AUDITED FINANCIAL STATEMENTS

University of Puerto Rico
Years Ended June 30, 2009 and 2008
With Report of Independent Auditors

Ernst & Young

University of Puerto Rico

Audited Financial Statements

Years Ended June 30, 2009 and 2008

## 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, 2009 and 2008, 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, 2009 and 2008 and June 30, 2009 and the three months ended June 30, 2008, 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, and this raises 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, 2009 and 2008, and the respective changes in financial position and cash flows thereon for the years then ended in conformity with US generally accepted accounting principles.

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As discussed in Note 1 to the financial statements, effective July 1, 2008, the University changed its accounting policy related to accounting for its other post-employment benefits to comply with the provisions of Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.*

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, this raises substantial doubt about its ability to continue as a going concern.

In accordance with *Government Auditing Standards*, we have also issued our report, dated June 24, 2010, 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 supplementary 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. The schedule of changes in sinking fund reserves has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, are fairly stated in all material respects in relation to the financial statements taken as a whole.

Ernst & Young LLP

June 24, 2010

Stamp No. 2532311
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, 2009 and 2008. 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

As of June 30, 2009, the University has total assets of $1,479,664,148, total liabilities of $1,111,715,110 and net assets of $367,949,039. The University's net assets decreased $(58,073,026) during the year ended June 30, 2009, when compared to the year ended June 30, 2008. These changes 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, 2009, 2008 and 2007 follow:

**Condensed Statements of Net Assets**

| | June 30 | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| **Assets** | | | |
| Current assets | **$ 285,485,099** | $ 299,997,233 | $ 344,095,972 |
| Noncurrent assets: | | | |
| Due from Commonwealth of Puerto Rico | **74,890,131** | 89,200,262 | 84,232,509 |
| Capital assets | **898,327,915** | 834,398,195 | 796,685,602 |
| Other assets | **220,961,003** | 271,532,922 | 258,215,364 |
| Total assets | **1,479,664,148** | 1,495,128,612 | 1,483,229,447 |
| **Liabilities** | | | |
| Current liabilities | **178,177,885** | 144,435,900 | 133,037,509 |
| Noncurrent liabilities | **933,537,225** | 924,670,647 | 923,472,066 |
| Total liabilities | **1,111,715,110** | 1,069,106,547 | 1,056,509,575 |
| **Net assets** | | | |
| Invested in capital assets net of related debt | **300,279,478** | 275,018,751 | 231,026,259 |
| Restricted: | | | |
| Nonexpendable | **63,745,889** | 65,446,685 | 62,406,256 |
| Expendable | **64,477,494** | 86,479,410 | 120,847,524 |
| Unrestricted | **(60,553,822)** | (922,781) | 12,439,834 |
| Total net assets | **$ 367,949,039** | $ 426,022,065 | $ 426,719,873 |

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

| | Year Ended June 30 | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| **Operating revenues** | | | |
| Tuition and fees (net of scholarship) | **$ 50,624,310** | $ 51,286,439 | $ 49,269,042 |
| Grants and contracts | **127,968,653** | 140,464,523 | 148,409,147 |
| Patient services | **55,532,119** | 48,665,826 | 48,669,981 |
| Other operating revenues | **33,968,190** | 37,860,307 | 39,919,317 |
| Total operating revenues | **268,093,272** | 278,277,095 | 286,267,487 |
| **Operating expenses** | **1,411,309,041** | 1,351,283,567 | 1,266,523,365 |
| Operating loss | **(1,143,215,769)** | (1,073,006,472) | (980,255,878) |
| **Nonoperating revenues and expenses** | | | |
| Commonwealth appropriations | **923,759,792** | 935,880,735 | 896,492,596 |
| Other nonoperating revenues and expenses, including interest on indebtness | **140,648,518** | 116,162,315 | 104,908,125 |
| Net nonoperating revenues | **1,064,408,310** | 1,052,043,050 | 1,001,400,721 |
| (Loss) income before other revenues | **(78,807,459)** | (20,963,422) | 21,144,843 |
| **Capital appropriations** | **17,240,100** | 17,576,892 | 12,607,556 |
| **Additions to permanent endowment** | **3,494,333** | 2,688,724 | 6,838,313 |
| Total (decrease) increase in net assets | **$ (58,073,026)** | $ (697,806) | $ 40,590,712 |

**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 Statement Nos. 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 Assets*

The statements of net assets present the assets, liabilities and net assets of the University as of June 30, 2009 and 2008. 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.

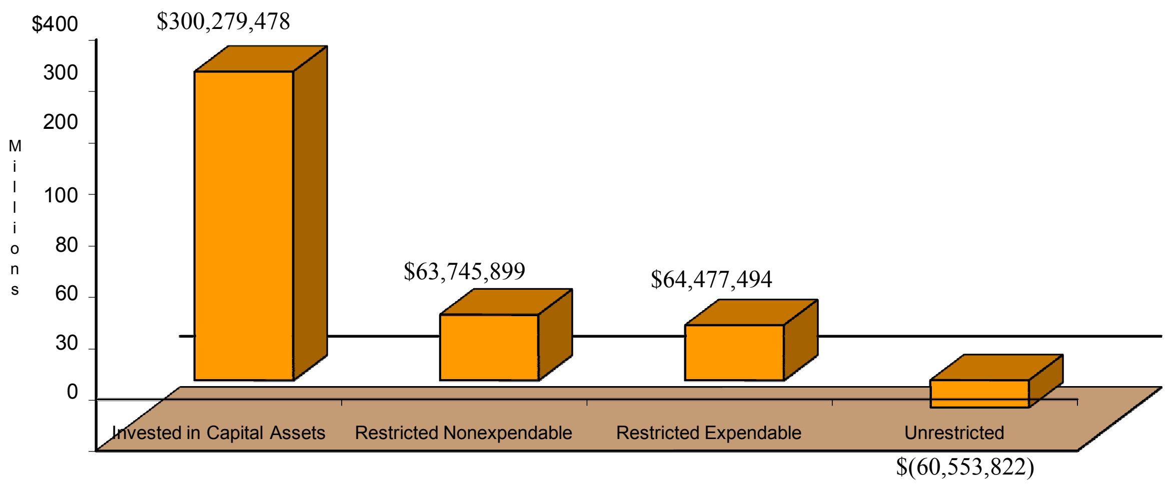
Assets included in the statements of net assets are classified as current or noncurrent. Current assets consist primarily of cash and cash equivalents, short-term investments and accounts receivable. Of these amounts, cash and cash equivalents, investments and accounts receivable comprise approximately 0%, 39% and 59%, respectively, of current assets and 73% of noncurrent assets are capital assets as of June 30, 2009. As of June 30, 2008, these amounts comprise approximately 6%, 38% and 54%, respectively, of current assets and 69% of noncurrent assets are capital assets. As of June 30, 2007, these amounts comprise approximately 14%, 35% and 46% of current assets and 70% of noncurrent assets are capital assets.

The University's cash, cash equivalents and investments decreased from $414,403,362 at June 30, 2007 to $356,401,170 at June 30, 2008 and decreased to $274,796,322 at June 30, 2009. The decrease in investments at fair value is mainly caused by the decrease in market value. Current accounts receivable decreased from $158,213,051 to $157,069,658.

Current liabilities consist primarily of bank overdraft, accounts payable and accrued liabilities and the current portion of long-term debt. Accounts payable and accrued liabilities increased from $93,117,021 to $99,510,982 between June 30, 2008 and 2009, mainly due to an increase in health and medical benefits to employees. Non-current liabilities consist primarily of bonded indebtedness. Long-term debt, net of current portion, decreased from $652,511,547 to $649,091,711 between June 30, 2008 and 2009.

Net assets represent the residual interest in the University's assets after liabilities are deducted. The major classifications of the net assets are shown in the following illustration:

**Chart 1 - Net Assets - June 30, 2009**




Net assets invested in capital assets, net of related debt, 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 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 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 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*

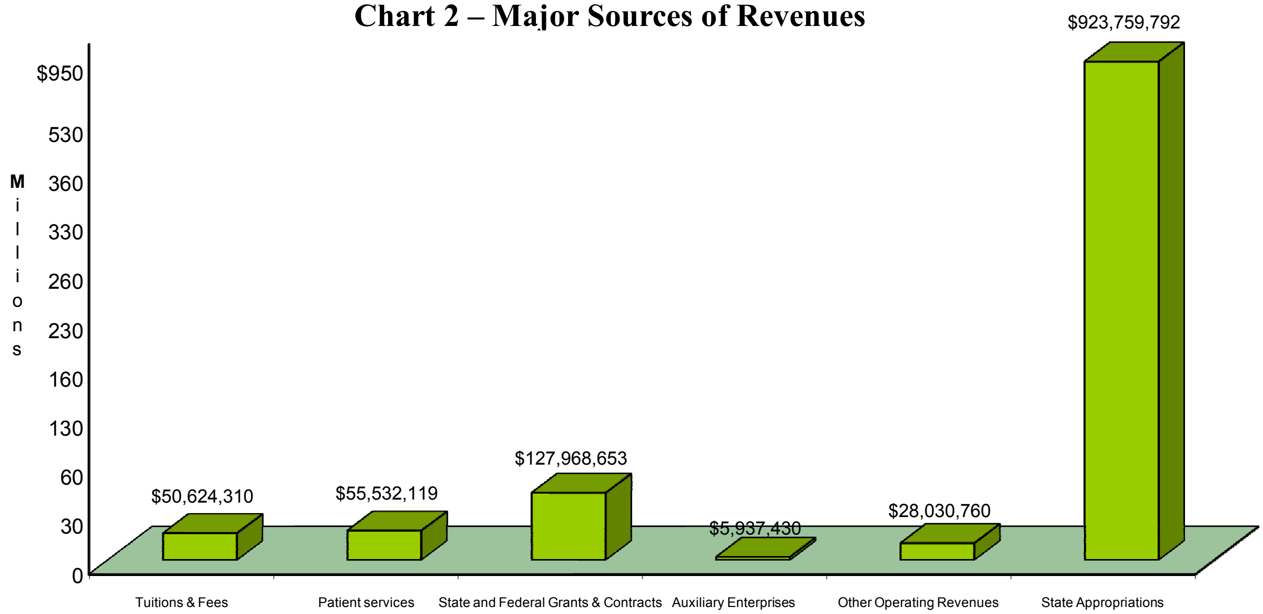
Changes in total University net assets as presented in the statements of net assets are based on the activity presented in the statements of revenues, expenses and changes in net assets. The purpose of these statements are to present the revenues earned by the University, both operating and nonoperating, 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 to provide 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 88% 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.

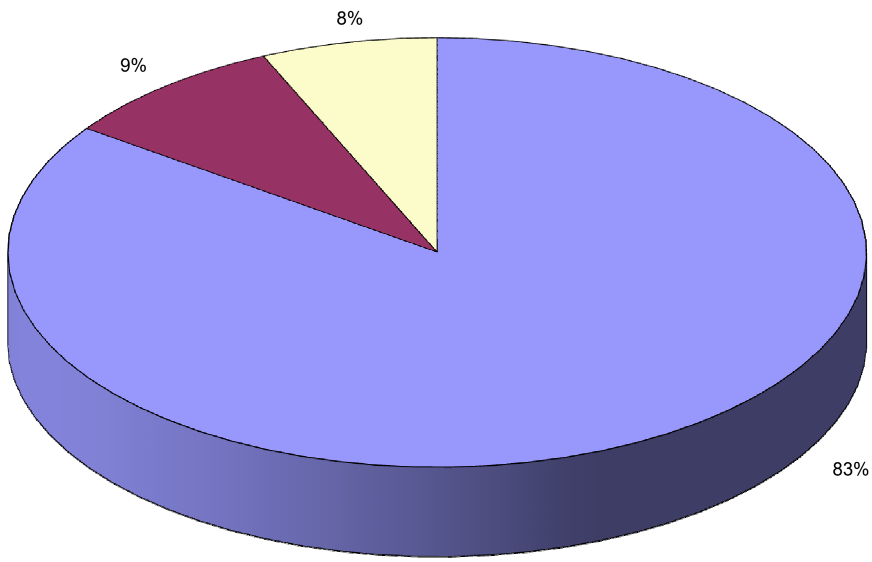
The following illustration presents the major sources of the University revenues (both operating and nonoperating) for the year ended June 30, 2009:

**Chart 2 – Major Sources of Revenues**



Federal grants represent 85% of the University grants revenues. The following illustration presents the grants revenues of the University of Puerto Rico, year ended June 30, 2009:

## Chart 3 - Grants Revenues

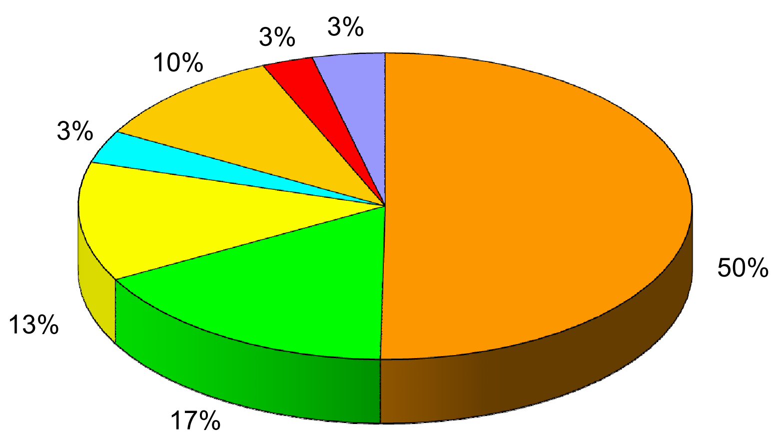



| | | | |
|---|---|---|---|
| Federal | $ | 115,121,931 | 83% |
| Commonwealth | | 12,846,721 | 9% |
| Other | | 10,362,071 | 8% |

University expenses are presented using natural expense classifications. Salaries and benefits represent 69% of the University's operating expenses.

The following illustration presents the major University operating expenses, using natural classification for the year ended June 30, 2009:

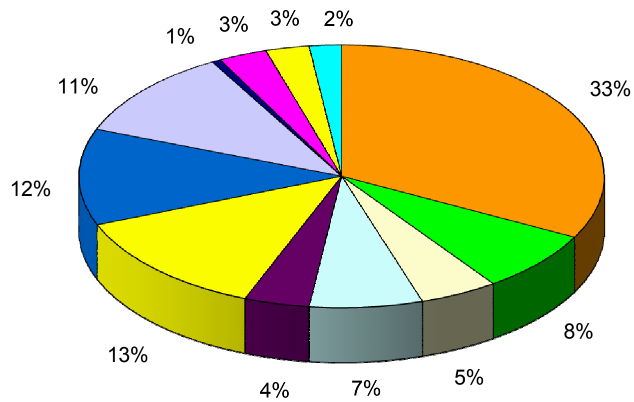
**Chart 4 - Operating Expenses**




| | | | |
|---|---|---|---|
| Salaries | $ | 704,298,736 | 50% |
| Benefits | | 235,232,465 | 17% |
| Scholarship and other services | | 176,635,726 | 13% |
| Utilities | | 48,278,972 | 3% |
| Supplies and other services | | 159,319,414 | 10% |
| Depreciation | | 37,551,456 | 3% |
| Other expenditures | | 49,992,272 | 3% |

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, 2009:

**Chart 5 - Expenses by Function**




| | | |
|---|---|---|
| Instruction | $ 459,012,458 | 33% |
| Research | 106,075,467 | 8% |
| Public Service | 68,344,747 | 5% |
| Academic Support | 105,800,111 | 7% |
| Student Services | 56,538,602 | 4% |
| Institutional Support | 183,121,315 | 13% |
| Operation and Maintenance of Plant | 166,975,404 | 12% |
| Scholarships and Fellowships | 153,981,903 | 11% |
| Auxiliary Enterprises | 8,130,262 | 1% |
| Patient Service | 41,924,925 | 3% |
| Depreciation | 37,551,456 | 3% |
| Other | 23,744,971 | 2% |

For the year ended June 30, 2009, the University reported an operating loss of $1,143,215,769. After adding nonoperating revenues and expenses, primarily Commonwealth appropriations and Federal Pell Grant, the total decrease in net assets for the year amounted to $58,073,026.

*Statements of Cash Flows*

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**

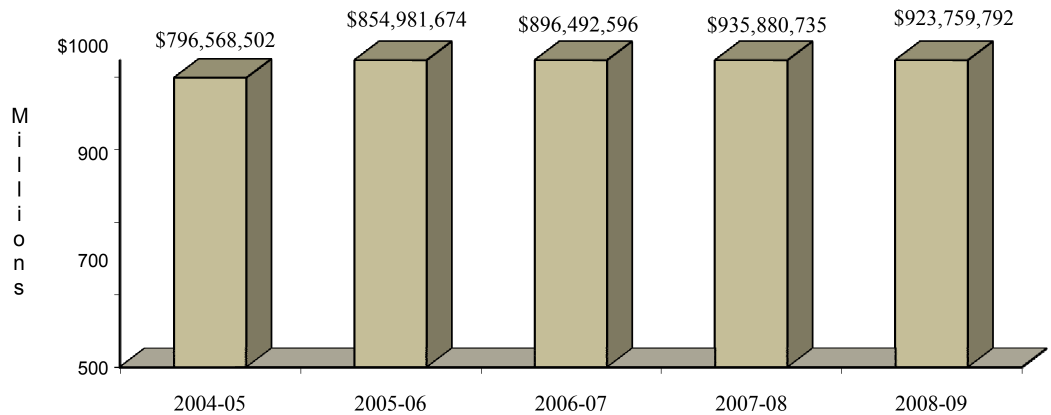
Significant capital assets additions for the year ended June 30, 2009 and 2008, consist mainly of renovation and rehabilitation of existing facilities, restoration of historic buildings, and modifications of existing facilities in light of new technology, educational standards and the requirements of modern building codes.

**Economic Outlook**

The economy of Puerto Rico must be analyzed as a region within the U.S. economy, since it is part of the U.S. monetary and banking system, as well as within its territorial boundaries. The main driver of the Puerto Rican economy is a huge external sector closely tied to the flow of merchandise, tourists, and capital between Puerto Rico and the Mainland.

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

**Chart 6 - Commonwealth Appropriations**




- Includes restricted funds for special activities not accounted for University General Funds.

The University projects a reduction in its General Fund Revenues of approximately $105.6 million. To address this reduction in revenues management has proposed a number of administrative and financial measures, among which are: expense reductions in various areas and increases in student tuition fees. After taking into consideration these measures, management's proposed budget for fiscal year 2010-2011 is balanced.

## 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 2009 | June 30 2008 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ – | $ 19,167,865 |
| Investments at fair value | **56,708,474** | 56,187,238 |
| Investments with bond trustees at fair value | **54,523,217** | 54,485,622 |
| Accounts receivable (less allowances for doubtful accounts of $135,702,573 and $132,409,296 for 2009 and 2008, respectively) | **157,069,658** | 158,213,051 |
| Due from Commonwealth of Puerto Rico | **12,570,000** | 7,570,127 |
| Inventories | **3,328,069** | 3,798,653 |
| Prepaid expenses and deferred charges | **1,285,681** | 574,677 |
| Total current assets | **285,485,099** | 299,997,233 |
| Noncurrent assets: | | |
| Restricted cash and cash equivalents | **8,248,521** | 5,826,799 |
| Investments at fair value | **155,316,110** | 220,733,646 |
| Due from Commonwealth of Puerto Rico (less allowance for doubtful accounts of $24,310,258 for 2009) | **74,890,131** | 89,200,262 |
| Prepaid expenses and other assets | **54,648,712** | 42,628,122 |
| Notes receivable, net | **2,747,660** | 2,344,355 |
| Capital assets (net of accumulated depreciation of $476,083,179 and $441,681,276 for 2009 and 2008, respectively) | **898,327,915** | 834,398,195 |
| Total noncurrent assets | **1,194,179,049** | 1,195,131,379 |
| Total assets | **1,479,664,148** | 1,495,128,612 |
| **Liabilities** | | |
| Current liabilities: | | |
| Bank overdraft | **23,641,417** | – |
| Accounts payable and accrued liabilities | **99,510,983** | 93,117,021 |
| Current portion of long-term debt | **20,825,000** | 21,455,000 |
| Obligation under capital lease, current portion | **1,133,349** | 1,063,344 |
| Other current liabilities | **33,067,136** | 28,800,535 |
| Total current liabilities | **178,177,885** | 144,435,900 |
| Noncurrent liabilities: | | |
| Long-term debt, net of current portion | **649,091,711** | 652,511,547 |
| Obligation under capital lease, noncurrent portion | **67,445,888** | 68,649,242 |
| Other long-term liabilities | **216,999,626** | 203,509,858 |
| Total noncurrent liabilities | **933,537,225** | 924,670,647 |
| Total liabilities | **1,111,715,110** | 1,069,106,547 |

*(Continues)*

| | June 30 | |
|---|---|---|
| | **2009** | 2008 |
| **Net assets** | | |
| Invested in capital assets, net of related debt | **$ 300,279,478** | $ 275,018,751 |
| Restricted, nonexpendable: | | |
| Scholarship and fellowships | **41,167,027** | 42,774,078 |
| Research | **18,858,765** | 18,942,504 |
| Other | **3,720,097** | 3,730,103 |
| Restricted, expendable: | | |
| Loans | **6,961,155** | 7,948,550 |
| Capital projects | **11,060,521** | 1,948,575 |
| Debt service | **51,869,168** | 51,875,735 |
| Other | **(5,413,350)** | 24,706,550 |
| Unrestricted | **(60,553,822)** | (922,781) |
| Total net assets | **$ 367,949,039** | $ 426,022,065 |

*See accompanying notes.*

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

| | June 30 | |
|---|---|---|
| | **2009** | **2008** |
| **Revenues** | | |
| Operating revenues: | | |
| Tuitions and fees (net of scholarship allowances of $43,745,849 and $41,390,629 for 2009 and 2008, respectively) | **$ 50,624,310** | $ 51,286,439 |
| Net hospital patient services revenue and other | **55,532,119** | 48,665,826 |
| Federal grants and contracts | **115,121,932** | 128,404,162 |
| Commonwealth grants and contracts (net of allowances of $3,991,174 and $6,895,713 for 2009 and 2008, respectively) | **12,846,721** | 12,060,361 |
| Nongovernmental grants and contracts | **10,362,071** | 13,329,915 |
| Sales and services of educational departments | **8,358,244** | 5,379,271 |
| Auxiliary enterprises (net of scholarship allowances of $159,317 and $159,257 for 2009 and 2008, respectively) | **5,937,430** | 5,923,312 |
| Other operating revenues | **9,310,445** | 13,227,809 |
| Total operating revenues | **268,093,272** | 278,277,095 |
| | | |
| **Operating Expenses** | | |
| Salaries: | | |
| Faculty | **396,196,291** | 396,824,902 |
| Exempt staff | **307,134,306** | 284,370,248 |
| Nonexempt wages | **968,139** | 1,111,335 |
| Benefits | **235,232,465** | 230,017,087 |
| Scholarship and fellowship | **176,635,726** | 160,492,568 |
| Utilities | **48,278,972** | 49,147,600 |
| Supplies and other services | **159,319,414** | 160,098,118 |
| Depreciation and amortization | **37,551,456** | 37,125,069 |
| Other expenses | **49,992,272** | 32,096,640 |
| Total operating expenses | **1,411,309,041** | 1,351,283,567 |
| Operating loss | **(1,143,215,769)** | (1,073,006,472) |
| | | |
| Nonoperating revenues (expenses): | | |
| Commonwealth appropriations | **923,759,792** | 935,880,735 |
| Federal Pell Grant program | **141,101,415** | 121,234,272 |
| Gifts | **14,855,593** | 6,279,553 |
| Net investment income | **1,949,771** | 4,774,072 |
| Interest on indebtedness | **(21,627,870)** | (18,607,741) |
| Other nonoperating (expenses) revenues | **4,369,609** | 2,482,159 |
| Net nonoperating revenues | **1,064,408,310** | 1,052,043,050 |
| Loss before other revenues | **(78,807,459)** | (20,963,422) |
| | | |
| Capital appropriations | **17,240,100** | 17,576,892 |
| Additions to term and permanent endowment | **3,494,333** | 2,688,724 |
| Decrease in net assets | **(58,073,026)** | (697,806) |
| | | |
| **Net Assets** | | |
| Beginning of year | **426,022,065** | 426,719,871 |
| End of year | **$ 367,949,039** | $ 426,022,065 |

*See accompanying notes.*

# University of Puerto Rico
## Statements of Cash Flows

| | Year Ended June 30 | |
|---|---|---|
| | **2009** | **2008** |
| **Cash flows from operating activities** | | |
| Tuition and fees | **$ 50,034,298** | $ 50,867,832 |
| Grants and contracts | **145,784,375** | 142,566,272 |
| Patient services | **55,532,119** | 48,665,826 |
| Auxiliary enterprises | **5,937,430** | 5,926,805 |
| Sales and services educational departments and other | **20,668,689** | 18,607,080 |
| Payments to suppliers and vendors | **(176,606,157)** | (176,721,917) |
| Payments to employees | **(690,429,033)** | (682,306,485) |
| Payments for utilities | **(48,278,972)** | (49,147,600) |
| Payments for benefits | **(235,232,465)** | (230,017,087) |
| Payments for scholarships and fellowships | **(176,635,726)** | (160,492,568) |
| New loans issued to students | **(8,982,384)** | (773,384) |
| Other payments | **(8,344,900)** | (1,172,309) |
| Net cash used in operating activities | **(1,066,552,726)** | (1,033,997,535) |
| **Cash flows from noncapital financing activities** | | |
| Commonwealth appropriations | **923,759,792** | 935,880,735 |
| Pell grant | **141,101,415** | 121,234,272 |
| Endowment gifts | **3,494,333** | 2,688,724 |
| Other non-operating revenues | **8,189,404** | – |
| Gifts and grants for other than capital purposes | **14,855,593** | 3,899,829 |
| Net cash provided by noncapital financing activities | **1,091,400,537** | 1,063,703,560 |
| **Cash flows from capital and related financing activities** | | |
| Bank overdraft | **23,641,417** | – |
| Capital appropriations | **17,240,100** | 17,576,892 |
| Additions of capital assets | **(105,850,470)** | (76,453,802) |
| Principal paid on indebtness | **(22,001,519)** | (20,355,173) |
| Interest paid on capital indebtness | **(21,627,870)** | (18,607,741) |
| Deposit with trustee | **(37,595)** | 3,747,723 |
| Capital lease | **(1,133,349)** | (1,063,344) |
| Proceeds from capital debt | **–** | 6,420,879 |
| Net cash used in capital and related financing activities | **(109,769,286)** | (88,734,566) |
| **Cash flows from investing activities** | | |
| Proceeds from sales and maturities of investments | **66,643,097** | 47,532,056 |
| Purchase of investments | **(417,536)** | (22,423,645) |
| Interest on investments | **1,949,771** | 4,774,072 |
| Net cash provided by investing activities | **68,175,332** | 29,882,483 |
| Net change in cash and cash equivalents | **(16,746,143)** | (29,146,058) |
| Cash and cash equivalents: | | |
| Beginning of year | **24,994,664** | 54,140,722 |
| End of year | **$ 8,248,521** | $ 24,994,664 |

*(Continues)*

| | Year Ended June 30 | |
|---|---|---|
| | **2009** | **2008** |
| **Reconciliation of operating loss to net cash used in operating activities** | | |
| Operating loss | **$ (1,143,215,769)** | $ (1,073,006,472) |
| Adjustments to reconcile operating loss to net cash used in operating activities: | | |
| Depreciation and amortization | **37,551,456** | 37,125,069 |
| Loss on disposal of capital assets | **4,369,294** | 1,616,141 |
| Amortization on bond premium, discount and future appreciated principal | **3,001,117** | 2,863,442 |
| Changes in assets and liabilities, net: | | |
| Grants and contracts receivables | **10,453,651** | (11,228,166) |
| Prepaid expenses, inventories and other | **(12,261,010)** | (21,336,339) |
| Accounts payable, accrued liabilities and capital lease | **24,150,329** | 15,472,841 |
| Accrued salaries and wages and other liabilities | **9,398,206** | 14,495,949 |
| Net cash used in operating activities | **$ (1,066,552,726)** | $ (1,033,997,535) |

*See accompanying notes.*

**Discretely Presented Component Unit**
**Servicios Médicos Universitarios, Inc.**
**(A Not-for Profit Organization)**
**Statements of Financial Condition**

| | June 30 | |
|---|---|---|
| | **2009** | **2008** |
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | **$ 1,153,685** | $ 674,716 |
| Patient accounts receivable, net of allowance for doubtful accounts of $10,778,461 in 2009 and $21,260,231 in 2008 | **11,895,713** | 14,525,193 |
| Accounts receivable - other | **386,103** | 232,268 |
| Inventories of supplies | **1,369,824** | 1,605,671 |
| Prepaid expenses | **246,227** | 247,777 |
| Total current assets | **15,051,552** | 17,285,625 |
| Property and equipment, net | **6,338,862** | 4,677,296 |
| Due from related parties | **3,854,237** | 3,662,632 |
| Total assets | **$ 25,244,651** | $ 25,625,553 |
| | | |
| **Liabilities and deficiency in unrestricted net assets** | | |
| Current liabilities: | | |
| Current portion of long-term debt | **$ 820,153** | $ 15,367,611 |
| Accounts payable | **22,818,872** | 24,946,113 |
| Accrued interest | **–** | 5,700,516 |
| Estimated third-party payor settlements-medicare | **253,220** | 675,570 |
| Accrued payroll taxes and employee benefits | **1,316,437** | 1,237,481 |
| Accrued expenses | **1,022,029** | 784,453 |
| Total current liabilities | **26,230,711** | 48,711,744 |
| | | |
| Long-term debt, net of current portion | **19,840,760** | 1,632,389 |
| Due to related parties | **43,477,844** | 39,603,404 |
| Accrued claim losses | **891,596** | 1,015,551 |
| Total liabilities | **90,440,911** | 90,963,088 |
| | | |
| Deficiency in unrestricted net assets | **(65,196,260)** | (65,337,535) |
| Total liabilities and deficiency in unrestricted net assets | **$ 25,244,651** | $ 25,625,553 |

*See accompanying notes.*

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

| | Year Ended June 30 | |
|---|---|---|
| | **2009** | **2008** |
| **Unrestriced revenues and other support** | | |
| Net patient service revenue | **$ 44,951,695** | $ 47,202,698 |
| Contributions | **–** | 592,000 |
| Other revenue | **1,565,372** | 1,247,311 |
| Total unrestricted revenues and other support | **46,517,067** | 49,042,009 |
| **Expenses** | | |
| Salaries and benefits | **16,963,996** | 15,954,944 |
| Contracted services | **4,996,041** | 5,382,947 |
| Professional services | **1,382,601** | 1,333,232 |
| Supplies | **13,003,957** | 12,902,106 |
| Utilities | **2,500,958** | 2,493,003 |
| Interest | **813,216** | 1,160,177 |
| Provision for bad debts | **6,501,411** | 7,779,349 |
| Provision for claim losses | **150,000** | 650,000 |
| Depreciation and amortization | **1,062,179** | 1,005,093 |
| Other | **1,726,202** | 1,704,835 |
| Total expenses | **49,100,561** | 50,365,686 |
| **Non-operating income** | | |
| Gain on debt relief from affilliate | **2,724,769** | – |
| Change in unrestricted net assets | **141,275** | (1,323,677) |
| Deficiency in unrestricted net assets, at beginning of year | **(65,337,535)** | (64,013,858) |
| Deficiency in unrestricted net assets, at end of year | **$ (65,196,260)** | $ (65,337,535) |

*See accompanying notes.*

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

| | Year Ended June 30 | |
|---|---|---|
| | **2009** | **2008** |
| **Cash flows from operating activities** | | |
| Change in unrestricted net assets | **$ 141,275** | $ (1,323,677) |
| Adjustments to reconcile change in unrestricted net assets to net cash provided by operating activities: | | |
| Depreciation and amortization | **1,062,179** | 1,005,093 |
| Provision for bad debts | **6,501,411** | 7,779,349 |
| Provision for claim losses | **150,000** | 650,000 |
| Gain from debt relief from affiliate | **(2,724,769)** | – |
| Increase in patient accounts receivable | **(3,871,932)** | (7,937,317) |
| Decrease (increase) in inventory of supplies | **235,847** | (49,276) |
| Decrease in prepaid expenses | **287,485** | 286,100 |
| (Increase) decrease in accounts receivable-other | **(153,835)** | 43,573 |
| Increase in accounts payable | **311,594** | 1,596,996 |
| (Decrease) in estimated third-party payor settlements-Medicare | **(422,350)** | (372,180) |
| Increase in accrued expenses, payroll taxes and employee benefits | **976,929** | 56,136 |
| Decrease in accrued claim losses | **(273,955)** | (114,449) |
| Total adjustments | **2,078,604** | 2,944,025 |
| Net cash provided by operating activities | **2,219,879** | 1,620,348 |
| | | |
| **Cash flows from investing actitivies** | | |
| Purchase of property and equipment | **(2,723,745)** | (2,022,319) |
| | | |
| **Cash flows from financing activities** | | |
| Net advances from University of Puerto Rico and other related parties | **982,835** | 1,044,625 |
| Net increase in cash | **478,969** | 642,654 |
| | | |
| Cash and cash equivalents, at beginning of year | **674,716** | 32,062 |
| Cash and cash equivalents, at end of year | **$ 1,153,685** | $ 674,716 |
| | | |
| **Supplemental disclosures of cash flows information** | | |
| Cash paid for interest | **$ 660,397** | $ 91,395 |
| | | |
| **Supplemental schedule of noncash investing and financing activities** | | |
| Debt restructure | **$ 20,660,913** | $ – |
| Debt relief from affiliate | **$ 2,724,769** | $ – |

*See accompanying notes.*

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

| | June 30 | |
|---|---|---|
| | **2009** | **2008** |
| **Assets** | | |
| Current assets: | | |
| Cash, including book overdraft of $22,176 and $38,546 | **$ 1,900,517** | $ 875,284 |
| Restricted cash | **268,841** | 380,671 |
| Restricted funds held by trustee | **14,167,903** | 13,715,072 |
| Net investment in direct financing lease | **68,749,661** | 69,890,698 |
| Due from the University of Puerto Rico | **596,783** | 1,139,982 |
| Prepaid expenses | **-** | 3,856 |
| Property and equipment | **19,219** | 25,100 |
| Bond issuance costs, net of accumulated amortization of $629,733 and $549,239 in 2009 and 2008, respectively | **2,159,471** | 2,239,985 |
| Other assets | **59,997** | 69,315 |
| Total assets | **$ 87,922,392** | $ 88,339,963 |
| | | |
| **Liabilities and net assets** | | |
| Liabilities: | | |
| Construction contract, project management fee and other payables, including retaineage of $1,600,076 in 2009 | **$ 1,705,358** | $ 1,783,408 |
| Operating trade accounts payable | **132,838** | 48,418 |
| Accrued interest payable | **2,051,926** | 2,090,552 |
| Accrued costs and expenses | **1,111,812** | 1,026,671 |
| Unearned student dormitories rental income | **71,192** | 69,076 |
| Commercial tenants and student dormitories security deposits | **38,145** | 90,554 |
| Bonds payable, net of discount of $273,922 and $294,005 in 2009 and 2008, respectively | **79,361,078** | 80,885,995 |
| Total liabilities | **84,472,349** | 85,994,674 |
| | | |
| Net assets - Unrestricted | **3,450,043** | 2,345,289 |
| Total liabilities and net assets | **$ 87,922,392** | $ 88,339,963 |

*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 June 30, 2009 | Three Months Ended June 30, 2008 |
|---|---|---|
| Revenues: | | |
| Income from investment in direct financing lease | **$ 4,558,327** | $ 1,151,083 |
| Fixed management fee | **900,000** | 189,500 |
| Reimbursable expenditures fee | **1,859,989** | 503,844 |
| Total revenues | **7,318,316** | 1,844,427 |
| Expenses: | | |
| Project operation and maintenance | **1,919,816** | 411,125 |
| General and administrative | **577,375** | 94,494 |
| Total expenses | **2,497,191** | 505,619 |
| Other income (expenses): | | |
| Interest and other financing, related expenses | **(4,195,303)** | (1,063,911) |
| Interest income | **478,932** | 130,262 |
| Total other expenses, net | **(3,716,371)** | (933,649) |
| Change in unrestricted net assets | **1,104,754** | 405,159 |
| Net assets - Unrestricted , beginning of period | **2,345,289** | 1,940,130 |
| Net assets - Unrestricted , end of period | **$ 3,450,043** | $ 2,345,289 |

*See accompanying notes.*

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

| | Year Ended June 30, 2009 | Three Months Ended June 30, 2008 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Increase in net assets | **$ 1,104,754** | $ 405,159 |
| Adjustments to reconcile increase in net assets to net cash provided by operating activities: | | |
| Depreciation | **5,881** | – |
| Bond discount amortization | **20,083** | 5,305 |
| Amortization of bonds issuances costs | **80,514** | 17,583 |
| Change in operating assets and liabilities: | | |
| Decrease (increase) in restricted cash | **111,830** | (59,881) |
| Principal collected from direct financing lease | **1,141,037** | 274,323 |
| Net decrease in due from Unversity of Puerto Rico | **543,199** | 2,257,641 |
| Decrease in prepaid expenses | **3,856** | 5,762 |
| Decrease (increase) in other assets | **9,318** | (45,152) |
| Decrease in construction contract and other development payables | **(78,050)** | (1,099) |
| Increase (decrease) in operating trade accounts payable | **84,420** | (88,952) |
| Decrease Increase in accrued interest payable | **(38,626)** | 1,039,157 |
| Increase in accrued costs and expenses | **85,141** | 2,450 |
| Increase in unearned student dormitories rental income | **2,116** | 45,975 |
| Decrease in commercial tenats and student dormitories security deposits | **(52,409)** | (29,491) |
| Net cash provided by operating activities | **3,023,064** | **3,828,780** |
| **Cash flows from investing activities:** | | |
| Net increase in restricted funds held by trustee | **(452,831)** | (3,900,288) |
| Capital expenditures | **–** | (25,100) |
| Net cash used in investing activities | **(452,831)** | **(3,925,388)** |
| **Cash flows from financing activities** | | |
| Principal payments on bonds payable | **(1,545,000)** | – |
| Net change in cash | **1,025,233** | **(96,608)** |
| Cash, beginning of period | **875,284** | 971,892 |
| Cash, end of period | **$ 1,900,517** | **$ 875,284** |

*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 healthcare 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 separate 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. 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 was 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 2008 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. Reclassifications

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. Fair value is based on quoted market prices. 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 (nonoperating activities).

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 Jun 30, 2009 and 2008, 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 has been incurred.

### H. Inventories

Inventories are valued at the lower of cost (first-in, first-out) 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 management 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 recorded 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 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, 2009 and 2008, the cost of the excess of 90 days of the accumulated sick leave was $11,278,263 and $10,748,463, 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 non-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 unconditional promises to give are recognized in the financial statements once all eligibility requirements, including time requirements, have been met. In the absence of such promises, 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.

### R. GASB Statement No. 45

During fiscal year 2008, the University adopted the provisions of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment 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. The impact of the adoption on the financial statements of the University is considered not to be significant. Further details are disclosed in Note 12.

## 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, 2009 and 2008, the carrying value of cash and cash equivalents amounted to $(15,392,896) (overdraft) and $24,994,664, respectively, and the cash deposited in the banks amounted to $13,455,402 and $54,217,337, respectively.

## 3. Investments

The University's investments held at June 30, 2009 and 2008, are summarized in the following table:

| | 2009 | 2008 |
|---|---|---|
| Certificates of deposit | **$ 1,425,067** | $ 127,937 |
| Government agency securities | **77,259,314** | 73,596,054 |
| Guaranteed investment certificate | **94,771,515** | 161,230,999 |
| Corporate bonds | **22,627,552** | 20,912,375 |
| Common stock and convertibles | **17,484,516** | 21,493,012 |
| Mutual Funds | **52,979,837** | 54,046,129 |
| | **$ 266,547,801** | $ 331,406,506 |

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 non-U.S. income securities investments are held by the University.

### Guaranteed Investment Certificate

The University maintains a Construction Fund account, related to the issuance of the Series Q University of Puerto Rico System Revenue Bonds. As of June 30, 2009 and 2008, the account balance amounted to approximately $95 million and $161 million, respectively. The account is held under a guaranteed investment certificate (the certificate) whereas the financial institution guarantees the University a fixed rate of return equal to 4.772%. As established in the contract, the financial institution has invested such funds in predetermined securities such as cash, U.S. Treasury and U.S. Government Agency securities. These securities are pledged and serve as collateral for the account balance. The fair value of the guaranteed investment certificate is determined based on the fair value of the underlying investments based on quoted market prices and then adjusted to contract value. As of June 30, 2009 and 2008 the contract value, which represents amounts deposited plus interest credited less withdrawals, is equal to the fair value.

## 3. Investments (continued)

### 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, 2009, the University's credit quality distribution for securities is as follows:

| | Carrying Value | Quality Rating | | | |
|---|---|---|---|---|---|
| | | AAA-A | AA | Unrated | No Risk |
| Government agency securities | $ 77,259,314 | $ – | $ – | $ – | $ 77,259,314 |
| Guaranteed investment certificate | 94,771,515 | – | 94,771,515 | – | – |
| Corporate Bonds | 22,627,552 | 22,627,552 | – | – | – |
| Common Stocks and Convertibles | 17,484,516 | 17,484,516 | – | – | – |
| Mutual Funds | 52,979,837 | – | – | 52,979,837 | – |
| | $ 265,122,734 | $ 40,112,068 | $ 94,771,515 | $ 52,979,837 | $ 77,259,314 |

### 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 in market interest rates. As of June 30, 2009, the maturity of Corporate Bonds in each fund follows:

| Investment Type | Maturities | Amount |
|---|---|---|
| Corporate Bonds | 15/Jun/10 - 15/May/44 | $ 4,927,213 |
| Corporate Bonds | 29/Jul/10 - 15/May/44 | 1,318,073 |
| Corporate Bonds | 29/Jul/10 - 15/May/44 | 7,076,065 |
| Corporate Bonds | 19/Jul/11 - 25/Jub/16 | 702,854 |
| Corporate Bonds | 29/Jun/11 - 12/Jul/35 | 170,664 |
| Corporate Bonds | 29/Jun/11 - 12/Jul/35 | 447,003 |
| Corporate Bonds | 29/Jul/11 - 12/Jul/35 | 7,966,407 |
| Corporate Bonds | 9/Dic/11 - 20/Feb/29 | 19,273 |
| | | $ 22,627,552 |

## 4. Accounts Receivable

Accounts receivable as of June 30 are as follows:

| | 2009 | 2008 |
|---|---|---|
| Commonwealth of Puerto Rico appropriations grants and contracts | **$ 51,239,135** | $ 43,886,782 |
| Other government agencies | **75,194,534** | 91,761,296 |
| Due from Federal Government | **23,493,501** | 23,799,975 |
| Due from medical plans | **74,567,580** | 67,311,384 |
| Due from Servicios Médicos Universitarios, Inc. | **35,996,756** | 33,296,756 |
| Other | **32,280,725** | 30,566,154 |
| | **292,772,231** | 290,622,347 |
| Less allowance for doubtful accounts | **(135,702,573)** | (132,409,296) |
| Accounts receivable, net | **$ 157,069,658** | $ 158,213,051 |

On September 7, 2004, the Commonwealth 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, 2009, the University has received $61,850,382 from this amount. The remaining balance will be received as follows:

| Fiscal Year | Amount |
|---|---|
| 2009-2010 | **$ 7,570,127** |
| 2010-2011 | **7,570,127** |
| 2011-2012 | **8,000,000** |
| 2012-2013 | **8,000,000** |
| 2013-2014 | **1,719,746** |
| | **$ 32,860,000** |

### Due from Commonwealth of Puerto Rico

As of June 30, 2009, the University has noncurrent accounts receivable from the Commonwealth of Puerto Rico (the Commonwealth) of $99,200,389. This outstanding balance includes $48,620,517 related to revenue from appropriations for fiscal years 2007 and 2008 which the University has not received.

## 4. Accounts Receivable (continued)

### Due from Commonwealth of Puerto Rico (continued)

On December 30, 2008, the University and the Office of Management & Budget (OMB), on behalf of the Commonwealth, entered into an Interagency Agreement which established the Commonwealth's intention and commitment to pay such amounts during the next three fiscal years, starting on fiscal year 2009-2010.

As of the date of the financial statements, the University and OMB have been unable to agree on a date when the payment of such accounts will be made. Both agencies have been working diligently to resolve the matter. Although the University believes it has the legal right and it is entitled to receive the revenues of approximately $49 million, as of June 30, 2009, Management has determined to apply an allowance for doubtful accounts equal to 50% of the outstanding balance. The effect has been presented net of Commonwealth appropriations in the Statement of Revenues, Expenses and Changes in Net Assets as of June 30, 2009.

## 5. Capital Assets

Changes in capital assets for the years ended June 30, 2009 and 2008, are as follows:

| | 2009 | | | | |
|---|---|---|---|---|---|
| | Beginning Balance | Additions | Transfers | Disposals | Ending Balance |
| Capital assets not being depreciated: | | | | | |
| Land | $ 42,161,028 | $ – | $ 277,611 | $ – | $ 42,438,639 |
| Construction - in progress | 135,314,220 | 93,026,554 | (44,812,639) | (5,010,115) | 178,518,020 |
| | 177,475,248 | 93,026,554 | (44,535,028) | (5,010,115) | 220,956,659 |
| Other capital assets: | | | | | |
| Land improvements | 31,660,682 | – | 73,206 | – | 31,733,888 |
| Building, fixed equipment, improvements and infrastructure | 743,035,676 | – | 43,471,225 | – | 786,506,901 |
| Equipment and library materials | 224,609,616 | 12,823,916 | 990,597 | (2,508,732) | 235,915,397 |
| Building and equipment under capital lease | 99,298,249 | – | – | – | 99,298,249 |
| | 1,098,604,223 | 12,823,916 | 44,535,028 | (2,508,732) | 1,153,454,435 |
| Less accumulated drepreciation and amortization for: | | | | | |
| Land improvements | (14,786,395) | (1,160,724) | – | – | (15,947,119) |
| Buildings, fixed equipment, improvements and infrastructure | (258,853,548) | (18,400,695) | – | – | (277,254,243) |
| Equipment and library materials | (163,168,577) | (14,979,123) | – | 3,149,553 | (174,998,147) |
| Building and equipment under capital lease | (4,872,756) | (3,010,914) | – | – | (7,883,670) |
| | (441,681,276) | (37,551,456) | – | 3,149,553 | (476,083,179) |
| Other capital assets, net of acumulated depreciation | 656,922,947 | (24,727,540) | 44,535,028 | 640,821 | 677,371,256 |
| Capital assets, net | $ 834,398,195 | $ 68,299,014 | $ – | $ (4,369,294) | $ 898,327,915 |

## 5. Capital Assets (continued)

| | 2008 | | | | |
|---|---|---|---|---|---|
| | Beginning Balance | Additions | Transfers | Disposals | Ending Balance |
| Capital assets not being depreciated: | | | | | |
| Land | $ 42,161,028 | $ – | $ – | $ – | $ 42,161,028 |
| Construction - in progress | 97,985,272 | 60,199,286 | (21,573,166) | (1,297,172) | 135,314,220 |
| | 140,146,300 | 60,199,286 | (21,573,166) | (1,297,172) | 177,475,248 |
| Other capital assets: | | | | | |
| Land improvements | 31,593,642 | – | 67,040 | – | 31,660,682 |
| Building, fixed equipment, improvements and infrastructure | 722,924,139 | – | 20,111,537 | – | 743,035,676 |
| Equipment and library materials | 214,047,507 | 16,254,516 | 1,394,591 | (7,086,998) | 224,609,616 |
| Building and equipment under capital lease | 99,298,349 | – | – | (100) | 99,298,249 |
| | 1,067,863,637 | 16,254,516 | 21,573,168 | (7,087,098) | 1,098,604,223 |
| Less accumulated drepreciation and amortization for: | | | | | |
| Land improvements | (13,626,245) | (1,160,150) | – | – | (14,786,395) |
| Buildings, fixed equipment, improvements and infrastructure | (240,932,843) | (17,920,705) | – | – | (258,853,548) |
| Equipment and library materials | (154,903,405) | (15,033,300) | – | 6,768,128 | (163,168,577) |
| Building and equipment under capital lease | (1,861,842) | (3,010,914) | – | | (4,872,756) |
| | (411,324,335) | (37,125,069) | – | 6,768,128 | (441,681,276) |
| Other capital assets, net of acumulated depreciation | 656,539,302 | (20,870,553) | 21,573,168 | (318,970) | 656,922,947 |
| Capital assets, net | $ 796,685,602 | $ 39,328,733 | $ 2 | $ (1,616,142) | $ 834,398,195 |

Amortization expense of assets recorded under capital leases amounted to $3,010,914 in 2009 and 2008.

## 6. Lines of Credit

As of June 30, 2009, the University has available a non-revolving line of credit agreement with GDB for the total authorized amount of $60,000,000. This line of credit is guaranteed by the Commonwealth of Puerto Rico. As of June 30, 2009, the University had $51,239,135 outstanding under this line of credit.

## 7. Noncurrent Liabilities

Changes in noncurrent liabilities for the year ended June 30, 2009 and 2008, are as follows:

**2009**

| | Beginning Balance | Additions | Reductions | Other | Ending Balance | Less Due Within One Year | Noncurrent Liabilities |
|---|---|---|---|---|---|---|---|
| Long-term debt: | | | | | | | |
| Notes payable | $ 36,061,717 | $ 15,177,418 | $ – | $ – | $ 51,239,135 | $ – | $ 51,239,135 |
| Bonds payable | 637,904,830 | 2,774,265 | (21,455,000) | (546,519) | 618,677,576 | 20,825,000 | 597,852,576 |
| Total long-term | $ 673,966,547 | $ 17,951,683 | $ (21,455,000) | $ (546,519) | $ 669,916,711 | $ 20,825,000 | $ 649,091,711 |
| Other long-term liabilities: | | | | | | | |
| Deferred compensation payable | $ 54,046,130 | $ – | $ (1,066,293) | $ – | $ 52,979,837 | $ – | $ 52,979,837 |
| Claims liability | 19,124,747 | 9,000,000 | (1,739,642) | 970,061 | 27,355,166 | 1,739,642 | 25,615,524 |
| Compensated absences | 159,139,516 | 38,996,490 | (28,404,247) | – | 169,731,759 | 31,327,494 | 138,404,265 |
| Capital lease obligation | 69,712,586 | – | (1,133,349) | – | 68,579,237 | 1,133,349 | 67,445,888 |
| Total other long-term liabilities | $ 302,022,979 | $ 47,996,490 | $ (32,343,531) | $ 970,061 | $ 318,645,999 | $ 34,200,485 | $ 284,445,514 |

**2008**

| | Beginning Balance | Additions | Reductions | Other | Ending Balance | Less Due Within One Year | Noncurrent Liabilities |
|---|---|---|---|---|---|---|---|
| Long-term debt: | | | | | | | |
| Notes payable | $ 20,271,404 | $ 15,790,313 | $ – | $ – | $ 36,061,717 | $ – | $ 36,061,717 |
| Bonds payable | 655,507,668 | 2,752,336 | (19,760,000) | (595,174) | 637,904,830 | 21,455,000 | 616,449,830 |
| Total long-term | $ 675,779,072 | $ 18,542,649 | $ (19,760,000) | $ (595,174) | $ 673,966,547 | $ 21,455,000 | $ 652,511,547 |
| Other long-term liabilities: | | | | | | | |
| Deferred compensation payable | $ 58,287,211 | $ – | $ (4,241,081) | $ – | $ 54,046,130 | $ – | $ 54,046,130 |
| Claims liability | 22,060,285 | – | (863,150) | (2,072,388) | 19,124,747 | 863,150 | 18,261,597 |
| Compensated absences | 144,527,515 | 37,785,817 | (23,173,816) | – | 159,139,516 | 27,937,385 | 131,202,131 |
| Capital lease obligation | 70,775,930 | – | (1,063,344) | – | 69,712,586 | 1,063,344 | 68,649,242 |
| Total other long-term liabilities | $ 295,650,941 | $ 37,785,817 | $ (29,341,391) | $ (2,072,388) | $ 302,022,979 | $ 29,863,879 | $ 272,159,100 |

Bonds payable are further discussed 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, 2009 and 2008:

| Series | Balance as of June 30, 2009 | Anual Interest Rate (%) | Due Date |
|---|---|---|---|
| C - Serial | $ 329,000 | 3.00% | 1972-2011 |
| D - Serial | 428,000 | 3.75% | 1973-2011 |
| F - Term | 7,400,000 | 5.50% | 1973-2012 |
| N - Capital Appreciation Serial Bonds | 41,505,000 | 5.65-5.75% | 1996-2013 |
| O - Serial | 7,060,000 | 4.5-3.75% | 1996-2012 |
| P - Serial | 238,860,000 | 5.00% | 010-2018 |
| P - Term | 47,645,000 | 5.00% | 2027-2030 |
| Q - Serial | 118,690,000 | 5.00% | 2008-2017 |
| Q - Term | 132,415,000 | 5.00% | 2027-2036 |
| | 594,332,000 | | |
| Less unamortized bond discount | (2,589) | | |
| Plus unaccreted premium | 34,168,650 | | |
| Less future appreciated principal | (5,372,598) | | |
| Deferred loss on refunding | (4,447,886) | | |
| | $ 618,677,577 | | |

| Series | Balance as of June 30, 2008 | Anual Interest Rate (%) | Due Date |
|---|---|---|---|
| C - Serial | $ 489,000 | 3.00% | 1972-2011 |
| D - Serial | 633,000 | 3.75% | 1972-2011 |
| F - Term | 8,700,000 | 5.50% | 1973-2012 |
| M - Serial | 4,940,000 | 4.35-5.45% | 1996-2009 |
| N - Capital Appreciation Serial Bonds | 51,980,000 | 5.65-5.75% | 1996-2013 |
| O - Serial | 7,060,000 | 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 | 123,065,000 | 5.00% | 2008-2026 |
| Q - Term | 132,415,000 | 5.00% | 2027-2036 |
| | 615,787,000 | | |
| Less unamortized bond discount | (4,316) | | |
| Plus unaccreted premium | 34,715,169 | | |
| Less future appreciated principal | (7,867,143) | | |
| Deferred loss on refunding | (4,725,879) | | |
| | $ 637,904,831 | | |

## 8. Bonds Payable (continued)

### A. Bonds (continued)

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

### B. Debt Service Requirement

At June 30, 2009, bonds payable require payments of principal and interest as follows:

| Fiscal Year | Principal | Interest | Total |
|---|---|---|---|
| 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 | 29,930,000 | 25,306,500 | 55,236,500 |
| 2014 | 18,110,000 | 24,444,250 | 42,554,250 |
| 2015 to 2019 | 105,075,000 | 107,698,250 | 212,773,250 |
| 2020 to 2024 | 134,110,000 | 78,668,250 | 212,778,250 |
| 2025 to 2029 | 119,565,000 | 45,327,750 | 164,892,750 |
| 2030 to 2034 | 80,140,000 | 19,041,000 | 99,181,000 |
| 2035 to 2036 | 31,885,000 | 2,410,500 | 34,295,500 |
| | $ 594,332,000 | $ 383,953,180 | $ 978,285,180 |

### C. Pledged Revenues

The bonds are general obligations of the University and are collateralized by the pledge of, and a first lien 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, 2009 and 2008:

## 8. Bonds Payable (continued)

### C. Pledged Revenues (continued)

| **Pledged Revenues:** | | **2009** | | **2008** |
|---|---|---|---|---|
| Tuition and other fees collected | $ | **78,857,654** | $ | 77,347,598 |
| Student fees collected | | **6,223,498** | | 6,431,462 |
| Rental and other charges received for the right of use and occupancy of the facilities in the University system | | **1,726,954** | | 1,289,912 |
| Bookstore receipts (gross sales less cost of books and supplies sold) | | **13,855** | | 464,502 |
| Interest on investment of University funds, excluding funds invested pursuant to Article VI of the Trust Agreement | | **262,266** | | 2,931,455 |
| Funds paid to the University in respect to overhead allowance on federal research projects | | **14,996,424** | | 16,260,829 |
| Other income | | **27,494,281** | | 30,028,753 |
| | $ | **129,574,932** | $ | 134,754,511 |

Interest earned on investments in the sinking fund reserve account amounted to $2,919,404 and $2,884,891 for the years ended June 30, 2009 and 2008, respectively.

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

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

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

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

**8. Bonds Payable (continued)**

**C. Pledged Revenues (continued)**

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

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

**D. Bonds 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 the 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)

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

Bonds payable at June 30, 2009 and 2008, consist of:

| Description | Interest Rate | Maturity | 2009 Face Amount | 2008 Face Amount |
|---|---|---|---|---|
| Serial Bonds | 4.00% | July 1, 2008 | **$ –** | $ 1,545,000 |
| Serial Bonds | 5.00% | July 1, 2009 | **1,620,000** | 1,620,000 |
| Serial Bonds | 4.13% | July 1, 2010 | **1,685,000** | 1,685,000 |
| Serial Bonds | 4.25% | 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 | 5.63% | July 1, 2020 | **2,880,000** | 2,880,000 |
| Serial Bonds | 5.00% | July 1, 2021 | **3,020,000** | 3,020,000 |
| Term Bonds | 5.00% | July 1, 2033 | **50,520,000** | 50,520,000 |
| | | | **79,635,000** | 81,180,000 |
| Less discount | | | **(273,922)** | (294,005) |
| | | | **$ 79,361,078** | $ 80,885,995 |

## 8. Bonds Payable (continued)

### D. 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 |

### E. Compliance with the Loan Agreement with AFICA – Discretely Presented Component Unit

At June 2008, the Company was not in compliance with Section 3.04 of the Loan Agreement with AFICA regarding allowed uses of funds in the Construction Fund, which are restricted to the payment of Project Costs, as defined in the Trust Agreement. Management and the Board of Directors understand that this situation does not jeopardize the tax exempt status of the underlying bonds. However, the Trustee and/or AFICA may notify in writing the Company's failure to observe this provision of the Loan Agreement and demand that it be remedied within sixty (60) days or that corrective action be instituted and diligently pursued by the Company within such period.

On October 15, 2008, the Trustee issued a Notice of Event of Default. Thereafter, on November 10, 2008, the Company received a payment from the University covering substantially all amounts due under the reimbursable expenses fee through June 30, 2008.

## 8. Bonds Payable (continued)

### E. Compliance with the Loan Agreement with AFICA – Discretely Presented Component Unit (continued)

On December 22, 2009, the Company and the University submitted an amended Certificate of Substantial Completion with updated financial information through June 30, 2008 and the appropriated wording. The Trustee has yet to clear in writing these events of default.

## 9. Obligation under Capital Lease

In October, 2007, 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, 2009 and 2008 on this capital lease is $68,579,237 and $69,712,586, respectively.

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

| Year Ending June 30, | Amount |
|---|---|
| 2010 | $ 5,697,550 |
| 2011 | 5,700,937 |
| 2012 | 5,701,938 |
| 2013 | 5,697,312 |
| 2014 | 5,702,063 |
| Thereafter | 108,130,957 |
| Subtotal | 136,630,757 |
| Less amounts representing interest | (68,051,520) |
| Total | $ 68,579,237 |

## 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 2009 and 2008 were:

| | 2009 | 2008 |
|---|---|---|
| Claims payable - July 1 | **$ 19,124,747** | $ 22,060,285 |
| Incurred claims and changes in estimates | **42,064,060** | 29,300,132 |
| Payments for claims and adjustments expenses | **(33,833,641)** | (32,235,670) |
| Claims payable - June 30 | **$ 27,355,166** | $ 19,124,747 |

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 the healthcare unit located in Carolina. This facility was acquired by the University and includes land, building and medical equipment.

During 2009, the Hospital restructured its line of credit facilities and accrued interest in the aggregated amount of $23,360,913, to extend the maturity date to June 30, 2025. As part of the loan agreement, the Hospital was required to make a down payment of $2,700,000.

Scheduled principal repayments of the long-term debt for the next five years and thereafter are as follows:

| Fiscal Year | Amount |
|---|---|
| 2010 | $ 820,153 |
| 2011 | 873,775 |
| 2012 | 930,905 |
| 2013 | 991,768 |
| 2014 | 1,056,611 |
| Thereafter | 15,987,701 |
| | $ 20,660,913 |

**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.

## 10. Commitments and Contingent Liabilities (continued)

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

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.

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 System's 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 | $64,072,208 |
| Contributions made | $72,605,262 |
| Actuarial valuation date | 6/30/2009 |
| 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 (Asset) |
|---|---|---|---|---|
| 6/30/2009 | $ 62,929,059 | $ 72,605,262 | 115.4% | $ (46,187,467) |
| 6/30/2008 | $ 58,814,476 | $ 81,553,088 | 138.7% | $ (36,511,264) |
| 6/30/2007 | $ 57,757,197 | $ 78,310,774 | 135.6% | $ (13,772,652) |

Pension asset has been recorded in prepaid expense and other assets.

## 12. Other Post-Employment Benefits (OPEB)

In addition to the pension benefits described in Note 11, the University provides post-employment 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.

The Governmental Accounting Standards Board released Statement No. 45 (GASB No. 45) in 2004. This statement requires employers to accrue the cost of Postemployment Benefit Plans while employees who will receive these benefits are providing services to the employer.

The University does not pre-fund its postemployment benefit plan and retiree benefits are paid out of the University's general assets each year. Accordingly, the discount rate is based on the long-term rates of return that the University expects to earn on general assets which are used to pay plan benefits.

The Annual OPEB Cost is calculated based on the Annual Required Contribution of the employer (ARC), an amount actuarially determined in accordance with the provisions of GASB Statement No. 45. The ARC represents a level of funding that, if paid on ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty years. The following table shows the components of the University's annual OPEB cost for the fiscal year 2008-2009:

| | |
|---|---|
| Annual OPEB cost (or ARC) | $ 9,690,994 |
| Actuarial Accrued Liability (AAL) | $ 186,689,632 |
| Unfunded AAL | $ 186,689,632 |
| Funded Ratio | 0% |

The University's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the Net OPEB Obligation on a funded and unfunded basis are as follow:

| Fiscal Year Ended | Annual OPEB Cost | Percentage of Annual OPEB Cost Contributed | Net OPEB Obligation |
|---|---|---|---|
| 6/30/2008 | $9,681,698 | 85.6% | $1,394,231 |
| 6/30/2009 | $9,690,994 | 99.5% | $1,439,612 |

During 2009, the University made contributions of $9,645,723.

## 12. Other Post-Employment Benefits (OPEB) (continued)

*OPEB Actuarial Valuation* – The University's other Post-Employment Benefits Program actuarial valuation was conducted by Deloitte Consulting, LLP as of July 1, 2007, members of the American Academy of Actuaries. The valuation was performed in accordance with GASB Statement No. 45 requirements.

Significant Actuarial Methods and Assumptions:

| | |
|---|---|
| Actuarial Valuation Date | July 1, 2007 |
| Actual Cost Method | Projected Unit Credit |
| Amortization Method | Level Dollar Amortization over 30 years |
| Medical Subsidy | 85% |
| Tuition Remission | $460 per retiree in fiscal 2009, increasing 4.0% per year |
| Payroll Growth | 4% |
| Discount Rate | 4% |

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

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

## 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 $65,196,260 as of June 30, 2009. 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 and aliens without medical insurance coverage. 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, the Department of Health has been unable to pay for such services. As shown in the accompanying financial statements, the Hospital has provided allowances for uncollectible accounts receivable in the approximate amount of $10,778,461.

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

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, has resulted in the accumulated deficit at June 30, 2009.

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.
- To build a new Imaging Center with the acquisition of a new generation 8 channel light performance MRI 1.5T System with the existing C.T.
- Increasing the Hospital operating cash flow by improving the reimbursement rate through more aggressive negotiations with medical insurance companies and restructuring the billing and collection department with the acquisition and implementation of a new accounting, billing and collection, and emergency room tracking and clinical documentation information systems, in order to reduce to at minimum denied reimbursement for services provided.
- Refurbishing pediatrics, Ob-Gyn, Surgery and other hospital general and common areas, improve hospital image and be able to attract insured patients sector.
- Expansion of the Intensive Care Unit area with twelve new beds. This will improve service provided to critical patients and as result of this an increase in patient days.

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, 2009 and 2008 were as follows:

**2009**

| Functional classification | Salaries and Benefits | Supplies and other Services | Scholarship and Felowship | Utilities | Depreciation | Other Expenditures | Total |
|---|---|---|---|---|---|---|---|
| Instruction | $ 433,771,643 | $ 13,857,816 | $ 8,827,308 | $ 92,553 | | $ 2,463,138 | **$ 459,012,458** |
| Research | 58,723,262 | 20,379,750 | 13,917,260 | 754,502 | | 12,300,693 | **106,075,467** |
| Public service | 50,958,025 | 14,643,335 | 1,183,942 | 587,171 | | 972,274 | **68,344,747** |
| Academic support | 83,291,660 | 19,450,719 | 711,755 | 64,079 | | 2,281,898 | **105,800,111** |
| Student service | 47,558,655 | 7,576,576 | 336,247 | 6,701 | | 1,060,423 | **56,538,602** |
| Institutional support | 129,644,721 | 46,529,634 | 243,130 | 3,651,065 | | 3,052,765 | **183,121,315** |
| Oper & Maintenance | 92,260,270 | 28,258,046 | 65 | 43,070,039 | | 3,386,984 | **166,975,404** |
| Student Aid | 2,319,398 | 544,312 | 150,996,286 | 291 | | 121,616 | **153,981,903** |
| Independent Operation | 32,755 | 64,897 | 9,394 | – | | 374 | **107,420** |
| Patient Service | 39,050,247 | 2,064,653 | 389,857 | 22,323 | | 397,845 | **41,924,925** |
| Auxiliary Enterprises | 1,920,565 | 5,949,676 | 20,482 | 30,248 | | 209,291 | **8,130,262** |
| Depreciation | – | – | – | – | 37,551,456 | – | **37,551,456** |
| Other | – | – | – | – | | 23,744,971 | **23,744,971** |
| | **$ 939,531,201** | **$ 159,319,414** | **$ 176,635,726** | **$ 48,278,972** | **$ 37,551,456** | **$ 49,992,272** | **$ 1,411,309,041** |

**2008**

| Functional classification | Salaries and benefits | Supplies and other services | Scholarship and fellowship | Utilities | Depreciation | Other Expenditures | Total |
|---|---|---|---|---|---|---|---|
| Instruction | $ 410,571,202 | $ 17,610,881 | $ 11,008,442 | $ 1,174,161 | $ – | $ 297,676 | $ 440,662,362 |
| Research | 67,422,998 | 26,982,113 | 10,958,266 | 1,168,046 | – | 688,189 | 107,219,612 |
| Public service | 53,366,517 | 13,547,886 | 2,612,691 | 763,571 | – | 588,255 | 70,878,920 |
| Academic support | 79,961,708 | 17,280,054 | 4,361,716 | 134,338 | – | 124,113 | 101,861,929 |
| Student service | 45,669,139 | 10,339,543 | 954,213 | 3,251 | – | 36,852 | 57,002,998 |
| Institutional support | 125,970,369 | 36,992,224 | 531,730 | 1,920,365 | – | 1,427,314 | 166,842,002 |
| Oper & Maintenance | 78,109,943 | 29,214,526 | 29,990 | 43,853,045 | – | 3,989,007 | 155,196,511 |
| Student Aid | 2,401,587 | 666,013 | 129,685,290 | 1,116 | – | 9,700 | 132,763,706 |
| Independent Operation | – | 8,181 | – | – | – | 76,991 | 85,172 |
| Patient Service | 43,665,393 | 2,715,026 | 295,491 | 61,284 | – | 2,876 | 46,740,070 |
| Auxiliary Enterprises | 5,184,714 | 4,741,671 | 54,739 | 68,423 | – | 1,243,359 | 11,292,906 |
| Depreciation | – | – | – | – | 37,125,069 | – | 37,125,069 |
| Other | – | – | – | – | – | 23,612,308 | 23,612,308 |
| | $ 912,323,570 | $ 160,098,118 | $ 160,492,568 | $ 49,147,600 | $ 37,125,069 | $ 32,096,640 | $ 1,351,283,567 |

## 15. Subsequent Events

During April 2010, students' protests caused the University to suspend operations. As of this date, it is uncertain when the University will resume its operations. The University has not determined the impact this event could have in the audited financial statements.

## 16. Significant New Accounting Pronouncements

### Pollution Remediation Obligations

In November 2007, 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,
- 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.

This Statement was adopted by the University during the year ended June 30, 2009 and did not have any material impact on the University's financial statements.

## 16. Significant New Accounting Pronouncements (continued)

### Land and Other Real Estate Held as Investments by Endowments

In November 2007, the GASB issued Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*. This Statement establishes consistent standards for the reporting of land and other real estate held as investments by essentially similar entities. It requires endowments to report their land and other real estate investments at fair value. Governments also are required to report the changes in fair value as investment income and to disclose the methods and significant assumptions employed to determine fair value, and other information that they currently present for other investments reported at fair value.

This Statement was adopted by the University during the year ended June 30, 2009 and did not have any material impact in the University's financial statements.

### The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments

In March 2009, the GASB issued Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, to incorporate the hierarchy of generally accepted accounting principles (GAAP) for state and local governments into the Governmental Accounting Standards Board's (GASB) authoritative literature. The "GAAP hierarchy" consists of the sources of accounting principles used in the preparation of financial statements of state and local governmental entities that are presented in conformity with GAAP, and the framework for selecting those principles.

Statement No. 55 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of state and local governmental entities that are presented in conformity with generally accepted accounting principles (the GAAP hierarchy).

The new standard lists the order of priority of pronouncements that a governmental entity should look to for accounting and financial reporting guidance. The sources of accounting principles that are generally accepted are categorized in descending order of authority as follows:

Officially established accounting principles—Governmental Accounting Standards Board (GASB) Statements and Interpretations. GASB Statements and Interpretations are periodically incorporated in the Codification of Governmental Accounting and Financial Reporting Standards.

GASB Technical Bulletins and, if specifically made applicable to state and local governmental entities by the American Institute of Certified Public Accountants (AICPA) and cleared by the GASB, AICPA Industry Audit and Accounting Guides, and AICPA Statements of Position.

## 16. Significant New Accounting Pronouncements (continued)

**The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments (continued)**

AICPA Practice Bulletins if specifically made applicable to state and local governmental entities and cleared by the GASB, as well as consensus positions of a group of accountants organized by the GASB that attempts to reach consensus positions on accounting issues applicable to state and local governmental entities.

Implementation guides (Q&As) published by the GASB staff, as well as practices that are widely recognized and prevalent in state and local government. This Statement applies to the financial statements of all state and local governments that are presented in conformity with GAAP and it was adopted by the University for the year ended June 30, 2009 and did not have any material impact on the University's financial statements.

**Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards**

In March 2009, the GASB issued Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements of Auditing Standards*, to incorporate into the Governmental Accounting Standards Board's (GASB) authoritative literature certain accounting and financial reporting guidance presented in the American Institute of Certified Public Accountants' Statements on Auditing Standards. This Statement addresses three issues not included in the authoritative literature that establishes *accounting* principles—related party transactions, going concern considerations, and subsequent events. The presentation of principles used in the preparation of financial statements is more appropriately included in accounting and financial reporting standards rather than in the auditing literature.

Statement No. 56 establishes accounting and financial reporting standards for related party transactions, subsequent events, and going concern considerations.

This Statement was adopted by the University for the year ended June 30, 2009.

# 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) |
|---|---|---|---|---|---|---|
| 6/30/2006 | $ 869,211,000 | $ 1,930,131,983 | $ 160,920,983 | 45.0% | $ 484,886,628 | 218.8% |
| 6/30/2007 | $ 953,197,000 | $ 2,068,102,695 | $ 114,905,695 | 46.1% | $ 513,486,180 | 217.1% |
| 6/30/2008 | $ 1,024,987,000 | $ 2,223,219,684 | $ 1,198,232,684 | 46.1% | $ 542,603,556 | 220.8% |

## Post Employment Plan

| Actuarial Valuation Date | Actual Value of Assets (a) | Actual Accrued Liability (AAL) (b) | Unfunded AAL (UAAL) (a – b) | Funded Ratio (a / b) |
|---|---|---|---|---|
| 6/30/2007 | $ – | $184,232,820 | $ (184,232,820) | 0% |
| 6/30/2008 | $ – | $ 186,689,632 | $ (186,689,632) | 0% |

# Other Financial Information

**University of Puerto Rico**
**Schedules of Changes in Sinking Fund Reserve**
***(Unaudited)***

| | 2009 | | |
|---|---|---|---|
| | **Bond Service Account** | **Bond Reserve Account** | **Total** |
| Additions: | | | |
| Transfer from Reserve Account | $ **546,022** | $ **–** | $ **546,022** |
| Transfer from unrestricted current funds | **49,048,784** | **–** | **49,048,784** |
| Net increase in fair marker value of investments | **–** | **–** | **–** |
| Interest Earned on Investments | **449,909** | **2,469,495** | **2,919,404** |
| Total receipts | **50,044,715** | **2,469,495** | **52,514,210** |
| Deductions: | | | |
| Payments of bond interest | **33,862,135** | **–** | **33,862,135** |
| Payments of bond principal | **15,809,918** | **–** | **15,809,918** |
| Net decrease in fair market value of investments | **372,660** | **1,742,929** | **2,115,589** |
| Transfer to Reserve Account | **–** | **546,022** | **546,022** |
| Total disbursements | **50,044,713** | **2,288,951** | **52,333,664** |
| Net decrease for the year | **2** | **180,545** | **180,546** |
| Balances at beginning of year | **–** | **54,486,449** | **54,486,449** |
| Balance at end of year | $ **2** | $ **54,666,994** | $ **54,666,995** |

| | 2008 | | |
|---|---|---|---|
| | **Bond Service Account** | **Bond Reserve Account** | **Total** |
| Additions: | | | |
| Transfer from Reserve Account | $ 2,198,378 | $ – | $ 2,198,378 |
| Transfer from unrestricted current funds | 46,460,002 | – | 46,460,002 |
| Net increase in fair marker value of investments | 3,271 | – | 3,271 |
| Interest Earned on Investments | 608,274 | 2,276,617 | 2,884,891 |
| Total receipts | 49,269,925 | 2,276,617 | 51,546,542 |
| Deductions: | | | |
| Payments of bond interest | 29,308,028 | – | 29,308,028 |
| Payments of bond principal | 19,760,000 | – | 19,760,000 |
| Net decrease in fair market value of investments | 202,754 | 477,035 | 679,789 |
| Transfer to Reserve Account | – | 2,110,521 | 2,110,521 |
| Total disbursements | 49,270,782 | 2,587,556 | 51,858,338 |
| Net decrease for the year | (858) | (310,939) | (311,796) |
| Balances at beginning of year | 857 | 54,797,389 | 54,798,246 |
| Balance at end of year | $ (1) | $ 54,486,450 | $ 54,486,450 |

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

Board of Trustees
University of Puerto Rico

We have audited the financial statements of the business-type activities and aggregate discretely presented component units of the University of Puerto Rico (the University) as of and for the year ended June 30, 2009, which collectively comprise the University's basic financial statements and have issued our report thereon dated June 24, 2010. Our report includes a reference to other auditors. We conducted our audit 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. Other auditors audited the financial statements of Servicios Médicos Universitarios, Inc. (the Hospital) and Desarrollos Universitarios, Inc. (the Company), as described in our report on the University's financial statements. This report does not include results of other auditor's testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statement of the Hospital and the Company were not audited in accordance with *Government Auditing Standards*.

**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 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the next paragraph, we identified a deficiency in internal control that we consider to be a material weakness.

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

**2009-1 Financial Statement Close Process**

*Criteria*

A fundamental element of a sound system of internal controls is an effective financial statement close process. Such a process is essential in enabling organizations to prepare timely and accurate financial statements. This process helps to ensure that all financial transactions are properly recorded, appropriately supported and subjected to supervisory review. The financial statement close process begins with accounting data recorded in the University's general ledger and culminates in the preparation of the University's financial statements, including identification and documentation of the relevant disclosures that are required under generally accepted accounting principles.

*Condition*

During our audit, we noted deficiencies in the University's financial statement close process, including the following:

- Multiple audit/post-closing entries that were not initially identified by the University's internal controls were required to properly record revenues and expense activity, accounts receivable activity, and certain liabilities. These entries were considered material to the financial statements.

- The compilation of financial data and reconciliation processes are not completed in a timely manner. The lack of procedures and controls in these areas result in inefficiencies during the financial statements preparation process.

*Cause*

The lack of adequate controls during the implementation of the new accounting system has resulted in an ineffective and inefficient financial statements close process.

*Effect*

There were numerous post-closing and audit adjustments that were recorded by the University as noted above.

*Recommendations*

Management should improve the annual closing process, including more effective monitoring controls over financial information. All general ledger accounts should be supported by reconciliations, rollforward schedules and other appropriate documentation which are timely reviewed at two levels, and evidenced by supervisory and signature approval. Journal entries should be supported by complete documentation and timely reviewed as well as reviewing the processing of journal entries at year end.

All accounting judgments and estimates should also be properly supported and reviewed. In reviewing and developing the closing process, the University should ensure that it has sufficient accounting personnel with the appropriate experience and training to effectively perform the financial statement close process. Additionally, key accounting personnel need to review the draft financial statements for correctness of accounting, presentation and disclosure prior to its presentation to the auditors. This may include holding internal training programs for the preparers and first level reviewers related to the financial statement close process.

**Compliance and other matters**

As part of obtaining reasonable assurance about whether 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule.

The University's response to the finding identified in our audit is described in the accompanying schedule of findings. We did not audit the University's response and accordingly, we express no opinion on it.

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

June 24, 2010

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