345** | | – |
| Unearned revenue | | **–** | | 25,598,183 |
| Bonds payable, net of discount of $320,850 and $343,692 | | **82,344,150** | | 83,736,308 |
| Total liabilities | | **86,809,313** | | 114,068,045 |
| | | | | |
| Contingencies | | | | |
| | | | | |
| Net assets | | **721,982** | | (271,818) |
| Total liabilities and net assets | **$** | **87,531,295** | $ | 113,796,227 |

*See accompanying notes.*

**Discretely Presented Component Unit**
**Desarrollos Universitarios, Inc.**
**(A Not-for-Profit Organization)**
**Statements of Activities and Changes in Net Assets**

| | Year Ended March 31 | |
|---|---|---|
| | **2007** | **20006** |
| Revenues: | | |
| Income from investment in direct financing lease | **$ 2,353,057** | $ – |
| Fixed management fee | **379,000** | – |
| Reimbursable expenditures fee | **1,209,366** | – |
| Total revenues | **3,941,423** | – |
| Expenses: | | |
| Project operation and maintenance | **1,045,402** | – |
| General and administrative | **138,678** | (174,361) |
| Total expenses | **1,184,080** | (174,361) |
| Other income (expenses): | | |
| Interest and other financing, related expenses | **(2,120,625)** | – |
| Interest income | **357,082** | – |
| Total other expenses | **(1,763,543)** | – |
| Change in unrestricted net assets | **993,800** | 174,361 |
| Deficiency in unrestricted net assets at beginning of year | **(271,818)** | (97,457) |
| Unrestricted net assets (deficiency) at end of year | **$ 721,982** | $ (271,818) |

*See accompanying notes.*

## Statements of Cash Flows

| | Year Ended March 31 2007 | 2006 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Excess of expenses over revenues | **$ 993,800** | $ (174,361) |
| Adjustments to reconcile excess of expenses over revenues to net cash used in operating activities: | | |
| Bond discount amortization | **22,842** | 24,323 |
| Amortization of bond issuance cost | **80,604** | 80,770 |
| Changes in operating assets and liabilities: | | |
| Increase in restricted cash | **(65,805)** | – |
| Principal collected from direct financing lease | **497,453** | – |
| Net increase in due from University of Puerto Rico | **(1,558,351)** | – |
| Increase in project in process | **(4,915,102)** | (13,627,824) |
| Increase in prepaid expenses | **(587)** | (89,717) |
| Increase in other assets | **(60,224)** | – |
| Increase (decrease) in construction contract, project management fee and other payables | **(705,589)** | 167,786 |
| Decrease in accrued interest payable | **(17,688)** | (13,600) |
| Increase in accrued expenses | **418,571** | 292,672 |
| Increase in unearned student dormitories rental income | **6,970** | – |
| Increase in student dormitories security deposits | **29,345** | – |
| Increase in unearned revenue | **2,171,850** | 5,701,614 |
| Net cash used in operating activities | **(3,101,911)** | (7,638,337) |
| | | |
| **Cash flows from investing activities** | | |
| Net proceeds from release of restricted funds held by trustee | **4,097,134** | 11,228,942 |
| | | |
| **Cash flows from financing activities** | | |
| Principal payments on bonds payable | **(1,415,000)** | (1,360,000) |
| Net change in cash | **(419,777)** | 2,230,605 |
| | | |
| Cash at beginning of year | **2,433,407** | 202,802 |
| Cash at end of year | **$ 2,013,630** | $ 2,433,407 |

*See accompanying notes.*

## 1. Reporting Entity and Summary of Significant Accounting Policies

### A. 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 tenured 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 of the campuses at 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 general funds 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 entity from the University and is governed by a separate board. The Hospital is a not-for-profit acute care corporation, organized under the Laws of the Commonwealth of Puerto Rico, on February 11, 1998, to operate and administer healthcare units. The principal objectives of the Hospital are to constitute it as the principal medical education, institution of the University and to offer care services to the residents of Puerto Rico. The University appoints a voting majority of the Hospital board and is also financially accountable for the Hospital. Complete financial statements of the Hospital can be obtained directly by contacting the Hospital's administrative offices.

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

**Desarrollos Universitarios, Inc.**

Desarrollos Universitarios, Inc. (the Company) is a legally separated entity 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). The Company developed the Plaza Universitaria Project, which 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) on December 20, 2000. In 2006 the University entered into a capital lease agreement with the Company for the Plaza Universitaria project. The Company is fiscally dependent on the University. Complete financial statements of the Company can be obtained directly by contacting the Company's administrative offices.

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

### B. 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.

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

### C. Reclassification

Reclassifications of prior year balances have been made to conform to the current year presentation.

### D. Cash Equivalents

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

### E. 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.)

### F. Restricted Funds Held by Trustee – Discretely Presented Component Unit

Restricted funds of Desarrollos Universitarios, Inc. held by trustee at March 31, 2007 and 2006, consist of money market funds and zero coupon bonds purchased with remaining maturities of six months or less.

### G. Capital Assets

All capital expenses 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.

### H. 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)

### I. 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.

### J. 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 operating 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.

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

### K. Bond Premium/Discount, Deferred Issuance Costs and Deferred Refunding Loss

Bond premium and/or discount and deferred issuance costs are amortized using the effective interest method. Deferred refunding loss is amortized over the remaining life of the old debt or the life of the new debt, whichever is shorter.

### L. 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.

### M. 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, 2007 and 2006, the cost of the excess of 90 days of the accumulated sick leave was $10,208,075 and $9,343,356, respectively.

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

### N. Net Patient Service Revenue (Discretely Presented Component Unit)

Servicios Médicos Universitarios, Inc has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

### O. 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 no exchange transactions, such as gifts and contributions, Federal Pell Grants 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.

### P. 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 No exchange 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)

### Q. 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. Deposits

All the operating cash of the University 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 at the GDB and EDB, both public corporations of the Commonwealth of Puerto Rico.

As of June 30, 2007 and 2006, the carrying value of cash and cash equivalents amounted to approximately $54,140,722 and $91,124,740, respectively, and the cash deposited in the banks amounted to $62,648,245 and $46,923,165, respectively.

## 3. Investments

The University's investments held at June 30, 2007 and 2006, are summarized in the following table:

| | 2007 | 2006 |
|---|---|---|
| Certficates of deposit | **$ 5,909,686** | $ 7,334,530 |
| Goverment agency securities | **260,888,675** | 57,482,454 |
| Corporate bonds and preferred stock | **15,249,929** | 14,859,225 |
| Common stock and convertibles | **19,927,139** | 16,789,941 |
| Mutual Bond Funds | **58,287,211** | 51,995,435 |
| | **$ 360,262,640** | $ 148,461,585 |

The custody of these investments is held by the trust department 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. As of June 30, 2007, the University's credit quality distribution for securities was as follows:

| | | Quality Rating | | |
|---|---|---|---|---|
| | Carrying Value | AAA-A | Unrated | No Risk |
| Government agency securities | $ 260,888,675 | $ – | $ – | $ 260,888,675 |
| Corporate Bonds and preferred stocks | 15,249,929 | 15,249,929 | – | – |
| Common Stocks and Convertibles | 19,927,139 | 19,927,139 | – | – |
| Mutual Bond Funds | 58,287,211 | – | 58,287,211 | – |
| | $ 354,352,954 | $ 35,177,068 | $ 58,287,211 | $ 260,888,675 |

## 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, 2007, the weighted average maturity by investment type in each fund follows:

| Investment Type | Maturities | Amount |
|---|---|---|
| Corporate Bonds | 25/Apr/10 - 17/May/40 | $ 2,571,611 |
| Corporate Bonds | 2/Jul/08 - 15/May/44 | 982,894 |
| Corporate Bonds | 2/Jul/08 - 15/May/44 | 5,313,610 |
| Corporate Bonds | 2/Jul/08 - 15/May/44 | 118,319 |
| Corporate Bonds | 2/Jul/08 - 15/May/44 | 308,250 |
| Corporate Bonds | 2/Jul/08 - 15/May/44 | 5,940,600 |
| Corporate Bonds | 15/Mar/12 - 15/Oct/30 | 14,646 |
| | | $ 15,249,930 |

## 4. Accounts Receivable

Accounts receivable as of June 30 are as follows:

| | 2007 | 2006 |
|---|---|---|
| Commonwealth of Puerto Rico appropriations grants and contracts | **$ 81,504,832** | $ 102,699,218 |
| Other goverment agencies | **55,967,383** | 15,213,636 |
| Due from Federal government | **22,329,643** | 28,415,065 |
| Due from medical plans | **60,044,847** | 52,613,163 |
| Due from Servicios Médicos Universitarios, Inc. | **33,296,756** | 31,246,756 |
| Other | **12,893,354** | 27,490,164 |
| | **266,036,815** | 257,678,002 |
| Less allowance for doubtful accounts | **(106,514,050)** | (112,752,800) |
| Accounts receivable, net | **$ 159,522,765** | $ 144,925,202 |

## 4. Accounts Receivable (continued)

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, 2007, the University has received $29,695,382 from this amount. The remaining balance is going to be received as follows:

| Fiscal Year | Amount |
|---|---|
| 2007-2008 | $ 8,155,254 |
| 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 |
| | $ 48,585,128 |

## 5. Capital Assets

Changes in capital assets for the year ended June 30, 2007 and 2006, are as follows:

| | 2007 | | | | |
|---|---|---|---|---|---|
| | Beginning Balance | Additions | Transfers | Reductions | Ending Balance |
| Capital assets not being depreciated: | | | | | |
| Land | $ 33,534,290 | $ – | $ 8,626,738 | $ – | $ 42,161,028 |
| Construction - in progress | 138,489,823 | 52,364,572 | (91,876,089) | (993,033) | 97,985,273 |
| | 172,024,113 | 52,364,572 | (83,249,351) | (993,033) | 140,146,301 |
| Other capital assets: | | | | | |
| Land improvements | 30,855,329 | – | 738,313 | – | 31,593,642 |
| Building, fixed equipment, improvements and infraestructure | 638,398,067 | 2,249,147 | 82,303,525 | (26,500) | 722,924,239 |
| Equipment and library materials | 202,446,186 | 18,649,056 | 207,513 | (7,255,248) | 214,047,507 |
| Building and equipment under capital lease | – | 99,298,249 | – | – | 99,298,249 |
| | 871,699,582 | 120,196,452 | 83,249,351 | (7,281,748) | 1,067,863,637 |
| Less accumulated drepreciation for: | | | | | |
| Land improvements | (12,518,386) | (1,124,949) | – | 17,090 | (13,626,245) |
| Buildings, fixed equipment, improvements and infraestructure | (225,160,046) | (15,783,169) | – | 10,372 | (240,932,843) |
| Equipment and library materials | (146,718,735) | (15,004,950) | – | 6,820,280 | (154,903,405) |
| Building and equipment under capital lease | – | (1,861,842) | – | | (1,861,842) |
| | (384,397,167) | (33,774,910) | – | 6,847,742 | (411,324,335) |
| Other capital assets, net of acumulated depreciation | 487,302,415 | 86,421,542 | 83,249,351 | (434,006) | 656,539,302 |
| Capital assets, net | $ 659,326,528 | $ 138,786,114 | $ – | $ (1,427,039) | $ 796,685,603 |

## 5. Capital Assets (continued)

| | 2006 | | | | |
|---|---|---|---|---|---|
| | Beginning Balance | Additions | Transfers | Reductions | Ending Balance |
| Capital assets not being depreciated: | | | | | |
| Land | $ 32,965,504 | $ – | $ 568,786 | $ – | $ 33,534,290 |
| Construction - in progress | 150,438,460 | 47,705,565 | (58,027,164) | (1,627,038) | 138,489,823 |
| | 183,403,964 | 47,705,565 | (57,458,378) | (1,627,038) | 172,024,113 |
| Other capital assets: | | | | | |
| Land improvements | 30,514,724 | – | 340,605 | – | 30,855,329 |
| Building, fixed equipment, improvements and infraestructure | 581,946,394 | – | 56,451,673 | – | 638,398,067 |
| Equipment and library materials | 196,938,459 | 14,277,003 | 666,100 | (9,435,376) | 202,446,186 |
| | 809,399,577 | 14,277,003 | 57,458,378 | (9,435,376) | 871,699,582 |
| Less accumulated drepreciation for: | | | | | |
| Land improvements | (11,463,481) | (1,054,905) | – | – | (12,518,386) |
| Buildings, fixed equipment, improvements and infraestructure | (210,719,487) | (14,440,559) | – | – | (225,160,046) |
| Equipment and library materials | (140,717,446) | (13,721,505) | – | 7,720,216 | (146,718,735) |
| | (362,900,414) | (29,216,969) | – | 7,720,216 | (384,397,167) |
| Other capital assets, net of acumulated depreciation | 446,499,163 | (14,939,966) | 57,458,378 | (1,715,160) | 487,302,415 |
| Capital assets, net | $ 629,903,127 | $ 32,765,599 | $ – | $ (3,342,198) | $ 659,326,528 |

## Project in Process – Discretely Presented Component Unit

Project in process of Desarrollos Universitarios, Inc. at March 31, 2007 and 2006, consist of:

| | 2007 | 2006 |
|---|---|---|
| Construction, professional services and project management | **$ 84,480,930** | $ 81,537,381 |
| Interest capitalized, net of interest and dividends earned from restricted funds of $10,202,733 and $9,945,138 | **14,817,419** | 12,845,866 |
| Subtotal | **99,298,349** | 94,383,247 |
| Less transferred to the University at inception of lease | **99,298,349** | – |
| Total | **$ –** | $ 94,383,247 |

## 6. Lines of Credit

As of June 30, 2007, the University has available one line of credit agreement with GDB for the total authorized amounts of $60,000,000. This line of credit is guaranteed by the Commonwealth of Puerto Rico. As of June 30, 2007, the University had $20,271,404 outstanding under this line of credit.

## 7. Noncurrent Liabilities

Changes in noncurrent liabilities for the year ended June 30, 2007 and 2006, are as follows:

**2007**

| | Beginning Balance | Additions | Reductions | Other | Ending Balance | Less Due Within One Year | Noncurrent Liabilities |
|---|---|---|---|---|---|---|---|
| Long-term debt: | | | | | | | |
| Notes payable | $ 79,645,174 | $ 23,209,527 | $ (82,583,297) | $ – | $ 20,271,404 | $ – | $ 20,271,404 |
| Bonds payable | 382,449,715 | 546,150,000 | (320,048,872) | 46,956,825 | 655,507,668 | 19,760,000 | 635,747,668 |
| Total long-term | $ 462,094,889 | $ 569,359,527 | $ (402,632,169) | $ 46,956,825 | $ 675,779,072 | $ 19,760,000 | $ 656,019,072 |
| Other long-term liabilities: | | | | | | | |
| Deferred compensation payable | $ 51,995,435 | $ 6,291,776 | $ – | $ – | $ 58,287,211 | $ – | $ 58,287,211 |
| Claims liability | 18,332,300 | 4,828,126 | (1,100,141) | – | 22,060,285 | 1,100,000 | 20,960,285 |
| Compensated absences | 135,075,173 | 9,452,342 | – | – | 144,527,515 | 24,919,842 | 119,607,673 |
| Capital lease obligation | – | 99,298,349 | (28,522,419) | – | 70,775,930 | 2,178,105 | 68,597,825 |
| Total other long-term liabilities | $ 205,402,908 | $ 119,870,593 | $ (29,622,560) | $ – | $ 295,650,941 | $ 28,197,947 | $ 267,452,994 |

**2006**

| | Beginning Balance | Additions | Reductions | Other | Ending Balance | Less Due Within One Year | Noncurrent Liabilities |
|---|---|---|---|---|---|---|---|
| Long-term debt: | | | | | | | |
| Notes payable | $ 47,962,569 | $ 31,682,605 | $ – | $ – | $ 79,645,174 | $ 71,414,037 | $ 8,231,137 |
| Bonds payable | 398,199,513 | 1,010,000 | (19,210,000) | 2,450,202 | 382,449,715 | 19,210,000 | 363,239,715 |
| Total long-term | $ 446,162,082 | $ 32,692,605 | $ (19,210,000) | $ 2,450,202 | $ 462,094,889 | $ 90,624,037 | $ 371,470,852 |
| Other long-term liabilities: | | | | | | | |
| Deferred compensation payable | $ 45,575,300 | $ 6,420,135 | $ – | $ – | $ 51,995,435 | $ – | $ 51,995,435 |
| Claims liability | 20,260,000 | – | (1,927,700) | – | 18,332,300 | 1,500,000 | 16,832,300 |
| Compensated absences | 127,832,345 | 7,242,828 | – | – | 135,075,173 | 22,506,108 | 112,569,065 |
| Total other long-terms liabilities | $ 193,667,645 | $ 13,662,963 | $ (1,927,700) | $ – | $ 205,402,908 | $ 24,006,108 | $ 181,396,800 |

Bonds payable are further disclosed in Note 8-A.

## 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, 2007:

| Series | Balance as of June 30, 2007 | Anual Interest Rate (%) | Due Date |
|---|---|---|---|
| C - Serial | $ 639,000 | 3.00% | 1972-2011 |
| D - Serial | 833,000 | 3.75% | 1972-2011 |
| F - Term | 9,950,000 | 5.50% | 2012 |
| M - Serial | 4,940,000 | 4.35-5.45% | 1996-2009 |
| N - Serial | 9,840,000 | 4.35-5.45% | 1996-2008 |
| N - Capital Appreciation Serial Bonds | 51,980,000 | 5.65-5.75% | 2009-2013 |
| O - Serial | 11,215,000 | 4.5-3.75% | 2001-2020 |
| P - Serial | 238,860,000 | 5.00% | 2010-2026 |
| P - Term | 47,645,000 | 5.00% | 2027-2030 |
| Q - Serial | 127,230,000 | 5.00% | 2008-2026 |
| Q - Term | 132,415,000 | 5.00% | 2027-2036 |
| | 635,547,000 | | |
| Less unamortized bond discount | (6,473) | | |
| Plus unaccreted premium | 35,310,342 | | |
| Less future appreciated principal | (10,339,329) | | |
| Deferred loss on refunding | (5,003,872) | | |
| | $ 655,507,668 | | |

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

### B. Debt Service Requirement

At June 30, 2007, bonds payable require payments of principal and interest as follows:

| Fiscal Year | Principal | Interest | Total |
|---|---|---|---|
| 2008 | $ 19,760,000 | $ 29,308,028 | $ 49,068,028 |
| 2009 | 21,455,000 | 28,217,053 | 49,672,053 |
| 2010 | 20,825,000 | 27,647,555 | 48,472,555 |
| 2011 | 27,652,000 | 27,127,880 | 54,779,880 |
| 2012 | 27,040,000 | 26,281,245 | 53,321,245 |
| 2013 to 2017 | 107,990,000 | 117,467,000 | 225,457,000 |
| 2018 to 2022 | 121,635,000 | 91,136,000 | 212,771,000 |
| 2023 to 2027 | 130,715,000 | 58,127,500 | 188,842,500 |
| 2028 to 2032 | 97,665,000 | 28,380,000 | 126,045,000 |
| 2033 to 2036 | 60,810,000 | 7,786,000 | 68,596,000 |
| | $ 635,547,000 | $ 441,478,261 | $ 1,077,025,261 |

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

## 8. Bonds Payable (continued)

### C. Issuance of University System Revenue Bonds and University System Revenue Refunding Bonds

In December 2006, the University issued $286,505,000 University System Revenue Refunding Bonds, Series P and $259,645,000 University System Revenue Bonds, Series Q, totaling $546,150,000.

The University System Revenue bonds were issued principally to repay the line of credit of the Government Development Bank of $82,583,296 and make a deposit to the Construction Fund of $168,271,793 for the Capital Improvement Program.

The University System Revenue Refunding Bonds were issued to advance refund and defease the University´s outstanding University System Revenue Bonds and the University System Revenue Refunding Bonds consisting of Series M and Series O of $136,350,000 and $163,935,000, respectively. This refunding resulted in an economic gain of approximately $2 million.

The proceeds of University System Revenue Refunding Bonds, Series P, were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide debt service payments until the bonds mature or are called.

## 8. Bonds Payable (continued)

### D. 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 years ended June 30, 2007 and 2006:

| **Pledged Revenues:** | **2007** | **2006** |
|---|---|---|
| Tuition and other fees collected | **$ 72,973,464** | $ 73,478,387 |
| Student fees collected | **6,160,271** | 6,458,828 |
| Rental and other charges received for the right of use and occupancy of the facilities in the University system | **1,241,694** | 1,292,336 |
| Bookstore receipts (gross sales less cost of books and supplies sold) | **810,127** | 1,039,252 |
| Interest on investment of University funds, excluding funds invested pursuant to Article VI of the Trust Agreement | **4,665,763** | 2,794,159 |
| Funds paid to the University in respect to overhead allowance on federal research projects | **18,981,291** | 15,271,829 |
| Other income | **27,788,421** | 28,234,976 |
| | **$ 132,621,031** | $ 128,569,767 |

Interest earned on investments in the sinking fund reserve account amounted to approximately $1,766,873 and $1,239,134 for the years ended June 30, 2007 and 2006, 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:

## 8. Bonds Payable (continued)

### D. Pledged Revenues (continued)

*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.

### 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.

## 8. Bonds Payable (continued)

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

Bonds payable at March 31, 2007 and 2006, consist of:

| Description | Interest Rate | Maturity | 2006 Face Amount | 2007 Face Amount |
|---|---|---|---|---|
| Serial Bonds | 5.00% | July 1, 2006 | $ 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 |
| | | | $ 84,080,000 | $ 82,665,000 |

## 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. Obligations under Capital Leases

In October, 2006, the University entered into a capital lease agreement with Desarrollos Universitarios, Inc. a nonprofit corporation and component unit of the University. The agreement is for the use of Plaza Universitaria a residential and commercial facility for the use of students and other persons or entities conducting business with the University. The agreement began on October 1, 2006 and expires on June 25, 2033. The outstanding liability at June 30, 2007 on this capital lease is $70,775,930.

During fiscal year 2007, $32,045,799 was applied to the obligation under capital lease, of which $3,523,380 represented interest and $28,522,419 represented principal, including the application of $27,770,032 to the principal balance previously recognized as prepaid expense. The interest rate as of June 30, 2007, was 6.6%. The carry values of assets held under capital lease net of accumulated depreciation was $97,436,407.

The future minimum lease payments under the capital leases are as follows:

**Minimun Lease Payments**

| Year | Amount |
|---|---|
| 2008 | $ 5,701,625 |
| 2009 | 5,699,375 |
| 2010 | 5,697,550 |
| 2011 | 5,700,938 |
| 2012 | 5,701,938 |
| 2013 to 2017 | 28,503,813 |
| 2018 to 2022 | 28,497,687 |
| 2023 to 2027 | 28,495,000 |
| 2028 to 2032 | 28,502,750 |
| 2033 | 5,701,500 |
| Total minimun lease payments | 148,202,176 |
| Less amount representing interest | (77,426,246) |
| Present value of net minimun lease payments | $ 70,775,930 |

## 10. 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 years 2007 and 2006 were:

| | 2007 | 2006 |
|---|---|---|
| Claims payable - July 1 | **$ 18,332,300** | $ 20,260,000 |
| Incurred claims and changes in estimates | **34,279,088** | 27,377,998 |
| Payments for claims and adjustments expenses | **(30,551,103)** | (29,305,698) |
| Claims payable - June 30 | **$ 22,060,285** | $ 18,332,300 |

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.

## 10. Commitments and Contingent Liabilities (continued)

### C. Discretely Presented Component Units

**Servicios Médicos Universitarios, Inc.** (the Hospital) is a non-for-profit corporation organized to operate and administer healthcare unit locate in Carolina. This facility was acquired by the University and includes land, building and medical equipment.

The Hospital entered into a loan agreement (the Agreement) with the Government Development Bank of 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 of the long-term debt for the next five years and thereafter are as follows:

| Fiscal Year | Amount |
|---|---|
| 2008 | $ 15,367,611 |
| 2009 | – |
| 2010 | – |
| 2011 | – |
| 2012 | – |
| Thereafter | 1,632,389 |
| | $ 17,000,000 |

## 10. Commitments and Contingent Liabilities (continued)

### C. Discretely Presented Component Units (continued)

**Desarrollos Universitarios, Inc.** (the Company) was incorporated on January 22, 1997. The Company is a non-for-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, 2007 and 2006, the University had paid in advance a total of $32,045,797 and $27,023,624 respectively, for these purposes and such amounts have been recorded in the accompanying statements of net assets as prepaid expenses and other assets.

## 10. Commitments and Contingent Liabilities (continued)

### C. Discretely Presented Component Units (continued)

Future minimum annual lease payments under this agreement at June 30, 2007 are: $5,701,000 in 2007; $5,701,000 in 2008; $5,700,000 in 2009; $5,698,000 in 2010, $5,700,000 in 2011 and $126,828,000 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 allegation are invalid under the terms of the 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.

## 11. University of Puerto Rico Retirement System

The University of Puerto Rico Retirement System (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.

The system issues stand-alone audited financial statements and can be obtained from the systems administrative offices.

**11. University of Puerto Rico Retirement System (continued)**

Effective July 1, 2006, the System changed its method of amortizing the unfunded actuarial liability from the "Level Dollar Amount" method to the "Level Percentage of Payroll" method. The newly adopted method is an accepted method of amortizing the unfunded actuarial liability of defined benefit plans. The change has been accounted for prospectively in the financial statements.

**Funding Policy and Annual Pension Cost**

| | |
|---|---|
| Contribution rates: | |
| University | 11.1% |
| Plan members | 7% |
| Annual pension cost | $57,737,197 |
| Contributions made | $78,310,774 |
| Actuarial valuation date | 6/30/2007 |
| Actuarial cost method | Entry age Normal (traditional) |
| Amortization method | Level percentage of payroll |
| Remaining amortization period | 30 years constant (open basis) |
| Asset valuation method | 5-year smoothed market |
| Actuarial assumptions: | |
| Investment rate of return* | 8.00% |
| Projected salary increases* | 5% |
| *Includes inflation at | 3.50% |
| Postretirement benefit increases | 3% every two (2) years |

| Year Ending | Annual Pension Cost (APC) | Employer Contribution | Percentage of APC Contributed | Net Pension Obligation |
|---|---|---|---|---|
| 6/30/2007 | $ 57,737,197 | $ 78,310,774 | 135.6% | $ (13,772,652) |
| 6/30/2006 | $ 56,160,455 | $ 73,658,083 | 131.2% | $ 6,800,925 |
| 6/30/2005 | $ 84,657,964 | $ 69,291,395 | 81.8% | $ 24,298,553 |

## 12. Post-Retirement Benefits

In addition to the pension benefits described in Note 11, the University provides post-retirement health care benefits for its retired employees. Substantially all of the employees may become eligible for this benefit 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. The cost of providing such benefits are recognized when paid. During the years ended June 30, 2007, the payments of health care benefits amounted to $8,196.843.

## 13. 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 $64,013,858 at June 30, 2007. 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 $41,822,363.

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, 2007.

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.
- Marketing of the ophthalmology services, including a new physician that has a specialization in cornea diagnosis and treatment.

## 13. Going Concern - Discretely Presented Component Unit (continued)

- More aggressive negotiation with medical insurance companies and restructuring the billing and collection department, in order to reduce to a minimum, denied reimbursement for service provided, to increase the reimbursement 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 Hospital's 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.

## 14. Functional Information

The University's operating expenses by functional classification during the years ended June 30 2007 and 2006 were as follows:

**2007**

| Functional classification | Salaries and benefits | Supplies and other services | Scholarship and felowship | Utilities | Depreciation | Other Expenditures | Total |
|---|---|---|---|---|---|---|---|
| Instruction | $ 383,324,453 | $ 18,945,647 | $ 10,846,926 | $ 1,126,143 | $ – | $ 82,508 | $ 414,325,677 |
| Research | 66,284,908 | 21,338,866 | 11,755,699 | 1,026,227 | – | 4,995,303 | 105,401,003 |
| Public service | 49,857,343 | 11,488,554 | 2,153,249 | 395,646 | – | 26,200 | 63,920,992 |
| Academic support | 79,270,040 | 17,460,444 | 4,118,524 | 123,684 | – | 36,300 | 101,008,992 |
| Student service | 43,680,136 | 9,838,406 | 924,629 | 461 | – | 24,010 | 54,467,642 |
| Institutional support | 120,318,861 | 41,876,263 | 507,043 | 1,762,543 | – | 184,187 | 164,648,897 |
| Oper & Maintenance | 77,452,882 | 16,516,950 | 16,569 | 39,970,471 | – | 273,708 | 134,230,580 |
| Student Aid | 2,161,073 | 612,771 | 119,897,505 | 344 | – | – | 122,671,693 |
| Independent Operation | – | 462 | – | – | – | – | 462 |
| Patient Service | 43,117,786 | 2,623,561 | 282,541 | 63,117 | – | 15,697 | 46,102,702 |
| Auxiliary Enterprises | 4,746,225 | 5,326,439 | 70,613 | 61,645 | – | 1,268,137 | 11,473,059 |
| Depreciation | – | – | – | – | 33,774,910 | – | 33,774,910 |
| Other | – | – | – | – | – | 14,496,756 | 14,496,756 |
| | $ 870,213,707 | $ 146,028,363 | $ 150,573,298 | $ 44,530,281 | $ 33,774,910 | $ 21,402,806 | $ 1,266,523,365 |

## 14. Functional Information (continued)

| 2006 | | | | | | | |
|---|---|---|---|---|---|---|---|
| Functional classification | Salaries and benefits | Supplies and other services | Scholarship and felowship | Utilities | Depreciation | Other Expenditures | Total |
| Instruction | $ 349,135,141 | $ 17,398,624 | $ 11,766,910 | $ 1,242,283 | $ – | $ 366,534 | $ 379,909,491 |
| Research | 65,931,577 | 20,600,117 | 9,640,336 | 1,088,837 | – | 4,150,261 | 101,411,128 |
| Public service | 46,091,816 | 10,280,808 | 2,718,761 | 392,811 | – | 113,743 | 59,597,939 |
| Academic support | 72,406,400 | 15,577,465 | 4,103,987 | 178,180 | – | 41,003 | 92,307,035 |
| Student service | 38,224,811 | 7,877,351 | 800,066 | 3,033 | – | 49,010 | 46,954,271 |
| Institutional support | 137,387,606 | 33,821,148 | 480,933 | 4,403,522 | – | 3,953,874 | 180,047,083 |
| Oper & Maintenance | 69,969,838 | 14,679,025 | 20,959 | 36,380,394 | – | 129,441 | 121,179,657 |
| Student Aid | 1,694,176 | 641,111 | 107,615,009 | 583 | – | – | 109,950,879 |
| Independent Operation | – | 58,206 | – | – | – | – | 58,206 |
| Patient Service | 44,117,250 | 2,487,040 | 221,631 | 93,088 | – | 13 | 46,919,022 |
| Auxiliary Enterprises | 4,981,184 | 5,337,565 | 76,758 | 384,118 | – | 23,695 | 10,803,320 |
| Depreciation | – | – | – | – | 29,216,968 | – | 29,216,968 |
| Other | – | – | – | – | – | 17,878,067 | 17,878,067 |
| | $ 829,939,799 | $ 128,758,460 | $ 137,445,350 | $ 44,166,848 | $ 29,216,968 | $ 26,705,641 | $ 1,196,233,066 |

## 15. Significant New Accounting Pronouncements

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, 2007.

- 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.

**15. Significant New Accounting Pronouncements (continued)**

- 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.

The University is currently evaluating the impact of this statement.

In September 2006, the GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues.* This Statement establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. Such transactions are likely to comprise the sale of delinquent taxes, certain mortgages, student loans, or future revenues such as those arising from tobacco settlement agreements.

In addition to clarifying guidance on accounting for sales and pledges of receivables and future revenues, the Statement:

- Requires enhanced disclosures pertaining to future revenues that have been pledged or sold,

- Provides guidance on sales of receivables and future revenues within the same financial reporting entity,

- Provides guidance on recognizing other assets and liabilities arising from the sale of specific receivables or future revenues.

The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2006.

In November 2006, the GASB recently issued Statement No. 49, *Pollution Remediation Obligations.* The Statement identifies the circumstances under which a governmental entity would be required to report a liability related to pollution remediation. According to the Statement, a government would have to estimate its expected outlays for pollution remediation if it knows a site is polluted and any of the following recognition triggers occur:

- Pollution poses an imminent danger to the public or environment and a government has little or no discretion to avoid fixing the problem,
- A government has violated a pollution prevention-related permit or license,

## 15. Significant New Accounting Pronouncements (continued)

- A regulator has identified (or evidence indicates a regulator will do so) a government as responsible (or potentially responsible) for cleaning up pollution, or for paying all or some of the cost of the clean up,
- A government is named in a lawsuit (or evidence indicates that it will be) to compel it to address the pollution,
- A government begins to clean up pollution or conducts related remediation activities (or the government legally obligates itself to do so).

Liabilities and expenses would be estimated using an "expected cash flows" measurement technique, which will be employed for the first time by governments. Statement 49 also would require governments to disclose information about their pollution remediation obligations associated with clean-up efforts in the notes to the financial statements.

Statement 49 will be effective for financial statements for periods beginning after December 15, 2007.

In May 2007, the GASB recently issued Statement No. 50, *Pension Disclosures,* which more closely aligns current pension disclosure requirements for governments with those that governments are beginning to implement for retiree health insurance and other post-employment benefits.

Specifically, Statement 50 amends GASB Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans,* and No. 27, *Accounting for Pensions by State and Local Governmental Employers,* by requiring:

- Disclosure in the notes to the financial statements of pension plans and certain employer governments of the current funded status of the plan—in other words, the degree to which the actuarial accrued liabilities for benefits are covered by assets that have been set aside to pay the benefits—as of the most recent actuarial valuation date.
- Governments that use the aggregate actuarial cost method to disclose the funded status and present a multi-year schedule of funding progress using the entry age actuarial cost method as a surrogate; these governments previously were not required to provide this information.
- Disclosure by governments participating in multi-employer cost-sharing pension plans of how the contractually required contribution rate is determined.

The provisions of Statement 50 generally are effective for periods beginning after June 15, 2007, with early implementation encouraged. The requirements relating to governments using the aggregate actuarial cost method are effective for financial statements and required supplementary information that contains information from actuarial valuations as of June 15, 2007, or later.

**15. Significant New Accounting Pronouncements (continued)**

In June 2007, the GASB recently issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets,* to provide guidance regarding how to identify, account for, and report intangible assets.

The new standard characterizes an intangible asset as an asset that lacks physical substance, is nonfinancial in nature, and has an initial useful life extending beyond a single reporting period. Examples of intangible assets include easements, computer software, water rights, timber rights, patents, and trademarks.

Statement 51 requires that intangible assets be classified as capital assets (except for those explicitly excluded from the scope of the new standard, such as capital leases). Relevant authoritative guidance for capital assets should be applied to these intangible assets.

Statement 51 provides additional guidance that specifically addresses the unique nature of intangible assets, including:

- Requiring that an intangible asset be recognized in the statement of net assets only if it is considered identifiable
- Establishing a specified-conditions approach to recognizing intangible assets that are internally generated (for example, patents and copyrights)
- Providing guidance on recognizing internally generated computer software
- Establishing specific guidance for the amortization of intangible assets.

The requirements Statement 51 are effective for financial statements for periods beginning after June 15, 2009. The GASB made significant changes to the transition provisions, based on constituent response to the proposed version of the standards, to make it easier for governments to implement.

# Required Supplementary Information

**Employees Retirement Plan**

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) - Entry Age (b) | Excess of Assets over AAL (b – a) | Funded Ratio (a / b) | Covered Payroll (c) | Excess as a Percentage of Covered ((b – a) / c) |
|---|---|---|---|---|---|---|
| 6/30/2005 | $ 820,501,000 | $ 1,848,175,710 | $ 1,027,674,710 | 44% | $ 460,956,060 | 222.90% |
| 6/30/2006 | $ 869,211,000 | $ 1,930,131,983 | $ 1,060,920,983 | 45% | $ 484,886,628 | 218.80% |
| 6/30/2007 | $ 933,197,000 | $ 2,068,102,695 | $ 1,114,905,695 | 45% | $ 513,486,180 | 217.10% |

# Other Financial Information

## University of Puerto Rico
## Schedules of Changes in Sinking Fund Reserve

**2007**

| | Bond Service Account | Bond Reserve Account | Total |
|---|---|---|---|
| Additions: | | | |
| Transfer from Reserve Account | $ 9,562,744 | $ 16,589,826 | $ 26,152,570 |
| Transfer from unrestricted current funds | 30,331,662 | – | 30,331,662 |
| Net increase in fair marker value of investments | 1,481,868 | 734,124 | 2,215,992 |
| Interest Earned on Investments | 258,731 | 1,508,142 | 1,766,873 |
| Total receipts | 41,635,005 | 18,832,092 | 60,467,097 |
| Deductions: | | | |
| Payments of bond interest | 14,760,000 | 1,385,961 | 16,145,961 |
| Payments of bond principal | 25,230,881 | – | 25,230,881 |
| Transfer to Reserve Account | 1,642,113 | 1,861,855 | 3,503,968 |
| Total disbursements | 41,632,994 | 3,247,816 | 44,880,810 |
| Net increase/(decrease) for the year | 2,011 | 15,584,276 | 15,586,287 |
| Balances at beginning of year | (1,154) | 39,213,113 | 39,211,959 |
| Balance at end of year | $ 857 | $ 54,797,389 | $ 54,798,246 |

**2006**

| | Bond Service Account | Bond Reserve Account | Total |
|---|---|---|---|
| Additions: | | | |
| Transfer from Reserve Account | $ 1,422,983 | $ – | $ 1,422,983 |
| Transfer from unrestricted current funds | 36,280,868 | – | 36,280,868 |
| Net increase in fair marker value of investments | 22,995 | 577,364 | 600,359 |
| Interest Earned on Investments | 336,180 | 902,954 | 1,239,134 |
| Total receipts | 38,063,026 | 1,480,318 | 39,543,344 |
| Deductions: | | | |
| Payments of bond interest | 19,864,180 | – | 19,864,180 |
| Payments of bond principal | 18,200,000 | – | 18,200,000 |
| Transfer to Reserve Account | – | 1,422,983 | 1,422,983 |
| Total disbursements | 38,064,180 | 1,422,983 | 39,487,163 |
| Net increase/(decrease) for the year | (1,154) | 57,335 | 56,181 |
| Balances at beginning of year | – | 39,155,778 | 39,155,778 |
| Balance at end of year | $ (1,154) | $ 39,213,113 | $ 39,211,959 |

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# Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

Board of Trustees
University of Puerto Rico

We have audited the accompanying financial statements of the business-type activities and the aggregate discretely presented component units of the University of Puerto Rico (the University), a component unit of the Commonwealth of Puerto Rico, as of and for the years ended June 30, 2007 and 2006, which collectively comprise the University's financial statements, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions 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), which represent 100% of the aggregate discretely presented component units, as of and for the years ended June 30, 2007 and 2006, and March 31, 2007 and 2006, respectively. Those financial statements were audited by other auditors whose reports thereon have 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 amounts included for the Hospital and the Company, is solely based on the reports of the other auditors.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the University's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

**Compliance and Other Matters**

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 grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the Board of Trustees, others within the entity, 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

April 29, 2008

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original of
this report.