

AUDITED FINANCIAL STATEMENTS

**University of Puerto Rico**

*Years Ended June 30, 2006 and 2005*

University of Puerto Rico

Audited Financial Statements

Years Ended June 30, 2006 and 2005

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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 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, 2006 and 2005, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Servicios Médicos Universitarios, Inc. (the Hospital) and Desarrollos Universitarios, Inc. (the Company), which represent 100% of the aggregate discretely presented component units, as of and for the years ended June 30, 2006 and 2005 and March 31, 2006 and 2005, respectively. Those financial statements were audited by other auditors whose reports thereon have been furnished to us. The Hospital's report included an explanatory paragraph stating that it has experienced recurring losses since it commenced operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Our opinion, insofar as it relates to amounts included for the Hospital and the Company, is solely based on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 opinion.

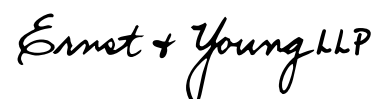
In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business type activities and the aggregate discretely presented component units of the University of Puerto Rico as of June 30, 2006 and 2005, and the respective changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 13 to the financial statements, the Hospital has experienced recurring losses since it commenced operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern.

In accordance with *Government Auditing Standards*, we have also issued our report, dated October 31, 2006, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

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

Our audits were conducted for the purpose of forming an opinion on the financial statements of the University of Puerto Rico taken as a whole. The schedule of changes in sinking fund reserves included in page 51 is presented for purposes of additional analysis and is not a required part of the financial statements. Such schedule has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.



October 31, 2006, except for  
Note 16, as to which the  
date is December 13, 2006

Stamp No. 2183592  
affixed to  
original of  
this report.



**University of Puerto Rico**  
**Management's Discussion and Analysis**  
**June 30, 2006 and 2005**

**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, 2006 and 2005. This discussion and analysis was prepared by University management and should be read in conjunction with the financial statements and notes thereto, which follow.

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

**Financial Highlights**

The financial position of the University remains strong at June 30, 2006, with total assets of \$1,138,476,196 total liabilities of \$752,347,037 and net assets of \$386,129,159. University net assets increased \$78,475,171 during the year ended June 30, 2006 when compared to \$6,892,002 during the year ended June 30, 2005 and to \$4,114,000 during the year ended June 30, 2004. These increases are explained in the section entitled "Analysis of Financial Position and Changes in Financial Position." An overview of the statements is presented below along with a financial analysis of the transactions impacting the statements.

Condensed financial statements for the University as of and for the years ended June 30, 2006, 2005 and 2004 follow:

	<b>2006</b>	<b>June 30 2005</b>	<b>2004</b>
<b>Assets</b>			
Current assets	\$ 341,443,766	\$ 277,300,121	\$ 308,392,463
Noncurrent assets:			
Due from Commonwealth of Puerto Rico	56,000,001	71,570,127	22,710,382
Capital	659,326,528	629,903,127	591,331,872
Other	81,705,901	69,972,192	57,460,819
Total assets	<u>\$ 1,138,476,196</u>	<u>\$ 1,048,745,567</u>	<u>\$ 979,895,536</u>
<b>Liabilities</b>			
Current liabilities	\$ 199,479,385	\$ 188,106,410	\$ 135,275,117
Noncurrent liabilities	552,867,652	552,985,169	543,858,433
Total liabilities	<u>\$ 752,347,037</u>	<u>\$ 741,091,579</u>	<u>\$ 679,133,550</u>
<b>Net assets</b>			
Invested in capital assets net of related debt	\$ 207,167,597	\$ 183,741,045	\$ 164,188,965
Restricted:			
Nonexpendable	52,247,594	45,310,063	38,902,830
Expendable	113,179,703	85,968,022	91,944,811
Unrestricted	13,534,265	(7,365,142)	5,725,380
Total net assets	<u>\$ 386,129,159</u>	<u>\$ 307,653,988</u>	<u>\$ 300,761,986</u>



University of Puerto Rico

Management's Discussion and Analysis (continued)

Condensed Statements of Revenues, Expenses and Changes in Net Assets

	Year ended June 30,		
	2006	2005	2004
<b>Operating revenues</b>			
Tuition and fees (net of scholarship)	\$ 51,115,866	\$ 36,951,309	\$ 40,235,263
Grants and contracts	240,430,728	257,270,339	251,075,661
Patient services	49,667,252	43,589,157	50,675,183
Other operating revenues	45,743,758	38,852,582	38,466,965
Total operating revenues	386,957,604	376,663,387	380,453,072
<b>Operating expenses</b>	1,196,233,066	1,182,072,684	1,120,598,736
<b>Operating loss</b>	(809,275,462)	(805,409,297)	(740,145,664)
<b>Nonoperating revenues</b>			
State appropriations	854,981,674	796,568,502	743,632,033
Other nonoperating expenses, including interest on indebtedness	18,743,277	(2,998,029)	(6,852,732)
Net nonoperating revenues	873,724,951	793,570,473	736,779,301
Income before other addition to permanent endowment and capital appropriations	64,449,489	(11,838,824)	(3,366,363)
Capital appropriations	10,160,608	12,323,593	2,243,129
Addition to permanent endowment	3,865,074	6,407,233	5,237,424
Total increase in net assets	\$ 78,475,171	\$ 6,892,002	\$ 4,114,190



## University of Puerto Rico

### Management's Discussion and Analysis (continued)

#### Using the Financial Statements

The University's financial statements were prepared in accordance with standards issued by the Governmental Accounting Standards Board (GASB). In June 1999, the GASB issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. This was followed in November 1999 by GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities – an amendment of GASB Statement No. 34*. The financial statement presentation required by GASB Statements No. 34 and 35 provides a comprehensive, entity-wide perspective of the University's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows.

#### Analysis of Financial Position and Changes in Financial Position

##### *Statement of Net Assets*

The statements of net assets present the assets, liabilities and net assets of the University as of June 30, 2006 and 2005. 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 24%, 26% and 39%, respectively, of current assets as of June 30, 2006. As of June 30, 2005, these amounts comprise approximately 9.4%, 25% and 57% of current assets and 93% of noncurrent assets are capital assets. As of June 30, 2004, these amounts comprise approximately 15%, 23% and 52% of current assets and 93% of noncurrent assets are capital assets. Approximately 86% of noncurrent assets are capital assets.



## University of Puerto Rico

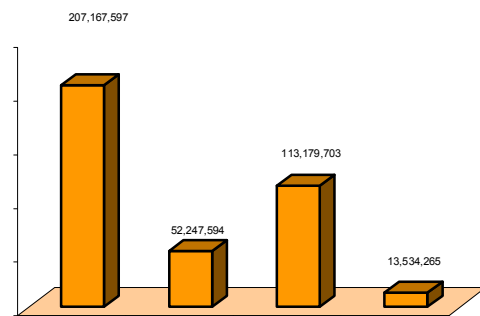
### Management's Discussion and Analysis (continued)

University's cash, cash equivalents and investments decreased from \$175,651,000 at June 30, 2004 to \$170,383,000 at June 30, 2005 and increased to \$239,586,325 at June 30, 2006. The increase is the result of an interest rate swap transaction, improvement in the collection of Federal Grants receivable and the increase in resources invested in the Deferred Compensation Plan. Currents accounts receivable decreased from \$161,078,000 to \$142,189,387 and increased to \$144,925,202 for the same periods. The decrease in accounts receivable between June 30, 2004 and 2005, is mainly due to an increase in collections from the Commonwealth of Puerto Rico. The increase in Net Accounts Receivables between June 30, 2005 and 2006 is due, basically by the increase in grants, contracts and appropriations from the Commonwealth of Puerto Rico.

Current liabilities consist primarily of accounts payable and accrued liabilities and the current portion of long-term debt. Accounts payable and accrued liabilities increased from \$81,097,000 to \$101,262,000 between June 30, 2004 and 2005. The increase is due to an increase in the annual required contribution to the University's Retirement System. Between June 30, 2005 and 2006, accounts payable decreased from \$101,262,000 to \$84,849,239. The decrease is due to an increase in contributions made to the University's Retirement System according to GASB Statement No. 27. Non Current Liabilities consist primarily of bonded indebtedness and notes payable. Long-term debt decreased from \$397,835,000 to \$382,261,000 between June 30, 2004 and 2005. The decrease is mainly related to principal payments. Between June 30, 2006 and 2005, long-term debt decreased from \$382,261,000 to \$371,470,852 for the same period as a result, mostly, of the repayment of principal.

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

Table 1 - Net Assets



Invested in Capital Assets	207,167,597
Restricted Nonexpendable	52,247,594
Restricted Expendable	113,179,703
Unrestricted	13,534,265

Net assets invested in capital assets, net of related debt amounting to \$207,167,597 represent the University's capital assets less accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

Restricted nonexpendable net assets, amounting to \$52,247,594, 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





## University of Puerto Rico

### Management's Discussion and Analysis (continued)

from these funds may be expended. Restricted expendable net assets, amounting to \$113,179,703, are subject to externally imposed restrictions governing their use. The funds are restricted primarily for debt service, capital projects, student loans and scholarship purposes.

Unrestricted net assets amounting to \$13,534,265 represent those balances from operational activities that have not been restricted by parties external to the University such as donors or grant agencies.

#### Statement of Revenues, Expenses and Changes in Net Assets

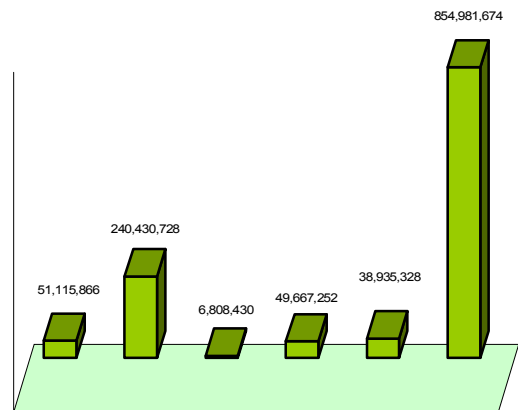
Changes in total University net assets as presented in the statements of net assets are based on the activity presented in the statements of revenues, expenses and changes in net assets. The purpose of these statements are to present the revenues earned by the University, both operating and nonoperating,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

Generally, operating revenues are received for providing goods and services to the various customers and constituencies of the University. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the University. Nonoperating revenues are revenues received for which goods and services are not provided.

Approximately 87% 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, 2006:

Table 2 - Revenues



#### Operating and Nonoperating Revenues

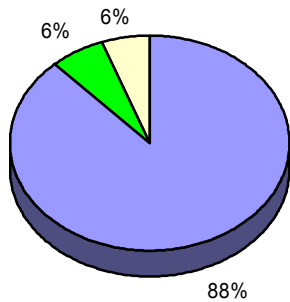
Tuitions & Fees (net of scholarship)	51,115,866
State and Federal Grants & Contracts	240,430,728
Auxiliary Enterprises	6,808,430
Patient services	49,667,252
Other Operating Revenues	38,935,328
State Appropriations	854,981,674



University of Puerto Rico

Management's Discussion and Analysis (continued)

Table 3 - Analysis of Grants Revenues

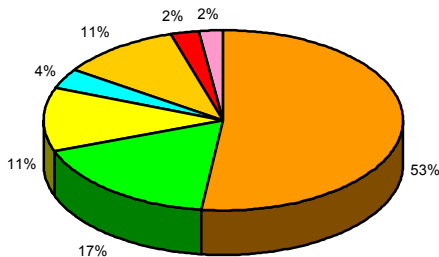


Federal	223,945,058	88%
Commonwealth	16,485,670	6%
Other	14,203,931	6%

University expenses are presented using natural expense classifications. Salaries and benefits represent 70% of the University's operating expenses.

The following illustration presents the major University operating expenses, using natural classification for the year ended June 30, 2006:

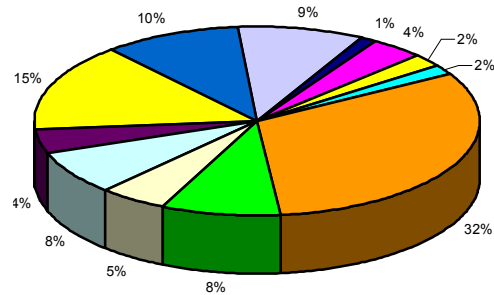
Table 4 - Operating Expenses



Salaries	\$ 621,157,925	53%
Benefits	208,781,874	17%
Scholarship and others services	137,445,350	11%
Utilltes	44,166,848	4%
Supplies and others services	128,758,460	11%
Depreciation	29,216,968	2%
Others Expenditures	26,705,641	2%

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, 2006:

Table 5 - Expenses by Function



Instruction	379,909,491	33%
Research	101,411,128	8%
Public Service	59,597,939	5%
Academic Support	92,307,035	8%
Student Services	46,954,271	4%
Institutional Support	180,047,083	15%
Operation and Maintenance of Plant	121,179,656	10%
Scholarships and Fellowships	109,950,879	9%
Auxiliary Enterprises	10,803,321	1%
Patient service	46,919,022	4%
Depreciation	29,216,968	2%
Other	17,936,273	1%



## University of Puerto Rico

### Management's Discussion and Analysis (continued)

For the year ended June 30, 2006, the University reported an operating loss of (\$790,658,462). After adding nonoperating revenues and expenses, primarily state appropriations, the total increase in net assets for the year amounted to \$78,475,171.

#### Statement 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 resulted 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 decreased from capital and related debt activity 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, 2006 consist mainly of renovation and rehabilitation of existing facilities, restoration of historic buildings, and modifications of existing facilities in light of new technology, educational standards and the requirements of modern building codes.

During fiscal year 2006, the University borrowed \$31,682,605 from the Government Development Bank of Puerto Rico, to finance new construction projects. Debt in the amount of approximately \$19,210,000 was retired during the year.

#### Economic Outlook

The economy of Puerto Rican must be analyzed as a region within the U.S. economy, since it is part of the U.S. monetary and banking system, as well as within its territorial boundaries. The main drive of the Puerto Rican economy is a huge external sector closely tied to the flow of merchandise, tourists, and capital between Puerto Rico and the Mainland. Thus, historically, the real growth rates of the Puerto Rico economy have closely followed those of the U.S. economy. In fiscal year 2006, real GDP of Puerto Rico economy continued to expand at rate of 3.6%. The overall expansion of the economy of Puerto Rico was negatively affected by a decline in the U.S. real GDP growth rate.

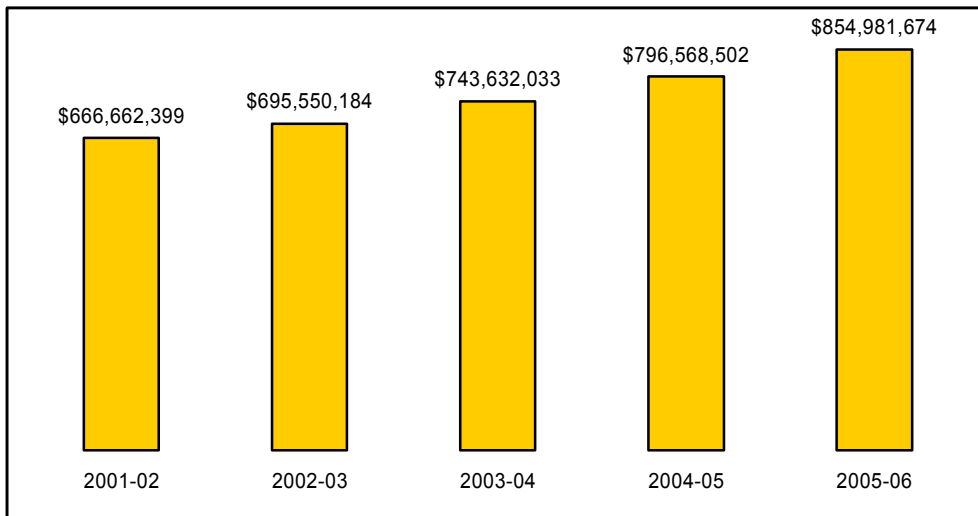


## University of Puerto Rico

### Management's Discussion and Analysis (continued)

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

**Table 6 – Commonwealth appropriations**



The University administration is not aware of any currently known facts, decisions or conditions that are expected to have a significant effect on the University's financial position or results of operation during fiscal year 2006 beyond those unknown variations having a global effect on virtually all types of business operations. While the University's overall financial position is strong, various factors influence the University's ultimate financial success.

#### **Request for Information**

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



University of Puerto Rico

Statements of Net Assets

	June 30	
	2006	2005
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 89,824,861	\$ 34,073,287
Investments at fair value	58,431,799	51,044,877
Investments with bond trustees at fair value	39,116,255	39,093,146
Accounts receivable (less allowances for doubtful accounts of \$112,752,800 and \$96,379,608 for 2006 and 2005, respectively)	144,925,202	142,189,387
Inventories	6,397,837	8,000,211
Prepaid expenses and other assets	2,747,812	2,899,213
Total current assets	<u>341,443,766</u>	<u>277,300,121</u>
Noncurrent assets:		
Restricted cash and cash equivalents	1,299,879	1,498,767
Investments at fair value	50,913,531	44,672,823
Due from Commonwealth of Puerto Rico	56,000,001	71,570,127
Prepaid expenses and other assets	27,023,624	21,321,860
Notes receivable, net	2,468,867	2,478,742
Capital assets (net accumulated depreciation of \$384,397,167 and \$362,900,414 for 2006 and 2005, respectively)	659,326,528	629,903,127
Total noncurrent assets	<u>797,032,430</u>	<u>771,445,446</u>
Total assets	<u>\$ 1,138,476,196</u>	<u>\$ 1,048,745,567</u>
<b>Liabilities</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 84,849,240	\$ 101,261,852
Current portion of long-term debt	90,624,037	63,901,010
Other current liabilities	24,006,108	22,943,548
Total current liabilities	<u>199,479,385</u>	<u>188,106,410</u>
Noncurrent liabilities:		
Long-term debt, net of current portion	371,470,852	382,261,072
Other long-term liabilities	181,396,800	170,724,097
Total noncurrent liabilities	<u>552,867,652</u>	<u>552,985,169</u>
Total liabilities	<u>\$ 752,347,037</u>	<u>\$ 741,091,579</u>

(Continues)



University of Puerto Rico

Statements of Net Assets (continued)

	June 30	
	2006	2005
<b>Net assets</b>		
Invested in capital assets, net of related debt	\$ 207,167,597	\$ 183,741,045
Restricted, nonexpendable		
Scholarship & fellowships	30,028,944	23,837,318
Research	18,541,039	18,546,717
Other	3,677,611	2,926,028
Restricted, expendable		
Research	23,325,933	15,729,216
Loans	7,866,623	7,881,602
Capital projects	35,235,157	5,662,370
Debt service	37,557,804	37,501,622
Other	9,194,186	19,193,212
Unrestricted (deficit)	13,534,265	(7,365,142)
Total net assets	<u>\$ 386,129,159</u>	<u>\$ 307,653,988</u>

*See accompanying notes.*



University of Puerto Rico

Statements of Revenues, Expenses and Changes in Net Assets

	Year ended June 30	
	2006	2005
<b>Revenues</b>		
Operating revenues:		
Tuitions and fees (net of scholarship allowances of \$36,576,974 and \$28,822,302 for 2006 and 2005, respectively)	\$ 51,115,866	\$ 36,951,309
Net hospital patient services and other	49,667,252	43,589,157
Federal grants and contracts	223,945,058	238,302,090
Commonwealth grants and contracts (net of allowance of \$6,423,178 and \$4,893,254 for 2006 and 2005 respectively)	16,485,670	18,968,249
Nongovernmental grants and contracts	14,203,931	10,852,762
Sales and services of educational departments	6,812,491	5,935,971
Auxiliary enterprises (net of scholarship allowances of \$181,659 and \$146,715 for 2006 and 2005, respectively)	6,808,430	6,659,812
Other operating revenues	17,918,906	15,404,037
Total operating revenues	<u>386,957,604</u>	<u>376,663,387</u>
<b>Expenses</b>		
Salaries:		
Faculty	358,229,060	339,512,616
Exempt staff	260,520,104	246,050,912
Nonexempt wages	2,408,761	2,481,087
Benefits	208,781,874	199,435,760
Scholarship and fellowship	137,445,350	151,106,021
Utilities	44,166,848	33,152,547
Supplies and other services	128,758,460	117,982,519
Depreciation	29,216,968	29,353,945
Other expenditures	26,705,641	62,997,277
Total operating expenses	<u>1,196,233,066</u>	<u>1,182,072,684</u>
Operating loss	(809,275,462)	(805,409,297)
<b>Nonoperating revenues (expenses)</b>		
Commonwealth appropriations	854,981,674	796,568,502
Gifts	5,438,676	7,284,899
Net investment income	5,802,197	3,154,496
Interest on indebtedness	(11,813,450)	(14,541,657)
Other nonoperating revenues	19,315,854	1,104,233
Net nonoperating revenues	<u>873,724,951</u>	<u>793,570,473</u>
Income (loss) before additions to term and permanent endowment and capital appropriations	64,449,489	(11,838,824)
Capital appropriations	10,160,608	12,323,593
Additions to term and permanent endowment	3,865,074	6,407,233
Increase in net assets	<u>78,475,171</u>	<u>6,892,002</u>
<b>Net Assets</b>		
Beginning of year	307,653,988	300,761,986
End of year	<u>\$ 386,129,159</u>	<u>\$ 307,653,988</u>

See accompanying notes.



## University of Puerto Rico

### Statements of Cash Flows

	Year ended June 30	
	2006	2005
<b>Cash flows from operating activities</b>		
Tuition and fees	\$ 49,889,882	\$ 37,297,489
Grants and contracts	271,886,732	255,755,608
Patient services	49,667,252	43,589,157
Auxiliary enterprises	6,472,420	6,349,042
Sales and services educational departments	3,666,463	10,203,787
Payments to suppliers and vendors	(133,018,328)	(117,067,834)
Payments to employees	(621,731,261)	(594,941,568)
Payments for utilities	(44,268,477)	(33,424,034)
Payments for benefits	(207,579,734)	(149,236,160)
Payments for scholarships and fellowships	(137,406,365)	(151,084,619)
New loans issued to students	(1,215,509)	(1,513,505)
Student loan repayments	1,225,385	1,558,255
Other payments	51,147,749	(52,896,185)
Net cash used in operating activities	(711,263,790)	(745,410,567)
<b>Cash flows from noncapital financing activities</b>		
Commonwealth appropriations	854,981,674	796,568,502
Endowment gifts	3,865,074	6,407,233
Gifts and grants for other than capital purposes	24,754,529	8,389,133
Net cash provided by noncapital financing activities	883,601,277	811,364,868
<b>Cash flows from capital and related financing activities</b>		
Capital appropriations	10,160,608	12,323,593
Additions of capital assets	(120,766,025)	(86,684,521)
Principal paid on indebtedness	(19,210,000)	(17,485,773)
Interest paid on capital indebtedness	(11,813,450)	(14,541,657)
Deposit with trustee	(23,109)	5,977
Proceeds from capital debt	32,692,605	32,011,113
Net cash used in capital and related financing activities	(108,959,370)	(74,371,268)
<b>Cash flows from investing activities</b>		
Proceeds from sales and maturities of investments	34,860,593	17,050,968
Purchase of investments	(48,488,221)	(33,044,325)
Interest on investments	5,802,197	3,154,496
Net cash used by investing activities	(7,825,431)	(12,838,861)
Net change in cash and cash equivalents	55,552,686	(21,255,828)
Cash and cash equivalents:		
Beginning of period	35,572,054	56,827,882
End of period	\$ 91,124,740	\$ 35,572,054

*Continues)*





## University of Puerto Rico

### Statement of Cash Flows (continued)

	Year ended June 30	
	2006	2005
<b>Reconciliation of operating loss to net cash used in operating activities</b>		
Operating loss	\$ (809,275,462)	\$ (805,409,297)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation expense	29,216,968	29,353,945
Reduction of capital assets	62,125,656	18,759,321
Amortization on bond land premium, discount and future appreciated principal	2,450,202	2,270,359
Changes in assets and liabilities, net:		
Grants and contracts receivables	12,834,310	(29,971,230)
Other receivables		
Prepaid expenses, inventories and other	(3,947,991)	(5,620,747)
Accounts payable and accrued liabilities	(16,402,736)	20,209,330
Accrued salaries and wages and other liabilities	11,735,263	24,997,752
Net cash used in operating activities	<u>\$ (711,263,789)</u>	<u>\$ (745,410,567)</u>

*See accompanying notes.*



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

	<b>June 30</b>	
	<b>2006</b>	<b>2005</b>
<b>Assets</b>		
Current assets:		
Cash	\$ 580,620	\$ 977,009
Patient accounts receivable, net of allowance for doubtful accounts of \$33,333,901 in 2006 and \$29,174,559 in 2005	14,000,380	11,413,732
Estimated third-party payor settlement - Medicare	182,043	-
Accounts receivable - other	1,820,927	188,786
Inventories of supplies	717,755	1,835,051
Prepaid expenses	-	868,524
Total current assets	17,301,725	15,283,102
Property and equipment, net	3,867,915	3,283,246
Total assets	\$ 21,169,640	\$ 18,566,348
 <b>Liabilities and deficiency in unrestricted net assets</b>		
Current liabilities:		
Current portion of long term debt	\$ 15,367,611	\$ 15,367,611
Current portion of capital lease obligations	278,984	278,984
Accounts payable	19,467,543	18,855,816
Accrued interest	3,681,155	2,762,252
Estimated third-party payor settlements-medicare	1,825,260	1,454,393
Accrued payroll taxes and employee benefits	1,128,678	1,512,775
Accrued expenses	2,058,496	4,338,471
Total current liabilities	43,807,727	44,570,302
Long-term debt, net of current portion	1,632,389	1,632,389
Due to related party	31,372,171	23,789,095
Total liabilities	76,812,287	69,991,786
Deficiency in unrestricted net assets	(55,642,647)	(51,425,438)
Total liabilities and deficiency in unrestricted net assets	\$ 21,169,640	\$ 18,566,348

*See accompanying notes.*



**Discretely Presented Component Unit  
Servicios Médicos Universitarios, Inc.**

**Statements of Operations and Deficiency in Unrestricted Net Assets**

	Year ended June 30	
	2006	2005
<b>Unrestricted revenues and other support</b>		
Net patient service revenue	\$ 37,319,625	\$ 37,700,670
Other revenue	1,671,181	1,445,330
Total revenues and other support	38,990,806	39,146,000
<b>Expenses</b>		
Salaries and benefits	18,549,982	17,222,514
Contracted services	2,229,824	2,378,480
Professional services	1,135,842	964,299
Supplies	12,574,931	12,029,608
Utilities	2,194,597	1,664,010
Interest	1,200,213	977,478
Provision for bad debts	5,290,454	6,292,064
Depreciation and amortization	757,957	586,230
Other	2,143,487	2,409,233
Total expenses	46,077,287	44,523,916
Excess of expenses over revenue before extraordinary gain	(7,086,481)	(5,377,916)
Extraordinary gain	2,869,272	-
Deficiency in unrestricted net assets, at beginning of year	(51,425,438)	(46,047,522)
Deficiency in unrestricted net assets, at end of year	\$ (55,642,647)	\$ (51,425,438)

*See accompanying notes.*



**Discretely Presented Component Unit**  
**Servicios Médicos Universitarios, Inc.**  
**Statements of Cash Flows**

	<b>Year ended June 30</b>	
	<b>2006</b>	<b>2005</b>
<b>Cash flows from operating activities:</b>		
Change in unrestricted net assets	\$ (4,217,209)	\$ (5,377,916)
Adjustments to reconcile change in unrestricted net assets to net cash (used in) operating activities:		
Depreciation and amortization	757,957	586,230
Provision for bad debts	5,290,454	6,292,064
Extraordinary gain	(2,869,272)	-
(Increase) in patient accounts receivable	(7,877,102)	(7,237,442)
Decrease (increase) in inventory of supplies	14,124	(299,598)
Decrease in prepaid expenses	150,769	8,709
Decrease (increase) in accounts receivable-other	6,743	(44,972)
Increase in accounts payable	611,726	1,983,080
Increase in estimated third-party payor settlements-Medicare	370,867	1,864,741
Increase in accrued expenses, payroll taxes and employee benefits	205,200	6,887
Increase in accrued interest	918,903	850,000
Total adjustments	<u>(2,419,631)</u>	<u>4,009,699</u>
Net cash (used) in operating activities	<u>(6,636,840)</u>	<u>(1,368,217)</u>
<b>Cash flows from investing activities:</b>		
Purchase of property and equipment	(1,342,625)	(1,317,631)
<b>Cash flows from financing activities:</b>		
Payments on long-term debt and capital lease obligations	-	(91,093)
Net advances from University of Puerto Rico and other related parties	7,583,076	2,919,023
Net cash provided by financing activities	<u>7,583,076</u>	<u>2,827,930</u>
Net (decrease) increase in cash	<u>(396,389)</u>	<u>142,082</u>
Cash and cash equivalents, at beginning of year	977,009	834,927
Cash and cash equivalents, at end of year	<u>\$ 580,620</u>	<u>\$ 977,009</u>
<b>Supplemental disclosures of cash flows information</b>		
Cash paid for interest	<u>\$ 116,693</u>	<u>\$ 40,916</u>

*See accompanying notes.*



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

	Year ended March 31	
	2006	2005
<b>Assets</b>		
Current assets:		
Cash	\$ 2,433,407	\$ 202,802
Restricted funds held by trustee	14,466,518	25,695,460
Project in process	94,383,247	80,755,423
Bond issuance costs, net of accumulated amortization of \$371,161 and \$290,391	2,418,063	2,498,833
Prepaid expenses	94,992	5,275
Total assets	\$ 113,796,227	\$ 109,157,793
 <b>Liabilities and deficiency in fund balance</b>		
Liabilities:		
Construction contract, project management fee and other payables, including retainage of \$2,154,231 and \$2,451,894	\$ 3,244,985	\$ 3,077,199
Accrued interest payable	1,083,933	1,097,533
Accrued expenses	404,636	111,964
Unearned revenue	25,598,183	19,896,569
Bonds payable, net of discount of \$343,692 and \$368,015	83,736,308	85,071,985
Total liabilities	114,068,045	109,255,250
 Deficiency in fund balance	(271,818)	(97,457)
Total liabilities and deficiency in fund balance	\$ 113,796,227	\$ 109,157,793

*See accompanying notes.*



**Discretely Presented Component Unit**  
**Desarrollos Universitarios, Inc.**  
**(A Not - for - Profit Organization)**  
**Statements of Operations and Deficiency in Fund Balance**

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	<b>Year ended March 31</b>	
	<b>2006</b>	<b>2005</b>
Expenses:		
General and administrative	\$ (174,361)	\$ (27,820)
Total expenses and excess of expenses over revenues	(174,361)	(27,820)
Deficiency in Fund Balance, beginning of year	(97,457)	(69,637)
Deficiency in Fund Balance, end of year	\$ (271,818)	\$ (97,457)

*See accompanying notes.*



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

	Year ended March 31	
	2006	2005
<b>Cash flows from operating activities</b>		
Excess of expenses over revenues	\$ (174,361)	\$ (27,820)
Adjustments to reconcile excess of expenses over revenues to net cash used in operating activities:		
Bond discount amortization	24,323	26,076
Amortization of bond issuance cost	80,770	79,979
Changes in operating assets and liabilities:		
Increase in project in process	(13,627,824)	(9,789,459)
Increase in prepaid expenses	(89,717)	(165)
Increase (decrease) in construction contract, project management fee and other payables	167,786	(710,362)
Decrease in accrued interest payable	(13,600)	(16,189)
Increase (decrease) in accrued expenses	292,672	(3,912)
Increase in unearned revenue	5,701,614	5,226,007
Net cash used in operating activities	<u>(7,638,337)</u>	<u>(5,215,845)</u>
<b>Cash flows from investing activities</b>		
Net proceeds from release of restricted funds held by trustee	11,228,942	6,635,841
<b>Cash flows from financing activities</b>		
Principal payments on bonds payable	<u>(1,360,000)</u>	<u>(1,295,000)</u>
Net change in cash	2,230,605	124,996
Cash, beginning of year	202,802	77,805
Cash, end of year	<u>\$ 2,433,407</u>	<u>\$ 202,801</u>

*See accompanying notes.*



**University of Puerto Rico**  
**Notes to Financial Statements**

**June 30, 2006**

**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 campus at Río Piedras, Mayagüez, Medical Sciences, Cayey, Humacao, Ponce, Bayamón, Aguadilla, Arecibo, Carolina and Utuado, and the Central Administration.

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

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

**Servicios Médicos Universitarios, Inc.**

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





## University of Puerto Rico

### Notes to Financial Statements (continued)

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

##### Desarrollos Universitarios, Inc.

Desarrollos Universitarios, Inc. (the Company) is legally separated entity from the University and is governed by a separate board. The Company was organized on January 22, 1997, under the laws of the Commonwealth of Puerto Rico, as a not-for-profit organization. The Company was organized to develop, construct, and operate academic, residential, administrative, office, commercial, and maintenance facilities for the use of students and other persons or entities conducting business with the University of Puerto Rico (the University). Currently, the Company is in the process of developing the Plaza Universitaria (Plaza Universitaria) and the Central Air Condition System projects (the Projects), to be leased to the University. Plaza Universitaria will consist of a student housing facility, a multi-story parking building and an institutions building to house administrative, student service and support functions and to a lesser extent to lease commercial space. The financing for the Projects is being provided by the issuance of \$86,735,000 in Educational Facilities Revenue Bonds through the Puerto Rico Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority (AFICA) on December 20, 2000. The Company is fiscally dependent on the University. Complete financial statement 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.



## University of Puerto Rico

### Notes to Financial Statements (continued)

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

##### C. Reclassification

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

##### D. Cash Equivalents

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

##### E. Investments

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

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

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

Restricted funds of Desarrollos Universitarios, Inc. held by trustee at March 31, 2006 and 2005 consist of money market funds and zero coupon bonds purchased with remaining maturities of six months or less.

##### G. Capital Assets

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

##### H. Inventories

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



## University of Puerto Rico

### Notes to Financial Statements (continued)

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

##### I. Classification of Net Assets

The University's net assets are classified as follows:

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

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

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

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

##### J. Scholarship Allowances and Student Financial Aid

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



## University of Puerto Rico

### Notes to Financial Statements (continued)

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

##### K. Bond Premium/Discount and Deferred Issuance Costs

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

##### L. Deferred Compensation Plan

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

##### M. Compensated Absences

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

Employees accumulate sick leave generally at a rate of 1.5 days per month up to a maximum of 90 days. The University pays, annually, the excess of 90 days of accumulated sick leave to the employees. Upon retirement, an employee receives compensation for all accumulated unpaid sick leave at the then current rate, provided the employee has at least 10 years of service with the University. During the years ended June 30, 2006 and 2005, the cost of the excess of 90 days of the accumulated sick leave was \$9,343,356 and \$8,664,000, respectively.



## University of Puerto Rico

### Notes to Financial Statements (continued)

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

##### O. Classification of Revenues

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

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

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

##### P. Gifts and Pledges

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

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



## University of Puerto Rico

### Notes to Financial Statements (continued)

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

##### Q. Grants and Contracts

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

##### 2. Deposits

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

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

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

As of June 30, 2006 and 2005, the carrying value of cash and cash equivalents amounted to approximately \$91,124,740 and \$35,572,000 respectively, and the cash deposited in the banks amounted to \$46,923,165 and \$70,938,000 respectively.



## University of Puerto Rico

### Notes to Financial Statements (continued)

### 3. Investments

The University's investments held at June 30, 2006 and 2005 are summarized in the following table:

	<b>2006</b>	<b>2005</b>
Certificates of deposit	\$ 7,334,530	\$ 7,457,224
Government agency securities	57,482,454	56,456,176
Corporate bonds and preferred stock	14,859,225	11,104,374
Common stock and convertibles	16,789,941	14,217,772
Mutual Bond Funds	51,995,435	45,575,300
	\$ 148,461,585	\$ 134,810,846

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

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

### Credit Risk

Issuer credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. As of June 30, 2006, the University's credit quality distribution for securities was as follows:

	<b>Carrying Value</b>	<b>Quality Rating</b>		
		<b>AAA-A</b>	<b>Unrated</b>	<b>No Risk</b>
Government agency securities	\$ 57,482,454	\$ -	\$ -	\$ 57,482,454
Corporate Bonds and preferred stocks	14,859,225	14,859,226	-	-
Common Stocks and Convertibles	16,789,941	16,789,941	-	-
Mutual Bond Funds	51,995,435	-	51,995,435	-
	\$ 141,127,055	\$ 31,649,167	\$ 51,995,435	\$ 57,482,454



**University of Puerto Rico**

**Notes to Financial Statements (continued)**

**3. Investments (continued)**

**Interest Rate Risk**

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value is to changes to market interest rates. As of June 30, 2006, the weighted average maturity by investment type in each fund follows:

Investments as of June 30 consist of the following:

<u>Investment Type</u>	<u>Maturities</u>	<u>Amount</u>
Corporate Bonds	June 2010 - May 2040	\$ 1,490,259
Corporate Bonds	August 2009 - July 2032	129,164
Corporate Bonds	July 2009 - March 2033	346,411
Corporate Bonds	October 2006 - May 2033	1,120,209
Corporate Bonds	October 2006 - May 2033	5,660,624
Corporate Bonds	July 2008 - May 2033	6,095,331
Corporate Bonds	March 2012 - October 2030	17,228
		<u>\$ 14,859,226</u>

**4. Accounts Receivable**

Accounts receivable as of June 30 are as follows:

	<u>2006</u>	<u>2005</u>
Commonwealth of Puerto Rico appropriations grants and contracts	\$ 102,699,218	\$ 72,747,663
Other government agencies	15,213,636	15,761,100
Due from Federal government	28,415,065	40,857,570
Due from medical plans	52,613,163	45,203,075
Due from Servicios Médicos Universitarios, Inc	31,246,756	24,646,756
Other	27,490,164	39,352,831
	<u>257,678,002</u>	<u>238,568,995</u>
Less allowance for doubtful accounts	(112,752,800)	(96,379,608)
Accounts receivable, net	<u>\$ 144,925,202</u>	<u>\$ 142,189,387</u>





## University of Puerto Rico

### Notes to Financial Statements (continued)

#### 4. Accounts Receivable (continued)

On September 7, 2004, the legislature of Puerto Rico approved a resolution to pay \$94,710,382 to the University on behalf of the Puerto Rico Department of Health and the Commonwealth of Puerto Rico, over the course of ten years. As of June 30, 2006 the University has received \$23,140,254 from this amount. The remaining balance is going to be received as follows:

Fiscal Year	Amount
2006-2007	\$ 15,570,127
2007-2008	15,570,127
2008-2009	7,570,127
2009-2010	7,570,127
2010-2011	7,570,127
2011-2012	8,000,000
2012-2013	8,000,000
2013-2014	1,719,493
	\$ 71,570,128

#### 5. Capital Assets

Changes in capital assets for the year ended June 30, 2006 and 2005 are as follows:

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



University of Puerto Rico

Notes to Financial Statements (continued)

5. Capital Assets (continued)

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

Project in Process – Discretely Presented Component Unit

Project in process of Desarrollos Universitarios, Inc. at March 31, 2006 and 2005 consist of:

	2006	2005
Construction, professional services and project management	\$ 81,537,381	\$ 71,492,429
Interest capitalized, net of interest and dividends earned from restricted funds of \$9,945,138 and \$9,122,543	12,845,866	9,262,994
Total	<u>\$ 94,383,247</u>	<u>\$ 80,755,423</u>



## University of Puerto Rico

### Notes to Financial Statements (continued)

#### 6. Lines of Credit

As of June 30, 2006, the University has available two lines of credits agreements with GDB for the total authorized amounts of \$100,000,000 and \$60,000,000. Advances under these agreements, which bear variable interest rates and are payable in a monthly and annual basis, respectively, amounted to \$75,407,134 and \$8,779,687 at June 30, 2006. The line of credit of \$60,000,000 is guaranteed by the Commonwealth of Puerto Rico.

#### 7. Noncurrent Liabilities

Changes in noncurrent liabilities for the year ended June 30, 2006 and 2005 are as follows:

2006							
	Beginning Balance	Additions	Reductions	Other	Ending Balance	Less Due Within One Year	Noncurrent Liabilities
Long-term debt							
Notes payable	\$ 47,962,569	\$ 31,682,605	\$ -	\$ -	\$ 79,645,174	\$ 71,414,037	\$ 8,231,137
Bonds payable	398,199,513	1,010,000	(19,210,000)	2,450,202	382,449,715	19,210,000	363,239,715
<b>Total long-term</b>	<b>\$ 446,162,082</b>	<b>\$ 32,692,605</b>	<b>\$ (19,210,000)</b>	<b>\$ 2,450,202</b>	<b>\$ 462,094,889</b>	<b>\$ 90,624,037</b>	<b>\$ 371,470,852</b>
Other long-term liabilities							
Deferred compensation payable	\$ 45,575,300	\$ 6,420,135	\$ -	\$ -	\$ 51,995,435	\$ -	\$ 51,995,435
Claims liability	20,260,000	-	(1,927,700)	-	18,332,300	1,500,000	16,832,300
Compensated absences	127,832,345	7,242,828	-	-	135,075,173	22,506,108	112,569,065
<b>Total other long-term liabilities</b>	<b>\$ 193,667,645</b>	<b>\$ 13,662,963</b>	<b>\$ (1,927,700)</b>	<b>\$ -</b>	<b>\$ 205,402,908</b>	<b>\$ 24,006,108</b>	<b>\$ 181,396,800</b>
2005							
	Beginning Balance	Additions	Reductions	Other	Ending Balance	Less Due Within One Year	Noncurrent Liabilities
Long-term debt							
Notes payable	\$ 16,182,229	\$ 32,011,113	\$ (230,773)	\$ -	\$ 47,962,569	\$ 45,701,010	\$ 2,261,559
Bonds payable	413,184,154	-	(17,255,000)	2,270,359	398,199,513	18,200,000	379,999,513
<b>Total long-term</b>	<b>\$ 429,366,383</b>	<b>\$ 32,011,113</b>	<b>\$ (17,485,773)</b>	<b>\$ 2,270,359</b>	<b>\$ 446,162,082</b>	<b>\$ 63,901,010</b>	<b>\$ 382,261,072</b>
Other long-term liabilities							
Deferred compensation payable	\$ 39,646,387	\$ 5,928,913	\$ -	\$ -	\$ 45,575,300	\$ -	\$ 45,575,300
Claims liability	13,598,042	7,000,000	(338,042)	-	20,260,000	2,000,000	18,260,000
Compensated absences	115,425,464	12,406,881	-	-	127,832,345	20,943,548	106,888,797
<b>Total other long-term liabilities</b>	<b>\$ 168,669,893</b>	<b>\$ 25,335,794</b>	<b>\$ (338,042)</b>	<b>\$ -</b>	<b>\$ 193,667,645</b>	<b>\$ 22,943,548</b>	<b>\$ 170,724,097</b>

Bonds payable are further disclosed in Note 8.



**University of Puerto Rico**

**Notes to Financial Statements (continued)**

**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, 2006:

<u>Series</u>	<u>Balance as of June 30, 2006</u>	<u>Annual Interest Rate (%)</u>	<u>Due Date</u>
C - Serial	\$ 789,000	3.00%	1972-2011
D - Serial	1,023,000	3.75%	1972-2011
F - Term	11,125,000	5.50%	2012
M - Serial	14,075,000	4.35-5.45%	1996-2009
M - Term	127,215,000	5.25-5.45%	2015-2025
N - Serial	19,110,000	4.35-5.45%	1996-2008
N - Capital Appreciation Serial Bonds	51,980,000	5.6-5.75%	2009-2013
O - Serial	77,220,000	4.5-3.75%	2001-2020
O - Term	101,905,000	5.38%	2030
	<u>404,442,000</u>		
Less unamortized bond discount	(10,341,401)		
	962,066		
Plus unaccreted premium	962,066		
Less future appreciated principal	(12,612,950)		
	<u>\$ 382,449,715</u>		

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

**B. Debt Service Requirement**

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 19,210,000	\$ 18,854,332	\$ 38,064,332
2008	20,280,000	17,784,858	38,064,858
2009	21,932,753	22,294,200	44,226,953
2010	22,196,314	22,028,891	44,225,205
2011	22,511,720	21,726,535	44,238,255
2012 to 2016	84,346,213	80,399,433	164,745,646
2017 to 2021	77,805,000	49,249,575	127,054,575
2022 to 2026	88,920,000	26,172,079	115,092,079
2027 to 2030	47,240,000	6,514,000	53,754,000
	<u>\$ 404,442,000</u>	<u>\$ 265,023,903</u>	<u>\$ 669,465,903</u>



## University of Puerto Rico

### Notes to Financial Statements (continued)

#### 8. Bonds Payable (continued)

##### C. Pledged Revenues

The bonds are general obligations of the University and are collateralized by the pledge of, and a first charge on, all revenues derived or to be derived by the University, except for appropriations and contributions, as defined in the Trust Agreement governing the bonds issued. In the event that the pledged revenues are insufficient to pay the principal of and the interest on, the bonds, the University agrees to provide any additional required monies from other funds available to the University for such purposes, including funds appropriated by the Commonwealth of Puerto Rico. The revenues pledged were as follows for the years ended June 30, 2006 and 2005:

<b>Pledged Revenues:</b>	<b>2006</b>	<b>2005</b>
Tuition and other fees collected	\$ 73,478,387	\$ 53,791,456
Student fees collected	6,458,828	5,024,000
Rental and other charges received for the right of use and occupancy of the facilities in the University system	1,292,336	1,142,215
Bookstore receipts (gross sales less cost of books and supplies sold)	1,039,252	720,050
Interest on investment of University funds, excluding funds invested pursuant to Article VI of the Trust Agreement	2,794,159	957,054
Funds paid to the University in respect to overhead allowance on federal research projects	15,271,829	16,732,754
Other income	28,234,976	28,606,408
	<u>\$ 128,569,767</u>	<u>\$ 106,973,937</u>

Interest earned on investments in the sinking fund reserve account amounted to approximately \$1,239,134 and \$846,000 for the years ended June 30, 2006 and 2005, 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:



## University of Puerto Rico

### Notes to Financial Statements (continued)

#### 8. Bonds Payable (continued)

##### C. Pledged Revenues (continued)

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

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

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

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

##### D. Bonds Arbitrage

During fiscal year 2006 the Government Development Bank performed an arbitrage test. The preliminary results of the test showed a negative arbitrage.

##### E. Bonds Payable – Discretely Presented Component Unit

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



University of Puerto Rico

Notes to Financial Statements (continued)

8. Bonds Payable (continued)

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

Bonds payable at March 31, 2006 and 2005 consist of:

Description	Interest Rate	Maturity	2006	2005
			Face Amount	Face Amount
Serial Bonds	4.00%	July 1, 2005	\$ -	\$ 1,360,000
Serial Bonds	5.00%	July 1, 2006	1,415,000	1,415,000
Serial Bonds	4.00%	July 1, 2007	1,485,000	1,485,000
Serial Bonds	5.00%	July 1, 2008	1,545,000	1,545,000
Serial Bonds	4.13%	July 1, 2009	1,620,000	1,620,000
Serial Bonds	4.25%	July 1, 2010	1,685,000	1,685,000
Serial Bonds	5.63%	July 1, 2011	1,760,000	1,760,000
Serial Bonds	5.63%	July 1, 2012	1,860,000	1,860,000
Serial Bonds	5.63%	July 1, 2013	1,960,000	1,960,000
Serial Bonds	5.63%	July 1, 2014	2,075,000	2,075,000
Serial Bonds	5.63%	July 1, 2015	2,190,000	2,190,000
Serial Bonds	5.63%	July 1, 2016	2,315,000	2,315,000
Serial Bonds	5.63%	July 1, 2017	2,445,000	2,445,000
Serial Bonds	5.63%	July 1, 2018	2,580,000	2,580,000
Serial Bonds	5.63%	July 1, 2019	2,725,000	2,725,000
Serial Bonds	5.00%	July 1, 2020	2,880,000	2,880,000
Serial Bonds	5.00%	July 1, 2021	3,020,000	3,020,000
Serial Bonds	5.00%	July 1, 2033	50,520,000	50,520,000
			<u>\$ 84,080,000</u>	<u>\$ 85,440,000</u>



University of Puerto Rico

Notes to Financial Statements (continued)

**8. Bonds Payable (continued)**

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

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

<b>Redemption Period</b>	<b>Amount</b>
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
	<u>\$ 50,520,000</u>





## University of Puerto Rico

### Notes to Financial Statements (continued)

#### 9. Commitments and Contingent Liabilities

##### A. Insurance

The University is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Through January 1993 the University was insured under claims-made insurance policies with respect to medical malpractice risks for \$250,000 per occurrence up to an annual aggregate of \$500,000. Subsequent to such date, the University was unable to obtain insurance at a cost it considered to be economically justifiable, consequently, the University is now self-insured for such risks. Under Law Number 98 of August 24, 1994, the responsibility of the University is limited to a maximum amount of \$75,000 per person, or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Self-insured risk liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend upon such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liabilities does not necessarily result in an exact amount. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. Changes in the claims liability amount in fiscal years 2006 and 2005 were:

	<u>2006</u>	<u>2005</u>
Claims payable - July 1	\$ 20,260,000	\$ 13,598,042
Incurred claims and changes in estimates	27,377,998	27,298,905
Payments for claims and adjustments expenses	(29,305,698)	(20,636,947)
Claims payable - June 30	<u>\$ 18,332,300</u>	<u>\$ 20,260,000</u>

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.



## University of Puerto Rico

### Notes to Financial Statements (continued)

#### 9. Commitments and Contingent Liabilities (continued)

##### C. Discretely Presented Component Units

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

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

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

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

	<u>Amount</u>
2007	\$ 15,367,611
2008	-
2009	-
2010	-
2011	-
Thereafter	1,632,389
	<u>\$ 17,000,000</u>

Total interest charged to operations was approximately \$29,500 and \$30,000 in 2006 and 2005, respectively.



## University of Puerto Rico

### Notes to Financial Statements (continued)

#### 9. Commitments and Contingent Liabilities (continued)

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

**Desarrollos Universitarios, Inc.** (the Company) was incorporated on January 22, 1997. The Company is a non-for-profit corporation, with the sole purpose of developing, constructing and operating academic, residential, administrative, office, commercial and maintenance facilities (Plaza Universitaria) for use by students, faculty members, administrators, employees, visitors, invitees, and other members of or persons and entities related to or conducting business with the University community, or other activities conducted in such facility.

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

On December 21, 2000, the University entered into a lease agreement with the Company in which the University agreed to pay directly to a trustee for the account of the Company, the basic lease payments (denominated into components of principal and interest) on or before the twenty-fifth (25) day of each month. As of June 30, 2006 and 2005, the University had paid in advance a total of \$ and \$ respectively, for these purposes and such amounts have been recorded in the accompanying statements of net assets as prepaid expenses and other assets.



## University of Puerto Rico

### Notes to Financial Statements (continued)

#### 9. Commitments and Contingent Liabilities (continued)

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

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

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

#### 10. Nonoperating Revenue – Interest Rate Lock Transaction

On November 2005 the University entered into two interest rate lock agreements for the purpose of refinancing its outstanding debt and issue new bonds for its capital improvement plan. On May 2006, as per recommendation of its fiscal agent, the Governmental Development Bank of Puerto Rico, the University cancelled these agreements. The University received \$18.6 million as the result of these cancellations.

Such amount was recorded as nonoperating income in the statement of revenues, expenses and changes in net assets.

#### 11. University of Puerto Rico Retirement System

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

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



**University of Puerto Rico**

**Notes to Financial Statements (continued)**

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

Effective July 1, 2005, 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	\$56,160,455
Contributions made	\$85,054,416
Actuarial valuation date	6/30/2006
Actuarial cost method	Entry age
Amortization method	Level percentage of payroll
Remaining amortization period	30 years
Asset valuation method	5-year smoothed market
Actuarial assumptions:	
Investment rate of return*	8.0%
Projected salary increases*	5%
*Includes inflation at	3.50%
Postretirement benefit increases	3% every two (2) years

	<b>Year Ending</b>	<b>Annual Pension Cost (APC)</b>	<b>Percentage of APC Contributed</b>	<b>Net Pension Obligation</b>
Employees	6/30/2004	\$70,244,303	87.4%	\$ 8,931,954
Retirement plan	6/30/2005	\$84,657,964	81.8%	\$24,298,553
	6/30/2006	\$56,160,455	133%	\$ 6,806,925



## University of Puerto Rico

### Notes to Financial Statements (continued)

#### 12. Post-Retirement Benefits

In addition to the pension benefits described in Note 11, the University provides post-retirement health care benefits for its retired employees. Substantially all of the employees may become eligible for this benefit if they reach normal retirement age while working for the University. Health care benefits are provided through insurance companies whose premiums are paid by the retiree and by the University up to maximum of \$125 per month for each retiree. The cost of providing such benefits are recognized when paid. During the years ended June 30, 2006, the payments of health care benefits amounted to \$7,759,401.

#### 13. Going Concern - Discretely Presented Component Unit

Since the Hospital commenced operations, it has experienced significant operating losses having an accumulated net assets deficiency of approximately \$58,511,900 at June 30, 2006. The Hospital has received advances from the University to cover its cash needs from operations. Most of these accumulated losses are mainly related to the fact that, as a former public hospital operated by the Department of Health, it provides a significant amount of services to indigent population for which the Hospital does not obtain a payment. Most of these patients are indigent persons not subscribed to the Health Reform Program are aliens without medical insurance coverage, among others. The medical services provided to these persons were supposed to be paid to the Hospital by the Puerto Rico Department of Health. However, since the beginning of the operations of the Hospital, the Department of Health has been unable to pay for such services. As shown in the accompanying financial statements, the Hospital has accumulated losses for uncollectible accounts receivable in the approximate amount of \$33,333,901.

The Hospital's management believes that all these factors had a material impact in the Hospital's results of operations during its years of operations and consequently in the accumulated deficit at June 30, 2006.

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.



## University of Puerto Rico

### Notes to Financial Statements (continued)

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

- Revaluation of the contract agreements with the anesthesiologists and radiologists, to share the costs of those services.
- More aggressive negotiation with medical insurance to increase the per diem rates.

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

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

#### 14. Functional Information

The University's operating expenses by functional classification during the years ended June 30 2006 and 2005 were as follows:

2006							
Functional classification	Salaries and benefits	Supplies and other services	Scholarship and fellowship	Utilities	Depreciation	Other Expenditures	Total
Instruction	\$ 349,135,141	\$ 17,398,624	\$ 11,766,910	\$ 1,242,283	\$ -	\$ 366,534	\$ 379,909,491
Research	65,931,577	20,600,117	9,640,336	1,088,837	-	4,150,261	101,411,128
Public service	46,091,816	10,280,808	2,718,761	392,811	-	113,743	59,597,939
Academic support	72,406,400	15,577,465	4,103,987	178,180	-	41,003	92,307,035
Student service	38,224,811	7,877,351	800,066	3,033	-	49,010	46,954,271
Institutional support	137,387,606	33,821,148	480,933	4,403,522	-	3,953,874	180,047,083
Oper & Maintenance	69,969,838	14,679,025	20,959	36,380,394	-	129,441	121,179,656
Student Aid	1,694,176	641,111	107,615,009	583	-	-	109,950,879
Independent Operation	-	58,206	-	-	-	-	58,206
Patient Service	44,117,250	2,487,040	221,631	93,088	-	13	46,919,022
Auxiliary Enterprises	4,981,184	5,337,565	76,758	384,118	-	23,695	10,803,321
Depreciation	-	-	-	-	29,216,968	-	29,216,968
Other	-	-	-	-	-	17,878,067	17,878,067
	\$ 829,939,799	\$ 128,758,460	\$ 137,445,350	\$ 44,166,848	\$ 29,216,968	\$ 26,705,641	\$ 1,196,233,066



University of Puerto Rico

Notes to Financial Statements (continued)

14. Functional Information (continued)

2005

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

15. Significant New Accounting Pronouncements

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

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

- Governments that were phase 1 governments for the purpose of implementation of Statement 34—those with annual revenues of \$100 million or more—are required to implement this Statement in financial statements for periods beginning after December 15, 2006.
- Governments that were phase 2 governments for the purpose of implementation of Statement 34—those with total annual revenues of \$10 million or more but less than \$100 million—are required to implement this Statement in financial statements for periods beginning after December 15, 2007.





## University of Puerto Rico

### Notes to Financial Statements (continued)

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

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

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

The University is currently evaluating the impact of this statement.

#### 16. Subsequent Event

On December 13, 2006 the University issued \$546,500,000 in bonds payable, consisting of Series P for \$286,505,000 and the Series Q for \$259,645,000. The proceeds from series P were use principally for the refinancing of portions of previously issued Series M and Series O. The proceeds of Series Q were used principally for the payment of amount owed on Line of Credit with the Governmental Development Bank of Puerto Rico and provide funds to the capital improvement program of the University.

## Required Supplementary Information



**University of Puerto Rico**  
**Schedule of Funding Progress**

**Employees Retirement Plan**

<b>Actuarial Valuation Date</b>	<b>Actuarial Value of Assets (a)</b>	<b>Actuarial Accrued Liability (AAL) – Entry Age (b)</b>	<b>Excess of Assets over AAL (b – a)</b>	<b>Funded Ratio (a / b)</b>	<b>Covered Payroll (c)</b>	<b>Excess as a Percentage of Covered ((b – a) / c)</b>
6/30/2004	\$803,498,000	\$1,748,529,453	\$ 945,031,453	46%	\$431,942,112	218.8%
6/30/2005	\$820,501,000	\$1,848,175,710	\$1,027,674,710	44.4%	\$460,956,060	222.9%
6/30/2006	\$869,211,000	\$1,930,131,983	\$1,060,920,983	45%	\$484,886,628	218.8%

## Other Financial Information



## University of Puerto Rico

### Schedules of Changes in Sinking Fund Reserve

	<u>2006</u>			<u>2005</u>		
	Bond Service Account	Bond Reserve Account	Total	Bond Service Account	Bond Reserve Account	Total
<b>Additions:</b>						
Transfer from Reserve Account	\$ 1,422,983	\$ -	\$ 1,422,983	\$ 4,834,555	\$ -	\$ 4,834,555
Transfer from unrestricted current funds	36,280,868	-	36,280,868	33,039,508	1,677,432	34,716,940
Net increase in fair market value of investments	22,995	577,364	600,359	47,519	41,939	89,458
Interest Earned on Investments	336,180	902,954	1,239,134	148,874	697,944	846,818
Total receipts	<u>38,063,026</u>	<u>1,480,318</u>	<u>39,543,344</u>	<u>38,070,456</u>	<u>2,417,315</u>	<u>40,487,771</u>
<b>Deductions:</b>						
Payments of bond interest	19,864,180	-	19,864,180	20,815,446	-	20,815,446
Payments of bond principal	18,200,000	-	18,200,000	17,255,000	-	17,255,000
Transfer to Reserve Account	-	1,422,983	1,422,983	-	4,834,555	4,834,555
Total disbursements	<u>38,064,180</u>	<u>1,422,983</u>	<u>39,487,163</u>	<u>38,070,446</u>	<u>4,834,555</u>	<u>42,905,001</u>
Net increase/(decrease) for the year	(1,154)	57,335	56,181	10	(2,417,240)	(2,417,230)
Balances at beginning of year	-	39,155,778	39,155,778	-	41,573,018	41,573,018
Balance at end of year	<u>\$ (1,154)</u>	<u>\$ 39,213,113</u>	<u>\$ 39,211,959</u>	<u>\$ 10</u>	<u>\$ 39,155,778</u>	<u>\$ 39,155,788</u>

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

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, 2006, and have issued our report thereon dated October 31, 2006. Our report was modified to include a reference to other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of the discretely presented component units, as described in our report on the University's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported separately by those auditors.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness, based on auditing standards generally accepted in the United States as established by the American Institute of Certified Public Accountants, is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control and its operation that we consider to be a material weakness. We noted certain matters that we reported to management of the University in a separate letter dated October 31, 2006.

Compliance

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the University in a separate letter dated October 31, 2006.

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

*Ernst & Young LLP*

October 31, 2006

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original of  
this report.