

FINANCIAL STATEMENTS, REQUIRED
SUPPLEMENTARY INFORMATION AND
SUPPLEMENTAL SCHEDULES

University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Years Ended June 30, 2012 and 2011
With Report of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

University of Puerto Rico

(A Component Unit of the Commonwealth of Puerto Rico)

Financial Statements, Required Supplementary Information and Supplemental Schedules

Years Ended June 30, 2012 and 2011

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Report of Independent Auditors

Board of Trustees
University of Puerto Rico

We have audited the accompanying basic financial statements of the business-type activities and the aggregate discretely presented component units of the University of Puerto Rico (the University), a component unit of the Commonwealth of Puerto Rico, as of and for the years ended June 30, 2012 and 2011, 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 then ended June 30, 2012 and 2011. These financial statements were audited by other auditors whose reports thereon have been furnished to us. Our opinion insofar as it relates to amounts included for the Hospital and the Company, is solely based on the reports of the other auditors.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Puerto Rico as of June 30, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 22, 2013, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States require that the management's discussion and analysis on pages 3 through 25 and the schedule of funding progress on page 73 be presented to supplement the basic financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the University's basic financial statements. The other financial information, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and accordingly, we do not express an opinion or provide any assurance on it.

Ernst & Young LLP

August 22, 2013

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original of
this report.



University of Puerto Rico
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Management's Discussion and Analysis

Introduction

The University of Puerto Rico (the University), founded in 1903, is a state supported university system created by Law No. 1 of January 20, 1966, "Law of the University of Puerto Rico" ("Act No. 1"), as amended, with the mission to serve the people of Puerto Rico and contribute to the development and enjoyment of the fundamental, ethical and esthetic values of Puerto Rican culture, and committed to the ideals of a democratic society. To advance its mission, the University strives to provide high quality education and create new knowledge in the Arts, Sciences and Technology.

The University is a public corporation of the Commonwealth of Puerto Rico (the Commonwealth) governed by a seventeen-member Board of Trustees, of which fourteen members were appointed by the Governor of Puerto Rico and confirmed by the Senate of Puerto Rico. The remaining members of the Board consisted of one full-time student and two tenured professors.

On April 30, 2013, Act No. 13 derogated Article 3 of Act No. 1 of 1966, as amended, and established a new Article 3 of Act No. 1 that, among other matters, defines the composition, faculties and duties of the Governing Board of the University of Puerto Rico (the "Governing Board"), the new governing body of the University. Act No. 13 substitutes the Board of Trustees of the University with the Governing Board composed of thirteen members, of which nine members are appointed by the Governor of Puerto Rico and confirmed by the Senate of Puerto Rico. The remaining members of the Governing Board consist of two tenured professors and two full-time students. The Secretary of the Department of Education of the Commonwealth becomes ex-officio member of the Governing Board.

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

The University is the largest institution of higher education on Puerto Rico. Commonwealth appropriations are the principal source of the University revenues, but additional revenues are derived from tuitions, federal grants, patient services, auxiliary enterprises, interest income, and other sources. The University is in good accreditation standing with the Middle States Commission on Higher Education, the regional accreditation entity of the eleven units that comprise the University of Puerto Rico system.

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

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.



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The following discussion presents an overview of the financial position and financial activities of the University, excluding its component units, for the years ended June 30, 2012, 2011 and 2010. This discussion and analysis was prepared by University management and should be read in conjunction with the basic financial statements of the University, including the notes thereto.

Financial Highlights

As of June 30, 2012, the University has total assets of \$1.52 billion, total liabilities of \$1.04 billion and net assets of \$472.4 million. The University's net assets increased by \$46.3 million or 11% when compared to prior year. The reason for this change is 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, 2012, 2011 and 2010 follow:

Condensed Statements of Net Assets (In thousands)

	June 30		
	2012	2011	2010
Assets			
Current assets	\$ 387,220	\$ 360,562	\$ 233,452
Noncurrent assets:			
Due from Commonwealth of Puerto Rico	11,720	24,720	56,609
Capital assets	953,054	965,895	961,168
Other assets	165,349	157,929	172,950
Total assets	<u>1,517,343</u>	<u>1,509,106</u>	<u>1,424,179</u>
Liabilities			
Current liabilities	165,117	184,902	204,944
Noncurrent liabilities	879,866	898,146	851,142
Total liabilities	<u>1,044,983</u>	<u>1,083,048</u>	<u>1,056,086</u>
Net assets			
Invested in capital assets, net of related debt	352,899	337,279	309,055
Restricted:			
Nonexpendable	89,696	87,973	78,591
Expendable	60,573	65,152	72,205
Unrestricted (deficit)	(30,808)	(64,346)	(91,758)
Total net assets	<u>\$ 472,360</u>	<u>\$ 426,058</u>	<u>\$ 368,093</u>



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Condensed Statements of Revenues, Expenses and Changes in Net Assets (In thousands)

	Year Ended June 30		
	2012	2011	2010
Operating revenues			
Tuition and fees, net	\$ 72,475	\$ 73,451	\$ 41,809
Governmental grants and contracts	174,166	161,547	131,682
Patient services	86,819	71,466	51,449
Other operating revenues	37,023	48,007	40,118
Total operating revenues	370,483	354,471	265,058
Operating expenses			
Salaries and benefits	827,755	860,079	933,653
Scholarships and fellowships	203,959	215,205	211,831
Supplies and other services and utilities	222,737	206,562	198,742
Other operating expenses	66,922	68,792	78,585
Total operating expenses	1,321,373	1,350,638	1,422,811
Operating loss	(950,890)	(996,167)	(1,157,753)
Nonoperating revenues (expenses)			
Commonwealth appropriations	834,097	839,372	839,318
Federal Pell Grant program	174,139	179,160	179,165
Federal ARRA program	-	15,000	105,000
Other nonoperating revenues (expenses), net	(13,326)	3,976	1,066
Net nonoperating revenues	994,910	1,037,508	1,124,549
Income (loss) before other revenues	44,020	41,341	(33,204)
Capital appropriations	465	5,580	1,288
Additions to term and permanent endowments	1,817	11,044	9,251
Changes in net assets	46,302	57,965	(22,665)
Net Assets			
Beginning of year	426,058	368,093	390,758
End of year	\$ 472,360	\$ 426,058	\$ 368,093

Overview of the Basic Financial Statements

This discussion and analysis is required supplementary information to the basic financial statements of the University and is intended to serve as introduction to the basic financial statements of the University.



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The accounting and reporting policies of the University conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities. The Governmental Accounting Standards Board (GASB) is the accepted standards setting body for establishing governmental accounting and financial reporting principles. The financial statement presentation required by GASB provides a comprehensive, entity-wide perspective of the University's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows.

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. 35, Basic Financial Statements-and Management's Discussion and Analysis-for Public Colleges and Universities. Accordingly, the University's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting.

The basic financial statements of the University include the following: (1) Statement of Net Assets, (2) Statement of Revenues, Expenses, and Changes in Net Assets, (3) Statement of Cash Flows, and (4) Notes to the Basic Financial Statements. The University also includes additional information to supplement the basic financial statements.

The statement of net assets provides information on the University's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the University is improving or deteriorating. 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 on third-party agreements 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 and expenses are recognized when others provide the service to the University, regardless of when cash is exchanged. Assets and liabilities included in the statements of net assets are classified as current or noncurrent.

The statement of revenues, expenses and changes in net assets presents information on how the University's net assets changed during the reporting periods. Changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. The purpose of this statement is to present the revenues earned, both operating and nonoperating, and the expenses paid and accrued and any other revenues, expenses, gains and losses earned or spent by the University during the reporting periods. Generally, operating revenues are used to provide goods and services to the various customers and constituencies of the University. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the University. Nonoperating revenues are revenues received for which goods and services are not provided.



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The statement of cash flows shows changes in cash and cash equivalents, resulting from operating, non-capital and capital financing and investing activities, which include cash receipts and cash disbursements information.

The notes to the basic financial statements provide additional information that is essential for a full understanding of the data provided in the basic financial statements.

The required supplementary information consists of two schedules concerning the following: (1) the supplementary information of the University's Employees retirement Plan as required by the GASB Statement No. 27, Accounting for Pensions by State and Local Government Employers, and (2) the supplementary information of the University's Postemployment Benefits Other Than Pensions Program as required by the GASB Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.

The other financial information consists of the schedules of changes in sinking fund reserves.

Analysis of Financial Position and Changes in Financial Position

Statements of Net Assets

Assets

Total assets amounted to \$1.52 billion, \$1.51 billion and \$1.42 billion at June 30, 2012, 2011, and 2010, respectively. Total assets increased by \$8.2 million or less than 1% in 2012 and by \$84.9 million or 6% in 2011 when compared with the prior year balances.

Current assets primarily consist of cash and cash equivalents, short-term investments and accounts receivable. As of June 30, 2012, cash and cash equivalents, investments and accounts receivable comprise approximately 28%, 35% and 37%, respectively, of the current assets; meanwhile 84% of the noncurrent assets are capital assets. As of June 30, 2011, cash and cash equivalents, investments and accounts receivable comprise approximately 29%, 36% and 33%, respectively, of the current assets; meanwhile 84% of the noncurrent assets are capital assets.

Cash and cash equivalents (mainly certificates of deposit) amounted to \$109.8 million, \$108.0 million and \$3.4 million at June 30, 2012, 2011, and 2010, respectively. The increases in the University's cash position of \$1.8 million in 2012 and \$104.6 million in 2011 mainly resulted from the advances taken from the lines of credit obtained during the fiscal years 2012 and 2011, collection of \$14.4 million of old accounts receivable from a Commonwealth's component unit in 2012, the stabilization fee established by the Board of Trustees of the University starting in fiscal year 2011 and the strict cost control measures implemented during the fiscal years 2012 and 2011 to address the University's budgetary deficit issues.



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In October 2010, the University obtained a \$100 million revolving line of credit facility with the Government Development Bank for Puerto Rico (GDB) for working capital purposes. This line of credit was increased to \$125 million in October 2011. In addition, the University obtained a \$5 million non-revolving line of credit with GDB in June 2011, which was increased to \$75 million in August 2011, to complete certain construction projects of the University's Program for Permanent Improvements. These lines of credit improved the University's cash positions at June 30, 2012 and 2011. The balances outstanding under the \$125 million and \$75 million lines of credit amounted to \$65.0 million and \$10.2 million, respectively, at June 30, 2012. Refer to Subsequent Events Section.

Also, to address the University's budgetary deficit issues, on June 30, 2010, the Board of Trustees of the University established a stabilization fee to be charged to all students in addition to tuition charges and other fees already in place in the University. The stabilization fee amounted to \$400 per student per semester and had no set termination date. The stabilization fee, which is included in revenue from tuitions and fees, amounted to \$44.2 million and \$41.3 million in the fiscal years ended June 30, 2012 and 2011, respectively. On January 26, 2013, the stabilization fee was repealed by the Board of Trustees of the University effective July 1, 2013. Refer to Subsequent Events Section.

In addition, by virtue of Act No. 176 of November 2010, as amended by Act No. 46 of April 2011, the Commonwealth of Puerto Rico (the Commonwealth) had committed to transfer 10% of the Additional Lottery's net annual income with a guaranteed minimum amount of \$30 million per academic year, for the creation of a Special Scholarship Fund for the University of Puerto Rico. The purpose of the fund was to provide financial aid to graduate and undergraduate students. The fund was administered by the University. Proceeds of this fund received by the University in fiscal years 2012 and 2011 amounted to \$30.0 million, of which \$25.9 million and \$23.4 million were granted as scholarships during the fiscal years ended June 30, 2012 and 2011, respectively. Unused fund balance at June 30, 2012 and 2011 amounted to \$10.7 million and \$6.6 million, respectively. On April 7, 2013, Act No. 176 was derogated by Act No. 7, which among other matters, eliminated the Special Scholarship Fund for the University. Refer to Subsequent Events Section.

On the other hand, the ARRA funds, designated for operational purposes, decreased by \$15.0 million in 2012 and \$90.0 million in 2011. No such funds were received in 2012. Management compensated the decreases in the ARRA funds with the line of credit with GDB, the stabilization fee and the cost control measures which resulted in a reduction of operating expenses by \$29.3 million or 2% in 2012 and \$72.2 million or 5% in 2011, when compared with prior year balances.

Total investments at June 30, 2012 amounted to \$222.9 million, an increase of \$9.4 million or 4% as compared to a balance of \$213.5 million at June 30, 2011. In 2011, total investments decreased by \$12.0 million or 5% as compared to a balance of \$225.5 million at June 30, 2010. The increase in 2012 was mainly due to the increase in investments designated to fund the University's Healthcare Deferred Compensation Plan. The decrease in 2011 was mainly due to the disposition of the investments designated to fund the University's construction projects, which was partially offset by the increase in investments designated to fund the University's Healthcare Deferred Compensation Plan.



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Accounts receivable, net, including due from the Commonwealth of Puerto Rico increased by \$9.1 million or 6% from \$144.7 million at June 30, 2011 to \$153.8 million at June 30, 2012. In 2011, accounts receivable, net decreased by \$22.5 million or 13% from \$167.2 million at June 30, 2010. The increase in 2012 mainly resulted from the increases in the due from Commonwealth's agencies of \$14.8 million and in the due from medical plans of \$17.6 million, which were partially offset by the decrease of \$29.1 million in the due from Commonwealth. Due from Commonwealth's agencies include an account receivable from a Commonwealth's agency of \$20.0 million as a result of contracts for professional development of public school teachers obtained in 2012. Due from medical plans increased in 2012 as a result of more services rendered to patients. Due from Commonwealth decreased in 2012 as a result of collections of \$31.6 million under two payment plans. During the year ended June 30, 2012, the University forgave amounts due by the Hospital and fully reserved by the University of \$34,496,756. The decrease in 2011 mainly resulted from collections of \$12.9 million in the due from Commonwealth and increased provisions for doubtful accounts of \$8.8 million for the year ended June 30, 2011.

Capital assets decreased by \$12.8 million or 1% from \$965.9 million at June 30, 2011, to \$953.1 million at June 30, 2012. For 2011, capital assets increased by \$4.7 million or less than 1% from \$961.2 million at June 30, 2010. The changes in both years mainly resulted from the University's investment in construction projects and other capital assets that amounted to \$36.0 million in fiscal year 2012 and \$49.2 million in fiscal year 2011, which effect was partially (or totally) offset by the depreciation and amortization expense of \$46.5 million in fiscal year 2012 and \$43.9 million in fiscal year 2011.

Liabilities

Total liabilities amounted to \$1.04 billion, \$1.08 billion and \$1.06 billion at June 30, 2012, 2011, and 2010, respectively, a decrease of \$38.1 million or 4% in 2012 and an increase of \$27.0 million or 3% in 2011 when compared with the prior year balances.

Current liabilities consist primarily of accounts payable and accrued liabilities, the current portion of long-term debt and other liabilities. Noncurrent liabilities primarily consist of long-term debt and leases and compensated absences.

Accounts payable and accrued liabilities decreased by \$9.5 million or 9% from \$105.5 million at June 30, 2011 to \$96.0 million at June 30, 2012. In 2011, these current liabilities decreased by \$37.9 million or 26% from \$143.4 million at June 30, 2010. The decrease in 2012 is mainly related to the decrease in amounts due to the Commonwealth's component units as a result of lower unpaid utilities invoices. The decrease in 2011 is mainly related to the University's positive cash position in fiscal year 2011 which offset the excess of outstanding checks over bank balance of \$10.9 million at June 30, 2010 and reduced the unpaid health and medical benefit costs, accounts payable to suppliers and other accounts payable.



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Long-term debt and capital lease obligations decreased by \$45.0 million or 6% from \$727.4 million at June 30, 2011, to \$682.4 million at June 30, 2012. In 2011, long-term debt and lease increased by \$61.3 million or 9% from \$666.1 million at June 30, 2010. The decrease in 2012 mainly resulted from principal paid on long-term debt and capital leases of \$57.2 million, net of advances of \$12.7 million obtained from the lines of credit with GDB and a commercial bank. In June 2011, the University obtained a \$5 million non-revolving line of credit with GDB, which was increased to \$75 million in August 2011, to complete certain construction projects of the University's Program for Permanent Improvements. In October 2010, the University obtained a \$100 million revolving line of credit facility with GDB for working capital purposes, which was increased to \$125 million in October 2011. These lines of credit improved the University's cash positions at June 30, 2012 and 2011. The balances outstanding under the \$125 million and \$75 million lines of credit amounted to \$65.0 million and \$10.2 million, respectively, at June 30, 2012. In January 2012, the University entered into two term loan agreements with a commercial bank for a total amount of \$2.4 million for the acquisition of medical equipments to be used in the Medical Sciences Campus. The increase in 2011 mainly resulted from the \$100 million line of credit obtained from GDB in October 2010 which was partially offset by principal paid on capital debt and leases of \$28.9 million during the fiscal year ended June 30, 2011. The balance outstanding under this line of credit amounted to \$93.7 million at June 30, 2011.

Long-term debt includes the University's revenue bonds amounted to \$540.1 million and \$567.6 million as of June 30, 2012 and 2011, respectively. These bonds are currently rated "Ba1" by Moody's Investors Service and "BBB-" by Standard & Poor's Ratings Services.

Compensated absences amounted to \$167.1 million, \$156.7 million and \$163.1 million at June 30, 2012, 2011 and 2010, respectively, an increase of \$10.4 million or 7% in 2012 and of \$6.4 million or 4% in 2011 when compared with prior year balances. Changes in compensated absences are mainly related to variations on the use of vacations by employees and total employees at the end of periods.

Net Assets

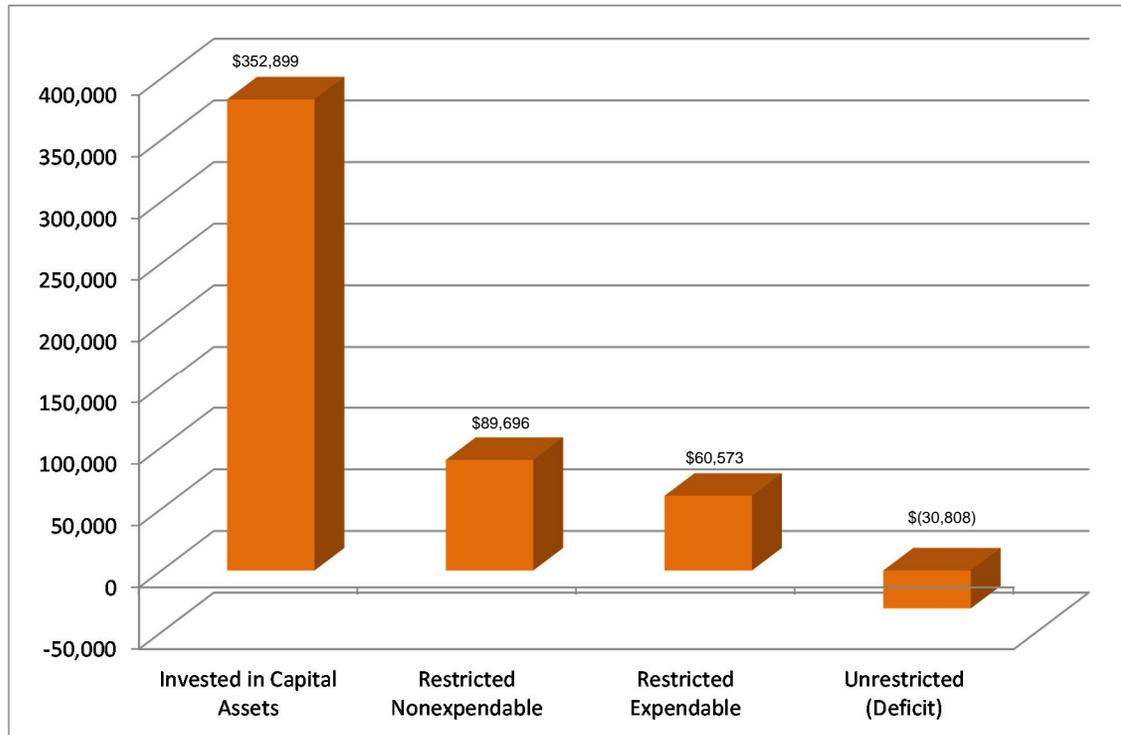
Net assets represent the residual interest in the University's assets after liabilities are deducted. Net assets amounted to \$472.4 million, \$426.1 million and \$368.1 million at June 30, 2012, 2011, and 2010, respectively, an increase of \$46.3 million or 11% in 2012 and of \$58.0 million or 16% in 2011 when compared with the prior year balances. These changes are explained in the section entitled "*Statements of Revenues, Expenses and Changes in Net Assets*".



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The major classifications of the net assets at June 30, 2012 are shown in the following illustration:

Chart 1 – Net Assets
(Dollars in thousands)



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

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

Unrestricted net assets represent those balances from operational activities that have not been restricted by parties external to the University such as donors or grant agencies.



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Statements of Revenues, Expenses and Changes in Net Assets

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.

Operating Revenues

Total operating revenues amounted to \$370.5 million, \$354.5 million and \$265.1 million for the years ended June 30, 2012, 2011, and 2010, respectively, an increase of \$16.0 million or 5% in 2012 and an increase of \$89.4 million or 34% in 2011. The changes in operating revenues mainly resulted from the changes in tuitions and fees, in governmental grants and contracts and in patient services revenues.

Tuitions and fees decreased by \$976,000 or 1%, from \$73.4 million in 2011 to \$72.5 million in 2012, mainly as a result of a lower student enrollment at the University. For fiscal year 2012, the student body of the University consisted of approximately 56,659 students, a decrease of 5,130 students or 8% when compared with approximately 61,789 students for fiscal year 2011. For fiscal year 2010, the student body of the University consisted of approximately 65,026 students. In fiscal year 2010, a student conflict interrupted operations of the University campuses for up to 62 days. Historical data demonstrate that a decrease in applicants and enrollment always follows labor or student conflicts, recuperating thereafter to normal rates. The University tuition is among the lowest in Puerto Rico and in the United States of America. In accordance with a Board of Trustees Resolution, tuition cost per credit has been increased 4% annually per incoming class since academic year 2007-2008 to academic year 2011-2012. In 2011, tuitions and fees increased by \$31.6 million or 76%, from \$41.8 million in 2010, mainly as a result of the stabilization fee established by the Board of Trustees of the University on June 30, 2010 to address the University's budgetary deficit issues. This stabilization fee is charged to all students in addition to tuition charges and other fees already in place in the University. The stabilization fee amounts to \$400 per student per semester. This stabilization fee increased revenue from tuitions and fees by \$41.3 million in fiscal year ended June 30, 2011. However, the positive effect of the stabilization fee on the revenue from tuitions and fees in 2011 was partially offset by the increase in the scholarship allowances of \$22.8 million or 46%, from \$49.7 million in 2010 to \$72.6 million in 2011.

In 2012, revenues from governmental grants and contracts increased by \$12.7 million or 8% from \$161.5 million in 2011, to \$174.2 million in 2012. In 2011, these revenues increased by \$29.8 million or 23% from \$131.7 million in 2010. The increase in 2012 mainly resulted from the increase in the Commonwealth's grants and contracts for professional development of public school teachers and other purposes. The increase in 2011 mainly resulted from the increases in the federal and in the Commonwealth's grants and contracts for agricultural station services and other purposes.

Patient services revenue amounted to \$86.8 million, \$71.5 million and \$51.4 million for the years ended June 30, 2012, 2011, and 2010, respectively, an increase of \$15.3 million or 21 % in 2012 and an increase of \$20.1 million or 39 % in 2011. In 2012 and 2011, patient service revenue increased as a result of more services rendered to patients.



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Non-operating Revenues

Total non-operating revenues amounted to \$994.9 million, \$1.04 billion and \$1.12 billion for the years ended June 30, 2012, 2011, and 2010, respectively, a decrease of \$42.6 million or 4% in 2012 and a decrease of \$87.0 million or 8% in 2011.

In 2011, the University received nonrecurring revenues from the American Reinvestment and Reconstruction Act (ARRA funds) of \$15.0 million when in 2010 it received \$105.0 million, a decrease of \$90 million. No such funds were received in 2012.

In addition, the Commonwealth appropriations amounted to \$834.1 million, \$839.4 million and \$839.3 million for the years ended June 30, 2012, 2011 and 2010, a decrease of \$5.3 million or less than 1% in 2012. They remained flat in 2011.

Appropriations from the Commonwealth are the principal source of revenues of the University and are mainly 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 preceding the current fiscal year (the Commonwealth formula appropriations). The non-operating revenues were negatively impacted by the continued reduction in the Commonwealth formula appropriations as a result of the reduction in the Commonwealth's general funds revenues. The Commonwealth formula appropriations amounted to \$685.9 million, \$691.5 million and \$729.1 million for the years ended June 30, 2012, 2011, and 2010, respectively, a decrease of \$5.6 million or less than 1% in 2012 and a decrease of \$37.6 million or 5% in 2011. On April 7, 2013, Act No. 7 amended Act No. 2 of January 20, 1966, as amended, and revised the formula for the Commonwealth appropriations effective July 1, 2013. Refer to Subsequent Events Section.

In addition, the Commonwealth has appropriated amounts for general current obligations, for capital improvement programs, and for loans and financial assistance to students. These Commonwealth appropriations amounted to \$148.2 million, \$147.9 million and \$110.2 million for the years ended June 30, 2012, 2011, and 2010, respectively, an increase of \$284,000 in 2012 and an increase of \$37.7 million or 34% in 2011. These appropriations remained flat in 2012. In 2011, the increase mainly resulted from the appropriations received from the Special Scholarship Fund. By virtue of Act No. 176 of November 2010, as amended by Act No. 46 of April 2011, the Commonwealth of Puerto Rico had committed to transfer 10% of the Additional Lottery's net annual income with a guaranteed minimum amount of \$30 million per academic year, for the creation of a Special Scholarship Fund for the University of Puerto Rico. The purpose of the fund was to provide financial aid to graduate and undergraduate students. The fund was administered by the University. Proceeds of this fund received by the University in 2012 and 2011 amounted to \$30 million, of which \$25.9 million and \$23.4 million were granted as scholarships during the fiscal years ended June 30, 2012 and 2011, respectively. Unused fund balance at June 30, 2012 and 2011 amounted to \$10.7 million and \$6.6 million, respectively. On April 7, 2013, Act No. 176 was derogated by Act No. 7, which among other matters, eliminated the Special Scholarship Fund for the University. Refer to Subsequent Events Section.

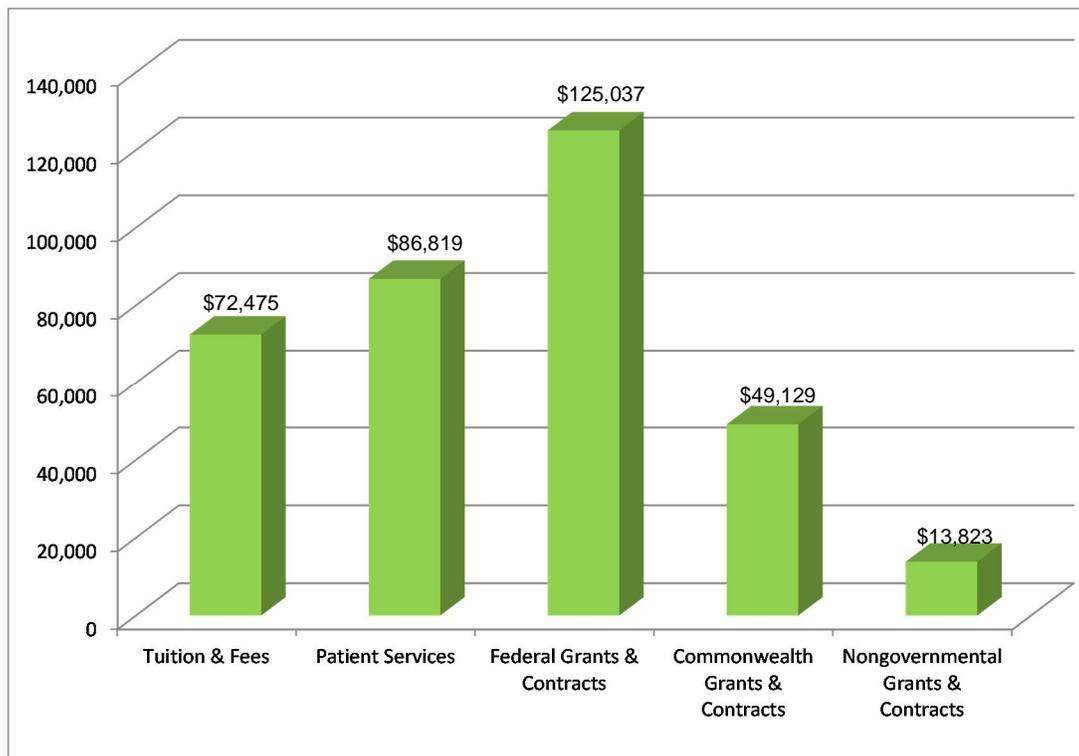


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Federal Pell Grant program revenues amounted to \$174.1 million in 2012 and \$179.2 million in 2011 and in 2010, a decrease of \$5.1 million or 3% in 2012 and remained flat in 2011. The decrease in 2012 was mainly due to the decrease in the Federal Pell Grant assistance along with a decrease in the number of eligible participants.

The following illustration presents the major sources of the University revenues (both operating and nonoperating) for the year ended June 30, 2012:

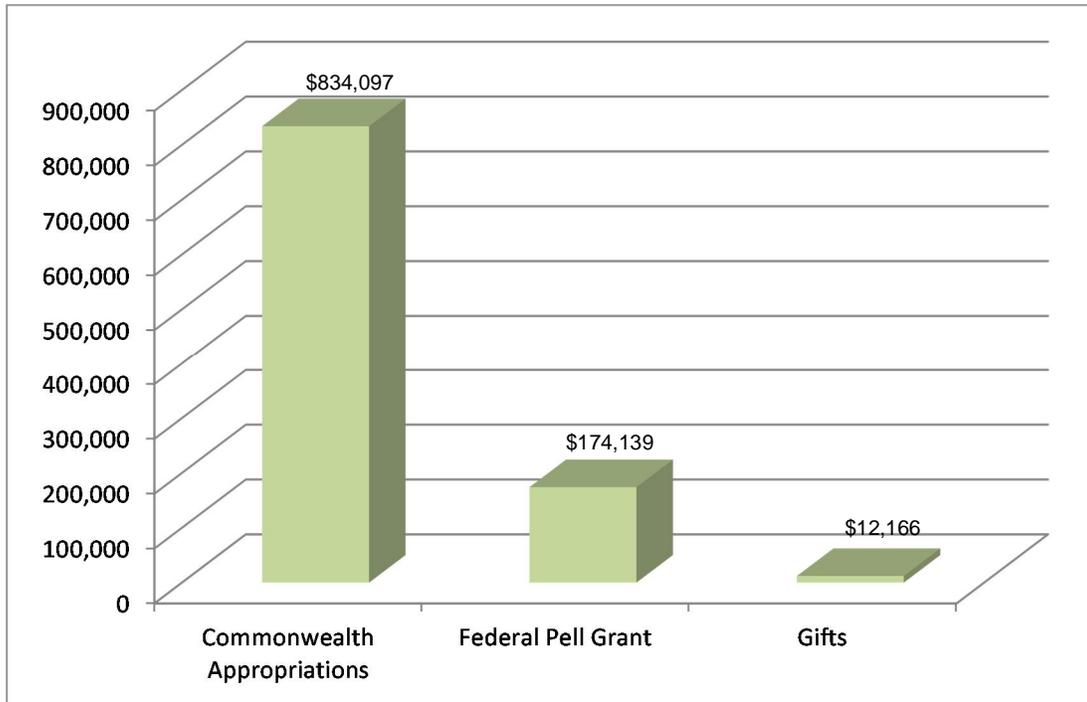
Chart 2 – Major Sources of Operating Revenues
(Dollars in thousands)





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Chart 3 – Major Sources of Nonoperating Revenues
(Dollars in thousands)

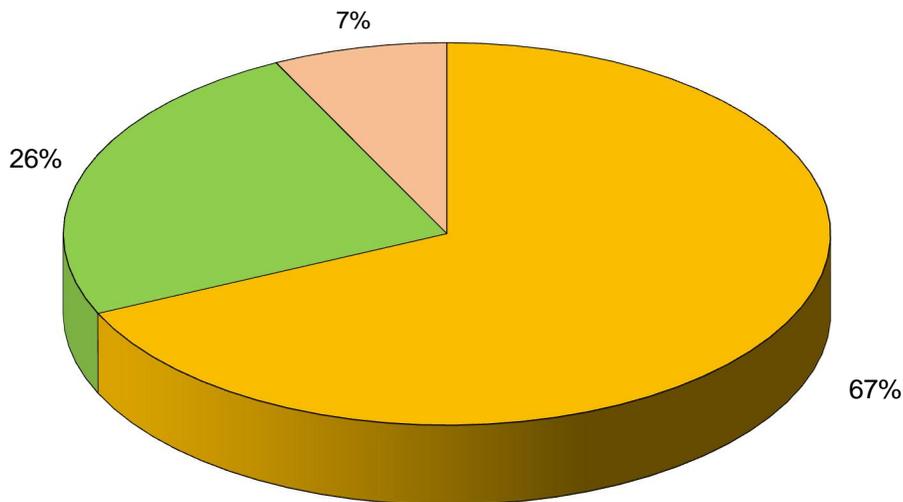




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Federal grants represent 67% of the University operating grants revenues. The following illustration presents the operating grants revenues of the University of Puerto Rico for the year ended June 30, 2012:

Chart 4 - Operating Grants Revenues
(Dollars in thousands)



■ Federal	\$ 125,037	67%
■ Commonwealth	49,129	26%
■ Nongovernmental	13,823	7%
Total	\$ 187,989	100%

Operating Expenses

The University's expenses are presented using natural expense classifications. Total operating expenses amounted to \$1.32 billion, \$1.35 billion and \$1.42 billion for the years ended June 30, 2012, 2011, and 2010, respectively, a decrease of \$29.3 million or 2% in 2012 and a decrease of \$72.2 million or 5% in 2011. The reduction in operating expenses is the result of the cost control measures taken by University in the fiscal years 2012 and 2011.



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Salaries and benefits, the most significant component of operating expenses, amounted to \$827.8 million, \$860.1 million and \$933.6 million for the years ended June 30, 2012, 2011 and 2010, respectively, a decrease of \$32.3 million or 4% in 2012 and a decrease of \$73.6 million or 8% in 2011. In 2012 and 2011, these expenses decreased as a result of strict control measures taken by Management which includes the replacement of no more than 33% of retired employees, reductions in employees' benefits such as excess compensated absences, among others. In 2012, the University reduced about 250 positions of retired employees and of employees under contracted services. Notwithstanding that salary expense decreased in 2012, the University increased its contribution rate to the retirement plan from 13.0% to 14.7% which resulted in an increase of \$4.3 million in the contribution benefit to the retirement plan. In 2011, the University reduced about 800 positions of retired employees and of employees under contracted services. Notwithstanding that salary expense decreased in 2011, the University increased its contribution rate to the retirement plan from 11.4% to 13.0% which resulted in an increase of \$10.0 million in the contribution benefit to the retirement plan.

Scholarships and fellowships amounted to \$204.0 million, \$215.2 million and \$211.8 million for the years ended June 30, 2012, 2011 and 2010, respectively, a decrease of \$11.2 million or 5% in 2012 and an increase of \$3.4 million or 2% in 2011. The decrease in 2012 mainly resulted from a decrease in the number of eligible participants. The increase in 2011 mainly resulted from \$24.0 million in scholarships granted under the Special Scholarship Fund approved by Act No. 176 of November 2010, as amended by Act No. 46 of April 2011, which was partially offset by a decrease in the number of eligible participants.

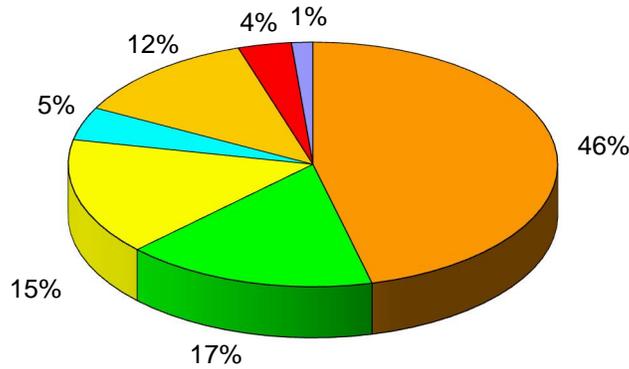
Supplies and other services and utilities amounted to \$222.7 million, \$206.5 million and \$198.7 million for the years ended June 30, 2012, 2011 and 2010, respectively, an increase of \$16.2 million or 8% in 2012 and an increase of \$7.8 million or 4% in 2011. The increases in 2012 and 2011 mainly resulted in the utilities expense category (mainly electricity), in supplies for educational and medical purposes and in additional professional services. Utilities amounted to \$58.0 million, \$50.6 million and \$48.5 million for the years ended June 30, 2012, 2011 and 2010, respectively, an increase of \$7.4 million or 15% in 2012 and of \$2.1 million or 4% in 2011. Such increases in utilities mainly resulted from significant oil prices increases experienced during the both periods.



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The following illustration presents the major University operating expenses, using natural classification for the year ended June 30, 2012:

Chart 5 - Operating Expenses
(Dollars in thousands)



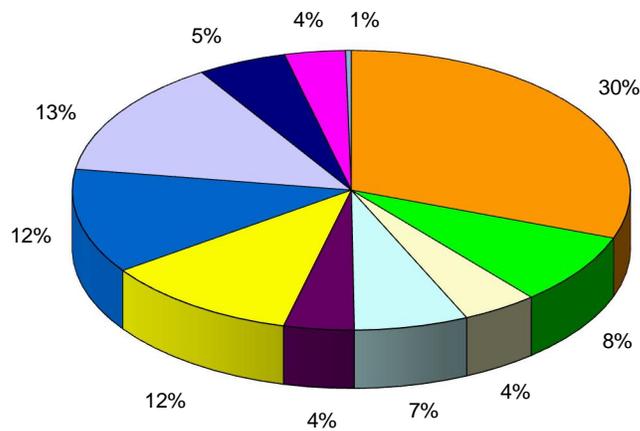
Salaries	\$ 607,115	46%
Benefits	220,640	17%
Scholarships and fellowships	203,959	15%
Supplies and other services	164,710	12%
Utilities	58,027	5%
Depreciation and amortization	46,474	4%
Other expenditures	20,448	1%
Total	\$ 1,321,373	100%



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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, 2012:

Chart 6 - Expenses by Function
(Dollars in thousands)



Instruction	\$	402,901	30%
Research		108,288	8%
Public service		57,478	4%
Academic support		86,988	7%
Student services		53,657	4%
Institutional support		155,162	12%
Operation and maintenance		159,361	12%
Student aid		178,627	13%
Patient service		68,027	5%
Depreciation and amortization		46,474	4%
Other		4,410	1%
Total	\$	1,321,373	100%



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Operating Loss and Net Change in Net Assets

For the year ended June 30, 2012, the University reported an operating loss of \$950.8 million. After adding nonoperating revenues of \$994.9 million, primarily from the Commonwealth's appropriations and Federal programs, and capital appropriations and additions to term and permanent endowments of \$2.3 million, the net assets increased by \$46.3 million for the year ended June 30, 2012 or 11% of last year net assets.

For the year ended June 30, 2011, the University reported an operating loss of \$996.2 million. After adding nonoperating revenues of \$1.04 billion, primarily from the Commonwealth's appropriations and Federal programs, and capital appropriations and additions to term and permanent endowments of \$16.6 million, the net assets increased by \$58.0 million for the year ended June 30, 2011 or 16% of last year net assets.

Statements of Cash Flows

Net cash provided by noncapital financing activities were primarily due to the receipts of the Commonwealth's appropriations and the federal Pell grants and the federal direct loans. Net cash provided by (used in) investing activities mainly results from the proceeds from sales and maturities of investments, net of the purchases of investments. The change in cash and cash equivalents was partially offset by the cash used in capital and related financing activities and in operating activities. Net cash used in capital and related financing activities was primarily due to purchases of capital assets and principal and interest payments on capital debt and leases. Net cash used in operating activities is consistent with the University's operating loss.

Subsequent Events

Subsequent events were evaluated through August 22, 2013, the date the financial statements were available to be issued, to determine if such events should be recognized or disclosed in the 2012 financial statements.

In January 2013, the \$75 million line of credit facility with the Government Development Bank for Puerto Rico was amended to extend the maturity date to January 31, 2014.

On April 7, 2013, Act No. 7 amended Act No. 2 of January 20, 1966, as amended, to revise the formula for the Commonwealth appropriations, 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 preceding the current fiscal year. Act No.7 is effective on July 1, 2013. Management expects to receive approximately \$77 million in additional Commonwealth formula appropriations in fiscal year 2014 as a result of Act No. 7.



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In addition, Act No. 7 of April 7, 2013 derogated Act No. 176 of November 2010, as amended by Act No. 46 of April 2011, in which the Commonwealth of Puerto Rico had committed to transfer 10% of the Additional Lottery's net annual income with a guaranteed minimum amount of \$30 million per academic year, for the creation of a Special Scholarship Fund for the University of Puerto Rico. The purpose of the fund was to provide financial aid to graduate and undergraduate students. Management expects a reduction in the Commonwealth appropriations and in scholarships expense of approximately \$30.0 million in fiscal year 2014 as a result of the derogation of Act. No. 176.

On January 26, 2013, Board of Trustees of the University approved Certification No. 41 (2012-2013) which derogated the stabilization fee established by the Board of Trustees of the University on June 30, 2010 to address the University's budgetary deficit issues. This stabilization fee was charged to all students in addition to tuition charges and other fees already in place in the University. The stabilization fee amounted to \$400 per student per semester. Board of Trustees Certification No. 41 is effective on July 1, 2013. Management expects a reduction in tuitions and fees of approximately \$47 million in fiscal year 2014 as a result of the derogation of the stabilization fee.

On April 30, 2013, Act No. 13 derogated Article 3 of Act No. 1 of 1966, as amended, and established a new Article 3 of Act No. 1 that, among other matters, defines the composition, faculties and duties of the Governing Board of the University of Puerto Rico (the "Governing Board"), the new governing body of the University. Act No. 13 substitutes the Board of Trustees of the University with the Governing Board composed of thirteen members, of which nine members are appointed by the Governor of Puerto Rico and confirmed by the Senate of Puerto Rico. The remaining members of the Governing Board consist of two tenured professors and two full-time students. The Secretary of the Department of Education of the Commonwealth becomes ex-officio member of the Governing Board.

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.

Effective April 23, 2012, the National Science Foundation (NSF), an independent U.S. government agency, suspended the federal awards for research and development in the Research and Development Center at the Mayagüez Campus and in the Resource Center for Science and Engineering ascribed to the Central Administration unit of the University because the University has not corrected the time and effort reporting deficiencies as established in the Corrective Action Plan related to previous audits' findings. NSF is responsible for promoting science and engineering through research programs and education projects. NSF will not reimburse expenditures incurred on and after April 23, 2012 by the University in the involved units. Most of the research and training activities under grants affected by the Suspension Status continue with funding from the University. Significant interactions between NSF and the University has led to a robust body of Effort Reporting System (ERS) policies and procedures, the creation of a system-wide Office for Research Compliance and Integrity and an overarching committee for continuous assessment and creation of sponsored programs, policies and procedures. The University is actively working with NSF to achieve full compliance and lift the administrative suspension.



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The amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time. Management believes the impact will not be material to the University's financial statements.

Capital Assets and Debt Administration

- **Capital assets, net decreased by \$12.8 million or 1% in 2012**

Capital assets are comprised of buildings used to provide high quality education and create new knowledge in the Arts, Sciences and Technology, equipments and assets under capital lease. Significant capital assets additions for the year ended June 30, 2012, consisted 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. Capital assets decreased by \$12.8 million or 1% from \$965.9 million at June 30, 2011, to \$953.1 million at June 30, 2012. The change in 2012 mainly resulted from the University's investment in construction projects and other capital assets that amounted to \$36.0 million, which effect was partially (or totally) offset by the depreciation and amortization expense of \$46.5 million. Construction commitments at June 30, 2012, entered into by the University, amounted to approximately \$46.6 million. Refer to Note 5 to the financial statements for further information regarding the University's net capital assets.

- **Long-term debt and capital lease obligation decreased by \$45.0 million or 6% in 2012**

The decrease in 2012 mainly resulted from principal paid on long-term debt and capital leases of \$57.2 million, net of advances of \$12.7 million obtained from the lines of credit with GDB and a commercial bank.

Long-term debt includes the University's revenue bonds and amounted to \$540.1 million as of June 30, 2012. 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. These bonds are currently rated "Ba1" by Moody's Investors Service (Moody's) and "BBB-" by Standard & Poor's Ratings Services (S&P). On December 14, 2012, Moody's downgraded the rating of the University's revenue bonds from Baa2 to Ba1. This rating action followed the downgrade on December 13, 2012 of the Commonwealth of Puerto Rico (the Commonwealth) and the Government Development Bank for Puerto Rico's bonds. In March 2013, S&P and Moody's revised their outlook perspectives of the University's revenue bonds to negative mainly as a result of the downgrade and negative outlook of the Commonwealth, which it has generally mirrored given the University significant dependence on Commonwealth's appropriations. While this strong link to the Commonwealth has historically benefited the University in terms of annual appropriations growth, its revenue stream is concentrated and vulnerable to the Commonwealth's economic slowdowns.



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In October 2007, the University entered into a capital lease agreement with Desarrollos Universitarios, Inc., a nonprofit corporation and discretely presented component unit of the University. The agreement is for the use of Plaza Universitaria, a residential and commercial facility for the use of students and other persons or entities conducting business with the University.

In June 2011, the University obtained a \$5 million non-revolving line of credit with GDB, which was increased to \$75 million in August 2011, to complete certain construction projects of the University's Program for Permanent Improvements. In October 2010, the University obtained a \$100 million revolving line of credit facility with GDB for working capital purposes, which was increased to \$125 million in October 2011. The balances outstanding under the \$125 million and \$75 million lines of credit amounted to \$65.0 million and \$10.2 million, respectively, at June 30, 2012. In January 2012, the University entered into two term loan agreements with a commercial bank for a total amount of \$2.4 million for the acquisition of medical equipment to be used in the Medical Sciences Campus.

Refer to Notes 6, 7, 8 and 9 to the financial statements for further information regarding the University's long-term debt and capital lease obligation.

Economic Outlook

The University's business activities are conducted in Puerto Rico. Its operating results are mainly funded by nonoperating revenues mainly from the Commonwealth of Puerto appropriations and from the United States of America Government grants (Federal Pell Grant Program).

Puerto Rico uses the U.S. currency and forms part of the U.S. financial system. Factors affecting the U.S. economy usually have a significant impact on the performance of the Puerto Rico economy. These include exports, direct investment, the amount of federal transfer payments, the level of interest rates, the level of oil prices, the rate of inflation, and tourist expenditures, among others. In the past, the economy of Puerto Rico has generally followed economic trends in the overall U.S. economy.

The Puerto Rico economy is currently in a recession that began officially in the fourth quarter of fiscal year 2006, a fiscal year in which the real gross national product grew by only 0.5%. There has been an overall contraction in sectors of Puerto Rico's economy, principally within the manufacturing and construction sectors, coupled with declines in tourism and retail sales, budget shortfalls and diminished consumer buying power driven by the implementation of a sales tax.

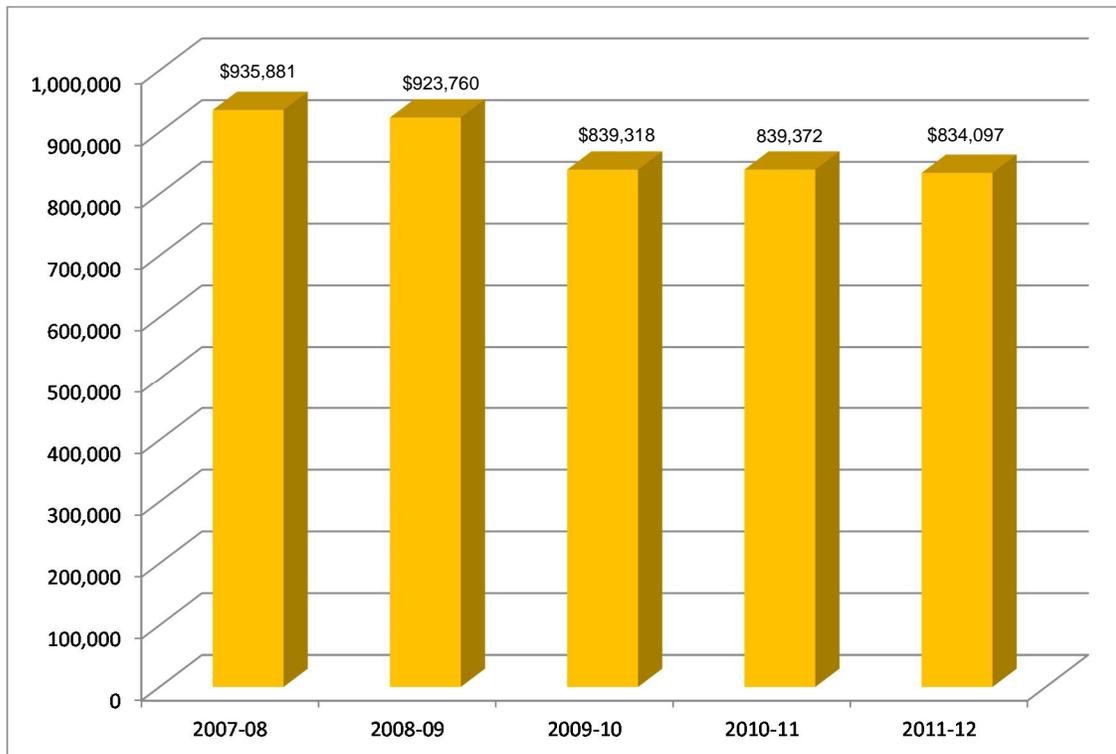
Appropriations from the Commonwealth are the principal source of revenues of the University and are supported by Act No. 2 of January 20, 1966, as amended. Under the Act, the Commonwealth appropriates for the University an amount equal to 9.60% of the average total amount of annual general funds revenues collected under the laws of the Commonwealth in the two fiscal years immediately preceding 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.



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

Chart 7 – Commonwealth Appropriations ⁽¹⁾
(Dollars in thousands)



⁽¹⁾Includes restricted funds for special activities.

If economic conditions worsen more than expected, it could significantly reduce the Commonwealth's revenues and therefore reduce the University's revenues from the Commonwealth's appropriations, which could have an adverse effect on the University's financial position or changes in its net assets.

The University and the Puerto Rico Industrial Development Company (PRIDCO) entered into an agreement to create the "Fondo de Investigación del Centenario de la Universidad de Puerto Rico" on June 30, 2004. As part of the agreement, the University will receive from PRIDCO \$40 million on a ten-year period of which PRIDCO has granted \$24.2 million as of June 30, 2012. The University expects to collect the remaining balance.



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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 Director of Finance. The executive offices of the University are located at 1187 Flamboyán Street, Jardín Botánico Sur, San Juan, Puerto Rico 00926.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Statements of Net Assets

	June 30	
	2012	2011
Assets		
Current assets:		
Cash and cash equivalents	\$ 94,529,117	\$ 96,139,332
Restricted cash and cash equivalents	12,056,085	8,396,509
Investments at fair value	80,135,053	73,997,945
Restricted investments at fair value- deposited with trustee	54,649,587	54,649,613
Accounts receivable (less allowances for doubtful accounts of \$132,074,100 and \$169,503,873 for 2012 and 2011, respectively)	126,562,190	88,408,504
Due from Commonwealth of Puerto Rico	15,500,000	31,598,442
Inventories	3,311,406	3,518,775
Prepaid expenses and deferred charges	476,496	3,853,165
Total current assets	387,219,934	360,562,285
Noncurrent assets:		
Restricted cash and cash equivalents	3,170,788	3,479,692
Restricted investments at fair value	88,120,242	84,818,821
Due from Commonwealth of Puerto Rico	11,720,254	24,720,254
Prepaid pension asset and other assets	70,118,269	66,317,282
Notes receivable, net	3,940,201	3,312,394
Capital assets (net of accumulated depreciation and amortization):		
Land and other nondepreciable assets	109,024,213	158,829,439
Depreciable assets	844,029,672	807,065,961
Total noncurrents assets	1,130,123,639	1,148,543,843
Total assets	1,517,343,573	1,509,106,128
Liabilities		
Current liabilities:		
Accounts payable and accrued liabilities	96,017,574	105,482,890
Current portion of long-term debt	30,404,791	45,056,638
Obligation under capital lease, current portion	1,472,628	1,383,308
Other current liabilities	37,222,070	32,979,704
Total current liabilities	165,117,063	184,902,540
Noncurrent liabilities:		
Long-term debt, net of current portion	587,328,733	616,290,379
Obligation under capital lease, net of current portion	63,220,500	64,693,128
Other long-term liabilities	229,317,139	217,162,554
Total noncurrent liabilities	879,866,372	898,146,061
Total liabilities	1,044,983,435	1,083,048,601

(Continued)



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Statements of Net Assets (continued)

	June 30	
	2012	2011
Net assets		
Invested in capital assets, net of related debt	\$ 352,899,491	\$ 337,279,006
Restricted, nonexpendable:		
Scholarship and fellowships	32,041,023	33,093,435
Research	46,733,728	53,175,807
Other	10,920,969	1,703,227
Restricted, expendable:		
Loans	8,008,289	7,675,624
Capital projects	-	5,388,897
Debt service	52,564,612	52,087,812
Unrestricted (deficit)	<u>(30,807,974)</u>	<u>(64,346,281)</u>
Total net assets	<u>\$ 472,360,138</u>	<u>\$ 426,057,527</u>

See accompanying notes.



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

	Year Ended June 30	
	2012	2011
Revenues		
Operating revenues:		
Tuitions and fees (net of scholarship allowances of \$66,985,162 and \$72,584,268 for 2012 and 2011, respectively)	\$ 72,474,954	\$ 73,451,284
Net patient services revenue and other	86,819,429	71,465,562
Federal grants and contracts	125,037,138	134,209,649
Commonwealth grants and contracts (net of provision (credit) to allowances of (\$5,322,450) and \$2,394,595 for 2012 and 2011, respectively)	49,128,919	27,337,138
Nongovernmental grants and contracts	13,823,194	15,106,195
Sales and services of educational departments	11,620,001	8,991,008
Auxiliary enterprises (net of scholarship allowances of \$136,405 and \$85,476 for 2012 and 2011, respectively)	2,986,223	3,000,567
Other operating revenues	8,593,530	20,909,278
Total operating revenues	370,483,388	354,470,681
Operating expenses:		
Salaries:		
Faculty	342,326,653	345,848,868
Exempt staff	263,976,483	275,398,975
Nonexempt wages	811,761	733,512
Benefits	220,640,249	238,097,899
Scholarships and fellowships	203,958,904	215,204,518
Supplies and other services	164,710,063	155,972,533
Utilities	58,027,211	50,588,808
Depreciation and amortization	46,473,333	43,921,130
Other expenses	20,448,034	24,871,422
Total operating expenses	1,321,372,691	1,350,637,665
Operating loss	(950,889,303)	(996,166,984)
Nonoperating revenues (expenses):		
Commonwealth and other appropriations	834,097,217	839,372,106
Federal Pell Grant program	174,139,169	179,160,009
Federal ARRA program	-	15,000,000
Gifts	12,166,408	15,666,211
Net investment income	2,381,749	2,568,356
Interest on capital assets - related debt	(23,477,739)	(13,828,789)
Interest on notes payable	(4,570,254)	(1,787,458)
Other nonoperating revenues, net	173,075	1,357,205
Net nonoperating revenues	994,909,625	1,037,507,640
Income before other revenues	44,020,322	41,340,656
Capital appropriations	465,279	5,579,578
Additions to term and permanent endowments	1,817,010	11,044,066
Change in net assets	46,302,611	57,964,300
Net assets:		
Beginning of year	426,057,527	368,093,227
End of year	\$ 472,360,138	\$ 426,057,527

See accompanying notes.



University of Puerto Rico
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Statements of Cash Flows

	Year Ended June 30	
	2012	2011
Cash flows from operating activities		
Tuition and fees	\$ 72,089,231	\$ 71,155,116
Grants and contracts	169,312,230	186,752,877
Patient services	70,853,228	65,391,480
Auxiliary enterprises	2,986,223	3,000,567
Sales and services educational departments and other	20,213,531	29,900,284
Payments to suppliers	(178,868,605)	(216,840,623)
Payments to employees	(601,788,241)	(618,868,343)
Payments for benefits	(220,710,086)	(238,665,640)
Payments for utilities	(55,745,561)	(54,815,847)
Payments for scholarships and fellowships	(203,958,903)	(215,204,517)
Loans issued to students, net of repayments	(627,807)	(196,627)
Other receipts (payments)	(1,429,824)	405,590
Net cash used in operating activities	(927,674,584)	(987,985,683)
Cash flows from noncapital financing activities		
Commonwealth appropriations	857,037,324	852,231,723
Federal ARRA program	-	15,000,000
Pell grant	174,139,169	179,160,009
Endowment gifts	1,817,010	11,044,066
Proceeds from noncapital debt	-	93,705,769
Principal paid on noncapital debt	(28,706,660)	-
Interest paid on notes payable	(4,629,396)	(1,334,547)
Other non-operating revenues	173,075	1,357,205
Gifts and grants for other than capital purposes	12,166,408	15,666,211
Net cash provided by noncapital financing activities	1,011,996,930	1,166,830,436
Cash flows from capital and related financing activities		
Capital appropriations	465,279	5,579,578
Purchases of capital assets	(35,965,027)	(49,217,333)
Proceeds from sales of capital assets	231,413	1,126,820
Proceeds from capital debt	12,674,324	-
Principal paid on capital debt and lease	(28,462,025)	(28,946,245)
Interest paid on capital debt and lease	(24,469,100)	(17,420,460)
Decrease (increase) in deposit with trustee	26	(26,740)
Net cash used in capital and related financing activities	(75,525,110)	(88,904,380)
Cash flows from investing activities		
Proceeds from sales and maturities of investments	35,790,786	69,666,116
Purchases of investments	(45,229,314)	(57,551,068)
Collections of interest and dividend income on investments	2,381,749	2,568,356
Net cash provided by (used in) investing activities	(7,056,779)	14,683,404
Net change in cash and cash equivalents	1,740,457	104,623,777
Cash and cash equivalents:		
Beginning of year	108,015,533	3,391,756
End of year	\$ 109,755,990	\$ 108,015,533

(Continued)



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Statements of Cash Flows (continued)

	Year Ended June 30	
	2012	2011
Reconciliation of operating loss to net cash used in operating activities		
Operating loss	\$ (950,889,303)	\$ (996,166,984)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	46,473,333	43,921,130
Provision for doubtful accounts	7,104,484	8,831,226
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Grants and contracts receivables	(29,062,334)	793,251
Prepaid expenses, inventories and other	(844,756)	(10,148,345)
Increase (decrease) in:		
Excess of outstanding checks over bank balance	-	(10,920,460)
Accounts payable and accrued liabilities	(7,884,460)	(27,408,513)
Accrued salaries, wages, benefits and other liabilities	7,428,452	3,113,012
Net cash used in operating activities	\$ (927,674,584)	\$ (987,985,683)
Supplemental schedule of noncash investing, capital and financing activities:		
Due from Servicios Médicos Universitarios, Inc. forgiven by the University of Puerto Rico	\$ 34,496,756	\$ -

See accompanying notes.



**Discretely Presented Component Unit
Servicios Médicos Universitarios, Inc.
Statements of Net Assets (Deficit)**

	June 30	
	2012	2011
		<i>As Restated</i>
Assets		
Current assets:		
Cash and cash equivalents	\$ 7,240,915	\$ 3,142,686
Patient accounts receivable, net of allowance for doubtful accounts of \$24,037,203 for 2012 and \$14,885,379 for 2011	12,924,676	13,215,573
Accounts receivable - other	2,009,910	1,118,160
Due from related parties	9,318,328	8,354,159
Inventories of supplies	1,008,543	1,050,759
Prepaid expenses	229,368	250,963
Estimated third-party payor settlements-Medicare	444,106	2,079,005
Total current assets	33,175,846	29,211,305
Noncurrent assets:		
Capital assets (net of accumulated depreciation and amortization of \$12,590,159 for 2012 and \$11,038,785 for 2011)		
Nondepreciable assets	1,083,642	260,842
Depreciable assets	4,767,399	4,555,485
Due from Department of Health of the Commonwealth of Puerto Rico	155,636	137,650
Total noncurrent assets	6,006,677	4,953,977
Total assets	39,182,523	34,165,282
Liabilities		
Current liabilities:		
Current portion of long-term debt and capital lease obligation	\$ 1,791,641	\$ 1,681,119
Accounts payable	17,729,053	17,464,644
Due to related parties	16,596,452	49,356,458
Accrued payroll taxes and employee benefits	1,691,204	1,502,296
Accrued expenses	2,924,144	2,013,275
Total current liabilities	40,732,494	72,017,792
Noncurrent liabilities:		
Long-term debt and capital lease obligation, net of current portion	17,653,223	19,222,494
Accrued claim losses	1,215,796	1,134,796
Total noncurrent liabilities	18,869,019	20,357,290
Total liabilities	59,601,513	92,375,082
Net assets- unrestricted (deficit)	\$ (20,418,990)	\$ (58,209,800)

See accompanying notes.



Discretely Presented Component Unit
Servicios Médicos Universitarios, Inc.
Statements of Revenues, Expenses and Changes in Net Assets (Deficit)

	Year Ended June 30	
	2012	2011
		<i>As Restated</i>
Revenues		
Operating revenues:		
Net patient service revenue, net of provisions of \$9,333,453 for 2012 and \$9,628,460 for 2011	\$ 42,269,761	\$ 38,248,101
Capital revenue	993,782	3,185,174
Other revenue	1,830,992	1,624,509
Total operating revenues	45,094,535	43,057,784
Operating Expenses:		
Salaries and benefits	15,953,049	15,085,774
Contracted services	3,229,444	3,018,469
Professional services	2,960,330	3,287,431
Supplies	13,470,657	12,944,843
Utilities	3,323,787	2,708,728
Provision for claim losses	150,000	150,000
Depreciation and amortization	1,551,374	1,634,396
Other	187,787	192,223
Total operating expenses	40,826,428	39,021,864
Operating income	4,268,107	4,035,920
Nonoperating expenses- interest on notes payable	(974,053)	(1,133,234)
Income before other revenues	3,294,054	2,902,686
Contribution from the University of Puerto Rico - forgiveness of debt	34,496,756	-
Change in net assets	37,790,810	2,902,686
Net assets:		
Beginning of year, as previously reported	(58,209,800)	(61,683,244)
Prior period adjustment	-	570,758
Net assets at beginning of year	(58,209,800)	(61,112,486)
Net assets at end of year	\$ (20,418,990)	\$ (58,209,800)

See accompanying notes.



**Discretely Presented Component Unit
Desarrollos Universitarios, Inc.
Statements of Net Assets**

	June 30	
	2012	2011
Assets		
Current assets:		
Cash	\$ 1,735,580	\$ 1,721,322
Restricted funds held by trustee	15,059,470	14,621,673
Current portion of net investment in direct financing lease	1,480,996	1,383,308
Reimbursable tenant improvements unbilled, net of construction certifications payable of \$127,745 for 2011	1,253,710	424,557
Total current assets	19,529,756	18,150,860
Noncurrent assets:		
Restricted cash	757,491	1,322,158
Net investment in direct financing lease, net of current portion	63,358,429	64,847,637
Capital assets- depreciable assets net of accumulated depreciation of \$28,068 for 2012 and \$19,409 for 2011	4,433	13,092
Bond issuance costs, net of accumulated amortization of \$871,112 for 2012 and \$790,920 for 2011	1,918,112	1,998,304
Other assets	436,418	274,951
Total noncurrent assets	66,474,883	68,456,142
Total assets	86,004,639	86,607,002
Liabilities		
Current liabilities:		
Current portion of bonds payable	\$ 1,860,000	\$ 1,760,000
Construction contract and other development payables, retainage of \$1,553,736 for 2012 and 2011	1,633,736	1,633,736
Operating trade accounts payable	88,500	85,294
Accrued interest payable	1,920,969	1,970,469
Accrued costs and expenses	1,130,364	1,139,626
Due to University of Puerto Rico, net	133,716	18,844
Commercial tenants and student dormitories security deposits	68,185	127,491
Total current liabilities	6,835,470	6,735,460
Noncurrent liabilities:		
Bonds payable, net of current portion and discount of \$219,748 for 2012 and \$236,856 for 2011	72,490,252	74,333,144
Total liabilities	79,325,722	81,068,604
Net assets:		
Invested in capital assets, net of related debt	4,433	13,092
Restricted, expendable:		
Capital project	1,432,390	1,432,390
Debt service	8,212,375	7,825,078
Others	689,306	1,194,667
Unrestricted (deficit)	(3,659,587)	(4,926,829)
Total net assets	\$ 6,678,917	\$ 5,538,398

See accompanying notes.



Discretely Presented Component Unit
Desarrollos Universitarios, Inc.
Statements of Revenues, Expenses and Changes in Net Assets

	Year Ended June 30	
	2012	2011
Revenues:		
Operating revenues:		
Income from investment in direct financing lease	\$ 4,310,412	\$ 4,398,634
Fixed management fee	900,000	900,000
Reimbursable expenditures fee	2,386,245	2,382,513
Total operating revenues	7,596,657	7,681,147
Operating expenses:		
Project operation and maintenance	2,342,045	2,426,816
General and administrative	600,446	625,980
Total operating expenses	2,942,491	3,052,796
Operating income	4,654,166	4,628,351
Nonoperating revenues (expenses):		
Interest and other financing related expenses	(3,939,910)	(4,040,222)
Interest income	426,263	424,603
Net nonoperating expenses	(3,513,647)	(3,615,619)
Change in net assets	1,140,519	1,012,732
Net assets:		
Beginning of year	5,538,398	4,525,666
End of year	\$ 6,678,917	\$ 5,538,398

See accompanying notes.



University of Puerto Rico

Notes to Financial Statements June 30, 2012

1. Reporting Entity and Summary of Significant Accounting Policies

A. Reporting Entity

The University of Puerto Rico (the University), founded in 1903, is a state supported university system created by Law No. 1 of January 20, 1966, “Law of the University of Puerto Rico” (“Act No. 1”), as amended, with the mission to serve the people of Puerto Rico and contribute to the development and enjoyment of the fundamental, ethical and esthetic values of Puerto Rican culture, and committed to the ideals of a democratic society. To advance its mission, the University strives to provide high quality education and create new knowledge in the Arts, Sciences and Technology.

The University is a public corporation of the Commonwealth of Puerto Rico (the Commonwealth) governed by a seventeen-member Board of Trustees, of which fourteen members were appointed by the Governor of Puerto Rico and confirmed by the Senate of Puerto Rico. The remaining members of the Board consisted of one full-time student and two tenured professors. The Governor appointed the original members for a term of six years. The terms for the student and professors are one year.

On April 30, 2013, Act No. 13 derogated Article 3 of Act No. 1 of 1966, as amended, and established a new Article 3 of Act No. 1 that, among other matters, defines the composition, faculties and duties of the Governing Board of the University of Puerto Rico (the “Governing Board”), the new governing body of the University. Act No. 13 substitutes the Board of Trustees of the University with the Governing Board composed of thirteen members, of which nine members are appointed by the Governor of Puerto Rico and confirmed by the Senate of Puerto Rico. The remaining members of the Governing Board consist of two tenured professors and two full-time students. The Secretary of the Department of Education of the Commonwealth becomes ex-officio member of the Governing Board.

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

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

Appropriations from the Commonwealth are the principal source of revenues of the University and are supported by Act No. 2 of January 20, 1966, as amended. Under the Act, the Commonwealth appropriates for the University an amount equal to 9.60% of the average total amount of annual general funds revenues collected under the laws of the Commonwealth in the two fiscal years immediately preceding 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:



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

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

A. Reporting Entity (continued)

Servicios Médicos Universitarios, Inc.

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

Desarrollos Universitarios, Inc.

Desarrollos Universitarios, Inc. (the Company) is a legally separate entity from the University and is governed by a separate board. The Company was organized on January 22, 1997, under the laws of the Commonwealth of Puerto Rico, as a not-for-profit organization. The Company was organized to develop, construct, and operate academic, residential, administrative, office, commercial, and maintenance facilities for the use of students and other persons or entities conducting business with the University. The Company developed the Plaza Universitaria Project, which consist of a student housing facility, a multi-story parking building and an institutions building to house administrative, student service and support functions and to a lesser extent to lease commercial space. The financing for the Projects was provided by the issuance of \$86,735,000 in Educational Facilities Revenue Bonds through the Puerto Rico Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority (AFICA) on December 20, 2000. In 2008, the University entered into a capital lease agreement with the Company for the Plaza Universitaria project. The Company is fiscally dependent on the University. Complete financial statements of the Company can be obtained directly by contacting the Company's administrative offices.

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

B. Measurement Focus and Basis of Accounting

The accounting and reporting policies of the University conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities. The Governmental Accounting Standards Board (GASB) is the accepted standards setting body for establishing governmental accounting and financial reporting principles.

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. 35, *Basic Financial Statements-and Management's Discussion and Analysis-for Public Colleges and Universities*. 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



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

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

B. Measurement Focus and Basis of Accounting (continued)

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.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

C. Reclassifications

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

D. Cash Equivalents

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

E. Investments

Investments are reported at fair value, except for money market investments which are carried at cost, in the statements of net assets. Fair value is based on quoted market prices. The changes in the fair value of investments are reported in the statements of revenues, expenses and changes in net assets as a component of net investment income (non-operating activities).

Donated investments are recorded at their fair value at the date of donation. Investments of the Deferred Compensation Plan are valued at fair value, except for investment positions in 2a-7 like external pools which are carried at the pool's share price, which approximates amortized cost.

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

Restricted funds of Desarrollos Universitarios, Inc. held by trustee at June 30, 2012 and 2011 consist of money market funds and zero coupon bonds purchased with remaining maturities of six months or less.



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

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

G. Allowance for Doubtful Accounts

The allowance for uncollectible accounts and other receivables is an amount that management believes will be adequate to absorb possible losses on existing receivables that may become uncollectible based on evaluations of the collectability of the receivables and prior credit loss experience. Because of uncertainties inherent in the estimation process, the related allowance may change in the future.

H. Inventories

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

I. Capital Assets

All capital expenditures of \$1,000 or more and having a useful life of two or more years are capitalized at cost at the date of acquisition. Donated assets are recorded at estimated fair value at the date of donation. Depreciation and amortization expense is computed using the straight-line method over the estimated useful lives of the assets, or in the case of assets under capital lease, over the term of the lease, whichever is shorter, generally 25 to 50 years for buildings and infrastructure, 5 to 20 years for equipment, library materials and software, 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 are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense has been incurred.

J. Impairment of Capital Assets

The University accounts for asset impairment under the provisions of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This statement establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This statement also establishes accounting requirements for insurance recoveries. A capital asset generally should be considered impaired if both (a) the decline in service utility of the capital asset is large in magnitude and (b) the event or change in circumstance is outside the normal life cycle of the capital asset. Impaired capital assets that will no longer be used by the government should be reported at the lower of carrying value or fair value. No impairment charges were recorded during the years ended June 30, 2012 and 2011.

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

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



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

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

L. Deferred Compensation Plan

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

M. Compensated Absences

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

Employees accumulate sick leave generally at a rate of 1.5 days per month up to a maximum of 90 days. The University pays, annually, the excess of 90 days of accumulated sick leave to the employees. Upon retirement, an employee receives compensation for all accumulated unpaid sick leave at the then current rate, provided the employee has at least 10 years of service with the University. At June 30, 2012 and 2011, the cost of the excess of 90 days of the accumulated sick leave was approximately \$10,886,000 and \$9,744,000, respectively, which is included in other current liabilities in the accompanying statements of net assets.

N. Classification of Net Assets

The University's net assets are classified as follows:

- *Invested in capital assets, net of related debt* consist of the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent proceeds from issuance of debt has been received 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.



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

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

N. Classification of Net Assets (continued)

- *Restricted, expendable* net assets include resources that the University is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.
- *Unrestricted* net assets represent resources derived from student tuition and fees, state appropriations, hospital revenues, sales and services of educational activities and auxiliary enterprises. Auxiliary enterprises are substantially self-supporting activities that provide services for students, faculty and staff. While unrestricted net assets may be designated for specific purposes by action of management or the Governing Board, they are available for use, at the discretion of the governing board, to meet current expenses for any purpose.

O. Classification of Revenues

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

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

Non-operating revenues include activities that have the characteristics of non-exchange transactions, such as gifts and contributions, Federal Pell Grants and other revenue sources that are defined as nonoperating revenues by GASB Statement No. 35 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. Scholarship Allowances and Student Financial Aid

Student tuition and fees, and certain other revenues from students, are recorded net of scholarship discounts and allowances in the statement of revenues, expenses and changes in net assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the University and the amount that is paid by students and/or third parties making payments on the students' behalf. Certain governmental grants, such as federal grants, 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) June 30, 2012

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

Q. Net Patient Service Revenue

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

R. 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.

S. Gifts and Pledges

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

T. Pension

The University accounts for pension costs under the provisions of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers, as amended by GASB Statement No. 50, Pension Disclosures*. Under GASB Statement No. 27, annual pension cost, measured on the accrual basis of accounting, is equal to the annual required contribution (ARC) to the plan. A pension liability or asset is reported equal to the cumulative difference between annual required contributions and the statutorily required contributions.



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

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

U. Postemployment Benefits Other Than Pensions

The University accounts for postemployment benefits other than pensions (“OPEB”) under the provisions of the GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This statement requires a systematic, accrual-basis measurement and recognition of OPEB cost (expense) over a period that approximates employees’ years of service and provides information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan. GASB Statement No. 45 allows employers to amortize the portion of the cost attributed to past service over a period not to exceed thirty (30) years.

V. Effect of New Accounting Standard Adopted

In June 2011, the GASB issued Statement No. 64, *Application of Hedge Accounting Termination Provisions*. The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of swap counterparty or swap counterparty’s credit support provider. This Statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2011. The adoption of this statement had no impact on the University’s financial statements.

W. Future Adoption of Accounting Pronouncements

The GASB has issued the following Statements:

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which is effective for periods beginning after December 15, 2011.
- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34*, which is effective for periods beginning after June 15, 2012.
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is effective for periods beginning after December 15, 2011.
- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which is effective for periods beginning after December 15, 2011.
- GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which is effective for periods beginning after December 15, 2012.



University of Puerto Rico

Notes to Financial Statements (continued)
June 30, 2012

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

W. Future Adoption of Accounting Pronouncements (continued)

- GASB Statement No. 66, Technical Corrections- 2012- an Amendment of GASB Statements No. 10 and No. 62, which is effective for periods beginning after December 15, 2012.
GASB Statement No. 67, Financial Reporting for Pension Plans- an Amendment of GASB Statement No. 25, which is effective for periods beginning after June 15, 2013.
GASB Statement No. 68, Accounting and Financial Reporting for Pension Plans- an Amendment of GASB Statement No. 27, which is effective for periods beginning after June 15, 2014.
GASB Statement No. 69, Government Combinations and Disposals of Government Operations, which is effective for periods beginning after December 15, 2013.
GASB Statement No. 70, Accounting and Financial Reporting for Nonexchange Financial Guarantees, which is effective for periods beginning after June 15, 2013.

Management is evaluating the impact that these statements will have on the University's financial statements.

2. Cash and Cash Equivalents

The University's cash and cash equivalents as of June 30, 2012 and 2011 consisted of the following:

Table with 3 columns: Unrestricted, Restricted, Total. Rows include Cash on hand and due from commercial banks, Cash equivalents (Certificates of deposit with Commercial banks, Economic Development Bank for Puerto Rico, Money market funds), Total cash equivalents, and Total.



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

2. Cash and Cash Equivalents (continued)

	2011		
	Unrestricted	Restricted	Total
Cash on hand and due from commercial banks	\$ 776,708	\$ 7,766,512	\$ 8,543,220
Cash equivalents:			
Certificates of deposit with:			
Commercial banks	93,182,624	–	93,182,624
Economic Development Bank for Puerto Rico	2,180,000	–	2,180,000
Money market funds	–	4,109,689	4,109,689
Total cash equivalents	95,362,624	4,109,689	99,472,313
Total	\$ 96,139,332	\$ 11,876,201	\$ 108,015,533

Custodial credit risk related to deposits is the risk that in the event of a financial institution failure, the University's deposits might not be recovered. 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 Economic Development Bank for Puerto Rico (EDB), collateralize the amount deposited in excess of federal depository insurance (\$250,000 at June 30, 2012) with securities that are pledged with the Department of the Treasury. There is no formal policy for custodial credit risk for cash accounts opened with commercial banks outside of Puerto Rico. Cash accounts opened with commercial banks outside of Puerto Rico amounted to \$185,543 at June 30, 2012.

The deposits at EDB, a public corporation of the Commonwealth of Puerto Rico, and in money market funds are uninsured and uncollateralized. These deposits are exposed to custodial credit risk.

Foreign currency risk is the risk that changes in exchange rates will adversely affect the value of a deposit. Cash in foreign currency amounted to \$185,543 at June 30, 2012. Cash in foreign currency present minimal foreign currency risk at June 30, 2012.

Cash equivalents of the University's permanent endowment funds amounted to \$3,215,405 and \$3,558,598 as of June 30, 2012 and 2011, respectively. Refer to Note 3.

As of June 30, 2012 and 2011, the cash deposited in the banks amounted to \$132,705,486 and \$133,182,213, respectively.



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

3. Investments

The University's investments held at June 30, 2012 and 2011 are summarized in the following table:

	<u>2012</u>	<u>2011</u>
U.S. Treasury notes	\$ 70,305,383	\$ 69,643,177
U.S. sponsored agencies bonds and notes	3,770,662	4,277,522
U.S. municipal bonds	1,303,912	1,158,300
Foreign government bonds	2,768,432	861,208
Mortgage-backed securities	11,496,782	5,909,223
Corporate bonds	20,927,772	27,466,545
Common stock and convertibles	27,600,192	26,806,449
External investment pools	77,011,969	69,596,673
Certificates of deposit	7,383,407	7,053,784
Guaranteed investment certificate	327,881	620,184
Others	8,490	73,314
Total	<u>\$ 222,904,882</u>	<u>\$ 213,466,379</u>

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

Restricted Investments in Sinking Fund

The University is required to maintain a sinking fund for the retirement of the "University System Revenue Bonds". The Trustee shall, upon the receipt of the pledged revenues, make deposits to the credit of the sinking fund accounts. Funds held by trustee at June 30, 2012 and 2011 amounted to \$54,649,587 and \$54,649,613, respectively, and consisted of U.S. Treasury notes purchased with remaining maturities of six months or less.

Restricted Investments in Permanent Endowment Funds

Restricted investments held in the University's permanent endowment funds at June 30, 2012 and 2011 amounted to \$88,120,242 and \$84,818,821, respectively. The corpus of these funds may not be expended and must remain with the University in perpetuity. Only the earnings from these funds may be expended.

If a donor has not provided specific instructions, state law permits the Governing Board to authorize for expenditure the net appreciation (realized and unrealized) of the investments of endowment funds. When administering its power to spend net appreciation, the Board of Trustees is required to consider the University's "long- and short-term needs, present and anticipated financial requirements, expected total return on its investments, price-level trends, and general economic conditions." Any net appreciation that is spent is required to be spent for the purposes for which the endowment was established.



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

3. Investments (continued)

Restricted Investments in Permanent Endowment Funds (continued)

As of June 30, 2012 and 2011, almost all the University's endowment funds only authorize for expenditure the realized portion of the net appreciation of their investments (including interest and dividend income on investment and cash equivalents) in amounts that range from 85% to 100% in accordance with the donor specific instructions. Unrealized net appreciations on investments of the endowment funds are not available for authorization for the expenditures by the Governing Board. As of June 30, 2012, net appreciation of approximately \$4,919,000 is restricted to specific purposes.

Investments Designated to Fund the University's Healthcare Deferred Compensation Plan

Investments designated to fund the University's Healthcare Deferred Compensation Plan, which consisted of external investment pools, amounted to \$77,011,969 and \$69,596,673 as of June 30, 2012 and 2011, respectively. 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. These investments are (until paid or made available to the employee or other beneficiary) solely the property and rights of the University (without being restricted to the provisions of benefits under the plan), subject only to the claims of the University's general creditors. Participants' rights under the plan are equal to that of general creditors of the University in an amount equal to the fair value of the deferred account for each participant.

Credit Risk

Issuer credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. All of the University's investments in U.S. Treasury securities and mortgage-backed securities guaranteed by the Government National Mortgage Association carry the explicit guarantee of the U.S. government.



University of Puerto Rico

Notes to Financial Statements (continued)
June 30, 2012

3. Investments (continued)

Credit Risk (continued)

As of June 30, 2012, the University’s credit quality distribution for securities is as follows:

	Carrying Value	Quality Rating		
		AAA to A-	Unrated	No Risk
U.S. Treasury notes	\$ 70,305,383	\$ –	\$ –	\$ 70,305,383
U.S. sponsored agencies bonds and notes	3,770,662	3,770,662	–	–
U.S. municipal bonds	1,303,912	1,303,912	–	–
Foreign government bonds	2,768,432	2,768,432	–	–
Mortgage-backed securities	11,496,782	9,785,028	–	1,711,754
Corporate bonds	20,927,772	20,927,772	–	–
Guaranteed investment certificate	327,881	–	327,881	–
Common stock and convertibles	27,600,192	–	27,600,192	–
External investment pools	77,011,969	–	77,011,969	–
Certificates of deposit	7,383,407	–	7,383,407	–
Others	8,490	–	8,490	–
Total	\$ 222,904,882	\$ 38,555,806	\$ 112,331,939	\$ 72,017,137

Custodial Credit Risk

Custodial credit risk related to investments is the risk that, in the event of failure of the counterparty to a transaction, the University may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. At June 30, 2012, 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.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value is to changes in market interest rates. Expected maturities will differ from contractual maturities, because counterparties may have the right to call or prepay obligations with or without call or prepayment penalties. No investment in any one issuer other than the U.S. Government and the ING Life Insurance and Annuity Company – Fixed Account (external investment pool), represented 5% or more of the total investment portfolio at June 30, 2012.



University of Puerto Rico

Notes to Financial Statements (continued)
June 30, 2012

3. Investments (continued)

Interest Rate Risk (continued)

The following table summarizes the type and maturity of investments held by the University at June 30, 2012:

	Within One Year	After One to Five Years	After Five to Ten Years	After Ten Years	No Stated Maturity Date	Total Fair Value
U.S. Treasury notes	\$ 54,649,587	\$ 8,963,216	\$ 6,692,580	\$ -	\$ -	\$ 70,305,383
U.S. sponsored agencies bonds and notes	-	1,406,719	2,363,943	-	-	3,770,662
U.S. municipal bonds	-	-	133,643	1,170,269	-	1,303,912
Foreign government bonds	-	2,768,432	-	-	-	2,768,432
Mortgage-backed securities	122,696	-	942,327	10,431,759	-	11,496,782
U.S. corporate bonds	2,395,331	8,000,780	10,531,661	-	-	20,927,772
Certificates of deposit	7,383,407	-	-	-	-	7,383,407
Guaranteed investment certificate	327,881	-	-	-	-	327,881
External investment pools	59,724,840	385,166	-	1,147,073	15,754,890	77,011,969
Others	8,490	-	-	-	-	8,490
Common stock and convertibles	-	-	-	-	27,600,192	27,600,192
Total	\$ 124,612,232	\$ 21,524,313	\$ 20,664,154	\$ 12,749,101	\$ 43,355,082	\$ 222,904,882

At June 30, 2012, the University has variable rate interest investments amounting to \$2,678,818, which reset in a semiannual basis at 100% of an interest rate index plus a spread.

4. Accounts Receivable, Due from Commonwealth of Puerto Rico and Other Related-Party Transactions

The University's accounts receivable as of June 30, 2012 and 2011 are as follows:

	2012	2011
Due from Commonwealth's:		
Agencies	\$ 42,516,956	\$ 27,735,523
Component units	44,897,357	45,905,730
Municipalities	2,641,867	2,750,575
Due from Federal Government	30,023,749	24,557,612
Due from Servicios Médicos Universitarios, Inc.	16,651,040	51,955,760
Due from medical plans	99,770,106	82,217,203
Other	22,135,215	22,789,974
	258,636,290	257,912,377
Less allowance for doubtful accounts	(132,074,100)	(169,503,873)
Accounts receivable, net	\$ 126,562,190	\$ 88,408,504



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

4. Accounts Receivable, Due from Commonwealth of Puerto Rico and Other Related-Party Transactions (continued)

During the year ended June 30, 2012, the University forgave amounts due by the Hospital and fully reserved by the University of \$34,496,756.

Due from Commonwealth's component units includes an account receivable from the Puerto Rico Tourism Company (PRTC), a component unit of the Commonwealth of Puerto Rico, of \$12,224,736 and \$6,066,401 at June 30, 2012 and 2011, respectively. This account receivable includes unremitted distributions of income to be received by the University from PRTC under the Gambling Law (slot machines and others) by virtue of Act No. 36 of 2005 which are payable upon demand. PRTC appropriations (nonoperating revenues) for the years ended June 30, 2012 and 2011 amounted to \$70,940,139 and \$72,468,106, respectively, and are included as part of Commonwealth appropriations in the accompanying statements of revenues, expenses and changes in net assets.

Due from Commonwealth of Puerto Rico

As of June 30, 2012 and 2011, the University has accounts receivable from Commonwealth of Puerto Rico (the Commonwealth) of \$27,220,254 and \$56,318,696, respectively. Due from the Commonwealth balance will be received as follows: \$15,500,000 in fiscal year 2013; \$6,720,254 in fiscal year 2014; and \$5,000,000 in fiscal year 2015.

Due from Commonwealth as of June 30, 2012 includes \$15,000,000 related to revenue from the Commonwealth legislative scholarships for fiscal years 2008 and 2009, which the Commonwealth is paying to the University in annual payments of \$5.0 million.

Due from Commonwealth also includes a payment plan approved on September 7, 2004 in which the Commonwealth agreed 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, 2012, the University has received \$84,990,128 from this amount. The remaining balance of \$9,720,254 will be received as follows: \$8,000,000 in fiscal year 2013 and \$1,720,254 in fiscal year 2014.

In addition, due from Commonwealth includes \$2,500,000 for funds to be received from the Special Scholarship Fund by virtue of Act No. 176 of November 2010 which are payable upon demand.



University of Puerto Rico

Notes to Financial Statements (continued)
June 30, 2012

4. Accounts Receivable, Due from Commonwealth of Puerto Rico and Other Related-Party Transactions (continued)

Other Related-Party Transactions

The University's accounts payable and accrued liabilities include the following related-party transactions as of June 30, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Due to Commonwealth's:		
Agencies	\$ 2,364,101	\$ 2,374,104
Component units	23,007,124	29,854,423
Due to Servicios Médicos Universitarios, Inc.	9,318,327	1,822,841
Due to the University of Puerto Rico Retirement System	<u>2,575,092</u>	<u>2,463,335</u>
Total	<u>\$ 37,264,644</u>	<u>\$ 36,514,703</u>

For additional related-party transactions see Notes 2, 7, 9 and 11.

5. Capital Assets

Changes in the University's capital assets for the years ended June 30, 2012 and 2011 are as follows:

	<u>2012</u>				
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Transfers</u>	<u>Disposals and Others</u>	<u>Ending Balance</u>
Capital assets not being depreciated:					
Land	\$ 49,615,849	\$ -	\$ -	\$ -	\$ 49,615,849
Construction in progress	109,213,590	23,843,784	(73,649,010)	-	59,408,364
	<u>158,829,439</u>	<u>23,843,784</u>	<u>(73,649,010)</u>	<u>-</u>	<u>109,024,213</u>
Other capital assets:					
Land improvements	35,706,696	-	573,531	-	36,280,227
Building, fixed equipment, improvements and infrastructure	954,420,659	-	69,322,109	(2,101,796)	1,021,640,972
Equipment, software and library materials	274,267,486	12,121,243	3,753,370	(5,503,803)	284,638,296
Building and equipment under capital lease	99,298,249	-	-	-	99,298,249
	<u>1,363,693,090</u>	<u>12,121,243</u>	<u>73,649,010</u>	<u>(7,605,599)</u>	<u>1,441,857,744</u>
Less accumulated depreciation and amortization for:					
Land improvements	(18,318,975)	(1,294,162)	-	-	(19,613,137)
Buildings, fixed equipment, improvements and infrastructure	(316,862,597)	(22,974,527)	-	-	(339,837,124)
Equipment, software and library materials	(207,540,057)	(19,221,005)	-	5,272,390	(221,488,672)
Building and equipment under capital lease	(13,905,500)	(2,983,639)	-	-	(16,889,139)
	<u>(556,627,129)</u>	<u>(46,473,333)</u>	<u>-</u>	<u>5,272,390</u>	<u>(597,828,072)</u>
Other capital assets, net	807,065,961	(34,352,090)	73,649,010	(2,333,209)	844,029,672
of accumulated depreciation	<u>\$ 965,895,400</u>	<u>\$ (10,508,306)</u>	<u>\$ -</u>	<u>\$ (2,333,209)</u>	<u>\$ 953,053,885</u>
Capital assets, net					



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

5. Capital Assets (continued)

	2011				
	Beginning Balance	Additions	Transfers	Disposals and Others	Ending Balance
Capital assets not being depreciated:					
Land	\$ 42,438,639	\$ -	\$ 7,177,210	\$ -	\$ 49,615,849
Construction in progress	210,561,495	39,271,996	(140,472,508)	(147,393)	109,213,590
	<u>253,000,134</u>	<u>39,271,996</u>	<u>(133,295,298)</u>	<u>(147,393)</u>	<u>158,829,439</u>
Other capital assets:					
Land improvements	33,102,107	-	2,604,589	-	35,706,696
Building, fixed equipment, improvements and infrastructure	824,585,366	-	129,835,293	-	954,420,659
Equipment, software and library materials	270,586,718	9,945,337	855,416	(7,119,985)	274,267,486
Building and equipment under capital lease	99,298,249	-	-	-	99,298,249
	<u>1,227,572,440</u>	<u>9,945,337</u>	<u>133,295,298</u>	<u>(7,119,985)</u>	<u>1,363,693,090</u>
Less accumulated depreciation and amortization for:					
Land improvements	(17,110,195)	(1,208,780)	-	-	(18,318,975)
Buildings, fixed equipment, improvements and infrastructure	(296,691,106)	(20,171,491)	-	-	(316,862,597)
Equipment, software and library materials	(194,708,980)	(19,529,945)	-	6,698,868	(207,540,057)
Building and equipment under capital lease	(10,894,586)	(3,010,914)	-	-	(13,905,500)
	<u>(519,404,867)</u>	<u>(43,921,130)</u>	<u>-</u>	<u>6,698,868</u>	<u>(556,627,129)</u>
Other capital assets, net of accumulated depreciation	708,167,573	(33,975,793)	133,295,298	(421,117)	807,065,961
Capital assets, net	<u>\$ 961,167,707</u>	<u>\$ 5,296,203</u>	<u>\$ -</u>	<u>\$ (568,510)</u>	<u>\$ 965,895,400</u>

As of June 30, 2012 and 2011, the carrying value of the University's assets recorded under capital leases amounted to approximately \$82,409,000 and \$85,393,000, respectively. Amortization expense on these assets amounted to approximately \$2,984,000 and \$3,011,000 in 2012 and 2011, respectively. In addition, the carrying value of the University's medical equipments that collateralized the term notes payable to a commercial bank (see Note 7) amounted to approximately \$2,426,000 as of June 30, 2012.

Capitalized interest on construction in progress amounted to approximately \$5,267,000 and \$7,655,000 for the years ended June 30, 2012 and 2011, respectively.

6. Noncurrent Liabilities

Changes in the University's noncurrent liabilities for the years ended June 30, 2012 and 2011 are as follows:

	2012						
	Beginning Balance	Additions	Reductions	Other	Ending Balance	Less Due Within One Year	Noncurrent Liabilities
Long-term debt:							
Notes payable	\$ 93,705,769	\$ 12,674,324	\$ (28,745,377)	\$ -	\$ 77,634,716	\$ 474,791	\$ 77,159,925
Bonds payable	567,641,248	-	(27,040,000)	(502,440)	540,098,808	29,930,000	510,168,808
Total long-term	<u>\$ 661,347,017</u>	<u>\$ 12,674,324</u>	<u>\$ (55,785,377)</u>	<u>\$ (502,440)</u>	<u>\$ 617,733,524</u>	<u>\$ 30,404,791</u>	<u>\$ 587,328,733</u>
Other long-term liabilities:							
Deferred compensation payable	\$ 69,561,616	\$ 7,450,353	\$ -	\$ -	\$ 77,011,969	\$ -	\$ 77,011,969
Claims liability	23,830,822	-	(2,107,714)	677,892	22,401,000	2,107,714	20,293,286
Compensated absences	156,749,820	13,900,646	(3,524,226)	-	167,126,240	35,114,356	132,011,884
Capital lease obligation	66,076,436	-	(1,383,308)	-	64,693,128	1,472,628	63,220,500
Total other long-term liabilities	<u>\$ 316,218,694</u>	<u>\$ 21,350,999</u>	<u>\$ (7,015,248)</u>	<u>\$ 677,892</u>	<u>\$ 331,232,337</u>	<u>\$ 38,694,698</u>	<u>\$ 292,537,639</u>



University of Puerto Rico

Notes to Financial Statements (continued)
June 30, 2012

6. Noncurrent Liabilities (continued)

	2011						
	Beginning Balance	Additions	Reductions	Other	Ending Balance	Less Due Within One Year	Noncurrent Liabilities
Long-term debt:							
Notes payable	\$ -	\$ 93,705,769	\$ -	\$ -	\$ 93,705,769	\$ 18,016,638	\$ 75,689,131
Bonds payable	598,704,715	1,563,296	(27,652,000)	(4,974,763)	567,641,248	27,040,000	540,601,248
Total long-term	\$ 598,704,715	\$ 95,269,065	\$ (27,652,000)	\$ (4,974,763)	\$ 661,347,017	\$ 45,056,638	\$ 616,290,379
Other long-term liabilities:							
Deferred compensation payable	\$ 60,092,390	\$ 9,469,226	\$ -	\$ -	\$ 69,561,616	\$ -	\$ 69,561,616
Claims liability	23,425,232	-	(2,337,408)	2,742,998	23,830,822	2,337,408	21,493,414
Compensated absences	163,106,036	5,489,606	(11,845,822)	-	156,749,820	30,642,296	126,107,524
Capital lease obligation	67,370,683	-	(1,294,247)	-	66,076,436	1,383,308	64,693,128
Total other long-term liabilities	\$ 313,994,341	\$ 14,958,832	\$ (15,477,477)	\$ 2,742,998	\$ 316,218,694	\$ 34,363,012	\$ 281,855,682

Notes payable and bonds payable are further discussed in Notes 7 and 8-A, respectively.

7. Notes Payable

The University obtained a \$125 million line of credit with the Government Development Bank for Puerto Rico (GDB), a public corporation of the Commonwealth, for working capital purposes. This line of credit was converted into a ten year term loan in October 2011 payable in monthly equal principal payments plus interest starting on October 1, 2013. The term loan is collateralized by the University's accounts receivable from the Commonwealth of Puerto Rico and its agencies as well as by the Commonwealth of Puerto Rico income guaranteed appropriations under Act No. 2 of January 20, 1966, as amended. This term loan matures on October 1, 2022 and bears interest per annum equal to prime rate plus 150 basis points, with a floor of 6% (6% at June 30, 2012). The balance outstanding of this term loan amounted to \$64,999,109 and \$93,705,769 at June 30, 2012 and 2011, respectively. The unused balance of this line of credit amounted to \$6.9 million at June 30, 2012.

In addition, the University has a \$75.0 million non-revolving line of credit facility with GDB to complete certain construction projects of the University's Program for Permanent Improvements. This line of credit bears interest per annum equal to prime rate plus 150 basis points, with a floor of 6% (6% at June 30, 2012). The balance outstanding of this line of credit amounted to \$10,248,324 at June 30, 2012. The unused balance of this line of credit amounted to \$64.8 million at June 30, 2012. As disclosed in Note 15, this line of credit was amended in January 2013 to extend the maturity date to January 31, 2014.

In January 2012, the University entered into two term loan agreements with a commercial bank for a total amount of \$2.4 million for the acquisition of medical equipments to be used in the Medical Sciences Campus. These term loans are payable in 60 monthly payments as follows: three interest only payments and 57 principal and interest payments amounting to \$46,803. These term loans are collateralized with the acquired medical equipment, mature on February 1, 2017 and bear interest per annum equal to 4%. The balance outstanding of these terms loan amounted to \$2,387,283 at June 30, 2012.



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

7. Notes Payable (continued)

The table that follows represents debt service payments on notes payable as of June 30, 2012. Although interest rates on variable rate debt change over time, the calculations included in the table below are based on the assumption that the variable rate on June 30, 2012 will remain the same for their term.

<u>Fiscal Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2013	\$ 474,791	\$ 4,601,696	\$ 5,076,487
2014	5,910,727	4,474,020	10,384,747
2015	17,984,714	3,782,408	21,767,122
2016	7,757,342	2,969,437	10,726,779
2017	7,590,995	2,515,243	10,106,238
2018-2022	36,110,616	6,048,528	42,159,144
2023	1,805,531	18,055	1,823,586
	<u>\$ 77,634,716</u>	<u>\$ 24,409,387</u>	<u>\$ 102,044,103</u>

A. Notes Payable – Discretely Presented Component Unit

Servicios Médicos Universitarios, Inc. (the Hospital) has notes payable amounting to \$19,444,864 and \$20,903,613 as of June 30, 2012 and 2011, respectively. A summary of the Hospital's notes payable at June 30, 2012 and 2011 follows:

	<u>2012</u>	<u>2011</u>
Term loan payable with GDB	\$ 17,588,844	\$ 18,818,920
Non-revolving line of credit with GDB	638,932	77,145
Term loan payable in 76 biweekly payments of principal and interest of \$30,000, bears fixed interest of 5.5% and matures on October 24, 2013.	950,942	1,605,234
Term loan payable in 36 monthly payments of principal and interest of \$12,000, bears fixed interest of 5.5% and matures on March 31, 2014.	237,362	364,489
Other	<u>28,784</u>	<u>37,825</u>
	19,444,864	20,903,613
Less: current portion	1,791,641	1,681,119
Noncurrent portion	<u>\$ 17,653,223</u>	<u>\$ 19,222,494</u>



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

7. Notes Payable (continued)

A. Notes Payable – Discretely Presented Component Unit (continued)

The Hospital operates and administers the healthcare unit located in Carolina. This facility was acquired by the University and includes land, building and medical equipment. During 2009, the Hospital restructured its line of credit facility with GDB and accrued interest in the aggregated amount of \$23,360,913 into a term loan and extended the maturity date to June 30, 2025. As part of the term loan agreement, the Hospital was required to make a down payment of \$2,700,000. The term loan is payable in 192 monthly installments of principal and interest of approximately \$171,637 and bears interest per annum equal to prime rate plus 150 basis points (3.25% at June 30, 2012). The loan is guaranteed by the University.

The non-revolving line of credit of \$1.1 million with GDB was granted for the acquisition of medical equipment and matures on December 20, 2015. It bears interest per annum equal to prime rate plus 150 basis points, with a floor of 6% and a ceiling of 12% (6.00% at June 30, 2012). The line of credit is guaranteed by the University.

The activity of the principal balance of the long-term debt for the years ended June 30, 2012 and 2011 is as follows:

	2012	2011
Beginning Balance	\$ 20,903,613	\$ 19,891,091
Additions	561,787	2,683,120
Reductions	(2,020,536)	(1,670,598)
Ending Balance	\$ 19,444,864	\$ 20,903,613

The table that follows represents debt service payments on long-term debt as of June 30, 2012. Although interest rates on variable rate debt change over time, the calculations included in the table below are based on the assumption that the variable rate on June 30, 2012 will remain the same for their term.

Fiscal Year Ending June 30	Principal	Interest	Total
2013	\$ 1,791,641	\$ 1,191,112	\$ 2,982,753
2014	1,337,030	1,093,408	2,430,438
2015	1,065,650	1,024,525	2,090,175
2016	1,766,677	944,721	2,711,398
2017	1,199,292	860,348	2,059,640
2018-2022	7,280,321	3,017,883	10,298,204
2023	5,004,253	566,353	5,570,606
	\$ 19,444,864	\$ 8,698,350	\$ 28,143,214



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

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, 2012 and 2011:

Series	Balance as of June 30, 2012	Balance as of June 30, 2011	Annual Interest Rate (%)	Due Date June 30, 2012
F - Term	\$ —	\$ 4,525,000	5.50%	
N - Capital Appreciation Serial Bonds	12,685,000	20,590,000	5.75%	2013
O - Serial	—	2,315,000	4.80%	
P - Serial	221,865,000	229,095,000	5.00%	2013-2026
P - Term	47,645,000	47,645,000	5.00%	2027-2030
Q - Serial	104,205,000	109,270,000	5.00%	2013-2026
Q - Term	132,415,000	132,415,000	5.00%	2027-2036
	<u>518,815,000</u>	<u>545,855,000</u>		
Plus unamortized premium	25,425,293	27,299,914		
Less:				
Unaccrued interest	—	(430)		
Future appreciated principal	(703,476)	(1,765,522)		
Deferred refunding loss	(3,438,009)	(3,747,714)		
	<u>\$ 540,098,808</u>	<u>\$ 567,641,248</u>		

At June 30, 2012, bonds payable require payments of principal and interest as follows:

Fiscal Year Ending June 30	Principal	Interest	Total
2013	\$ 29,930,000	\$ 25,306,500	\$ 55,236,500
2014	18,110,000	24,444,250	42,554,250
2015	19,015,000	23,538,750	42,553,750
2016	19,970,000	22,588,000	42,558,000
2017	20,965,000	21,589,500	42,554,500
2018 to 2022	121,635,000	91,136,000	212,771,000
2023 to 2027	130,715,000	58,127,500	188,842,500
2028 to 2032	97,665,000	28,380,000	126,045,000
2033 to 2036	60,810,000	7,786,250	68,596,250
	<u>\$ 518,815,000</u>	<u>\$ 302,896,750</u>	<u>\$ 821,711,750</u>

B. Pledged Revenues

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



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

8. Bonds Payable (continued)

B. Pledged Revenues (continued)

The University's revenues pledged were as follows for the years ended June 30, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Pledged Revenues:		
Tuition and other fees collected	\$ 78,529,284	\$ 86,413,916
Student fees collected	4,881,215	4,455,726
Stabilization Fee	44,186,568	41,326,364
Rental and other charges received for the right of use and occupancy of the facilities in the University system	1,784,483	1,764,561
Interest on investment of University funds, excluding funds invested pursuant to Article VI of the Trust Agreement	369,158	306,052
Funds paid to the University in respect to overhead allowance on federal research projects	19,529,583	16,924,540
Other income	31,415,272	28,577,584
Total Pledged Revenues	180,695,563	179,768,744
Sinking Fund Reserve Interest	234,771	691,439
Total Pledged Revenues Plus Interest	\$ 180,930,334	\$ 180,460,183
Aggregate Debt Service:		
Principal and Interest Requirement	\$ 53,321,245	\$ 54,779,880
Senior Debt Service Coverage Ratio	3.39	3.29
Desarrollo Universitarios Bonds (Subordinate to the University's Bonds)	\$ 5,601,938	\$ 5,625,938
Aggregate Debt Service	\$ 58,923,183	\$ 60,405,818
Total Debt Service Ratio	3.07	2.99

The Trust Agreement governing the bonds issued required a ratio of total pledged revenues plus interest earned on reserve account to principal and interest requirements for the University's bonds of at least 1.5 to 1 (total debt service coverage ratio). At June 30, 2012, the University was in compliance with the total debt service coverage ratio requirement.

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

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

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



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

8. Bonds Payable (continued)

B. Pledged Revenues (continued)

- *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.

The University complied with the sinking fund requirements at June 30, 2012.

C. Bonds Payable – Discretely Presented Component Unit

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



University of Puerto Rico

Notes to Financial Statements (continued)
June 30, 2012

8. Bonds Payable (continued)

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

Bonds payable at June 30, 2012 and 2011, consist of:

Description	Interest Rate	Maturity	2012 Face Amount	2011 Face Amount
Serial Bonds	5.63%	July 1, 2012	\$ –	\$ 1,760,000
Serial Bonds	5.63%	July 1, 2013	1,860,000	1,860,000
Serial Bonds	5.63%	July 1, 2014	1,960,000	1,960,000
Serial Bonds	5.63%	July 1, 2015	2,075,000	2,075,000
Serial Bonds	5.63%	July 1, 2016	2,190,000	2,190,000
Serial Bonds	5.63%	July 1, 2017	2,315,000	2,315,000
Serial Bonds	5.63%	July 1, 2018	2,445,000	2,445,000
Serial Bonds	5.63%	July 1, 2019	2,580,000	2,580,000
Serial Bonds	5.00%	July 1, 2020	2,725,000	2,725,000
Serial Bonds	5.00%	July 1, 2021	2,880,000	2,880,000
Serial Bonds	5.00%	July 1, 2033	3,020,000	3,020,000
Serial Bonds	5.00%	July 1, 2034	50,520,000	50,520,000
Total			74,570,000	76,330,000
Less unaccrued interest			(219,748)	(236,856)
Total			\$ 74,350,252	\$ 76,093,144

The activity of the principal balance of the bonds payable for the years ended June 30, 2012 and 2011, is as follows:

	2012	2011
Beginning Balance	\$ 76,330,000	\$ 78,015,000
Reductions	(1,760,000)	(1,685,000)
Ending Balance	\$ 74,570,000	\$ 76,330,000



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

8. Bonds Payable (continued)

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

At June 30, 2012, bonds payable require payment of principal and interest as follows:

<u>Fiscal Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2013	\$ 1,860,000	\$ 3,737,313	\$ 5,597,313
2014	1,960,000	3,627,063	5,587,063
2015	2,075,000	3,510,344	5,585,344
2016	2,190,000	3,387,155	5,577,155
2017	2,315,000	3,256,938	5,571,938
2018 to 2022	13,650,000	14,117,687	27,767,687
2023 to 2027	17,535,000	10,085,000	27,620,000
2028 to 2032	22,385,000	4,997,750	27,382,750
2033 to 2035	10,600,000	271,500	10,871,500
Total	<u>\$ 74,570,000</u>	<u>\$ 46,990,750</u>	<u>\$ 121,560,750</u>

Interest on the bonds is payable each January 1 and July 1. Bonds maturing after July 1, 2011 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.

<u>Redemption Period</u>	<u>Amount</u>
July 1, 2023	\$ 3,175,000
July 1, 2024	3,330,000
July 1, 2025	3,500,000
July 1, 2026	3,675,000
July 1, 2027	3,855,000
July 1, 2028	4,050,000
July 1, 2029	4,255,000
July 1, 2030	4,465,000
July 1, 2031	4,690,000
July 1, 2032	4,925,000
July 1, 2033	5,170,000
July 1, 2034	5,430,000
Total	<u>\$ 50,520,000</u>



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

9. Obligation under Capital Lease

In October 2007, the University entered into a capital lease agreement with Desarrollos Universitarios, Inc., a nonprofit corporation and discretely presented component unit of the University. The agreement is for the use of Plaza Universitaria, a residential and commercial facility for the use of students and other persons or entities conducting business with the University. The agreement began on October 1, 2006 and expires on June 25, 2033. The outstanding liability at June 30, 2012 and 2011 on this capital lease is \$64,693,128 and \$66,076,436, respectively. The effective interest rate was determined at 6.60%.

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

<u>Year Ending June 30,</u>	<u>Amount</u>
2013	\$ 5,697,312
2014	5,702,063
2015	5,700,344
2016	5,702,156
2017	5,701,938
2018-2022	28,497,687
2023-2027	28,495,000
2028-2032	28,502,750
2033	5,701,500
Total future minimum lease payments	<u>119,700,750</u>
Less amounts representing interest costs	(55,007,622)
Present value of minimum lease payments	<u>\$ 64,693,128</u>

10. Commitments and Contingent Liabilities

A. Claims Liability

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.

The University was insured through January 1993 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. The process used in computing claims liabilities does not necessarily result in an exact amount, because actual claims liabilities depend upon such complex factors as inflation, changes in legal doctrines, and damage awards. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.



University of Puerto Rico

Notes to Financial Statements (continued)
June 30, 2012

10. Commitments and Contingent Liabilities (continued)

A. Claims Liability (continued)

Changes in the claims liability amount for medical malpractice in the years ended June 30, 2012 and 2011 were:

Table with 3 columns: Description, 2012, and 2011. Rows include Claims payable - July 1, Incurred claims and changes in estimates, Payments for claims and adjustments expenses, and Claims payable - June 30.

In addition, the University is a defendant in several lawsuits other than medical malpractice arising out of the normal course of business. Management has recorded an accrual of \$10,445,000 and \$11,576,822 as of June 30, 2012 and 2011, respectively, to cover claims and lawsuits that may be assessed against the University.

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.

Effective April 23, 2012, the National Science Foundation (NSF), an independent U.S. government agency, suspended the federal awards for research and development in the Research and Development Center at the Mayagüez Campus and in the Resource Center for Science and Engineering ascribed to the Central Administration unit of the University because the University has not corrected the time and effort reporting deficiencies as established in its Corrective Action Plan related to previous audits' findings.

The amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time. Management believes the impact will not be material to the University's financial statements.

C. Construction Commitments

Construction commitments at June 30, 2012, entered by the University, amounted to approximately \$46.6 million.



University of Puerto Rico

Notes to Financial Statements (continued)
June 30, 2012

10. Commitments and Contingent Liabilities (continued)

D. Operating Lease Agreement

The University rents a building of an outside clinic of the medical practice plan of the Medical Sciences Campus under non-cancelable long-term operating lease agreement which expires in July 2018. This lease contains escalation clauses providing for increased rental. Rent charged to operations in fiscal year 2012 and 2011 amounted to \$1,344,000. At June 30, 2012, the minimum annual future rentals, without considering renewal options, are approximately as follows:

Table with 2 columns: Fiscal Year Ending June 30 and Amount. Rows include years 2013 through 2017 and a 2018-2019 period, with a total amount of \$7,922,000.

E. Guaranty Commitment

The University guarantees the Hospital long-term debt (a term loan and a line of credit) with the Government Development Bank for Puerto Rico amounting to \$18,227,776 at June 30, 2012. See Note 7A.

F. Discretely Presented Component Units

Desarrollos Universitarios, Inc. (the Company) operates the Plaza Universitaria facilities 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



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

10. Commitments and Contingent Liabilities (continued)

F. Discretely Presented Component Units (continued)

and a variable component. The fixed component shall be in an amount sufficient to guarantee to bondholders the payment of principal and interest on the AFICA Bonds as may be established in the financing documents, and will be pledged to guarantee such payments. The variable component of the lease payments will be used to cover operating, maintenance, administrative, management, and other fees and costs, which will be established periodically and reviewed annually between the parties, as well as such amounts for reserves and special funds, which may be required under the financing documents related to the bond issue.

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

11. University of Puerto Rico Retirement System

Plan Description and Membership – 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 income taxes. The System is not subject to the requirements of the Employees Retirement Income Security Act of 1974 (ERISA). The System issues a publicly available financial report that includes financial statements and required supplementary information for the plan. That report may be obtained by writing to the University of Puerto Rico Retirement System at P.O. Box 21769, San Juan, Puerto Rico 00931-1769.

The System provides retirement, disability and death benefits to participants and beneficiaries. Cost-of-living adjustments are provided to participants and beneficiaries at the discretion of the Governing Board the University (Governing Board). Participants who have completed 20 years of service by July 1, 1979 are entitled to annual retirement benefits at any age after 30 years of service. Otherwise, participants are entitled to annual retirement benefits at age 55 after 30 years of service. Participants may elect to receive their retirement benefits at age 58 after 10 years of service, or at age 55 after 25 years of service. The amount of the service retirement annuity is based on the applicable retirement formula, as defined.

A participant whose employment terminates after ten years of service, and who does not withdraw his or her contributions, receives a retirement annuity payable beginning at age 60 based on the applicable retirement formula. If termination of employment occurs prior to completing ten years of service, participant is entitled to a refund of his or her own contributions. Refund of a participant's own contributions can also be obtained after attainment of ten years of service but in that event the vested benefit is forfeited.



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

11. University of Puerto Rico Retirement System (continued)

At June 30, 2012, membership in the System consisted of the following:

Retirees and beneficiaries currently receiving benefits	7,697
Terminated plan participants entitled to but not yet receiving benefits	465
Terminated non-vested plan participants entitled to return of their contributions	7,881
Current participating employees	<u>11,148</u>
 Total membership	 <u>27,191</u>

Funding Policy – The contribution requirements of participants and the University are established and may be amended by the Governing Board. Plan members are required to contribute from 7% to 11% of their annual covered salary up to certain specified amounts, as defined. The University is supposed to contribute at an actuarially determined rate; the rate as of June 30, 2012 and 2011 was 14.70% and 13.0%, respectively, of annual covered payroll. The actuarially determined employer contribution rate comes from actuarial valuation at start of the fiscal year. It takes into account payment of administrative expenses. Therefore, administrative expenses are paid out of the plan fund.

Annual Pension Cost and Prepaid Pension Asset – The University’s annual pension cost and prepaid pension asset movement for the years ended June 30, 2012 and 2011 were as follows:

	2012	2011
Annual required contribution (ARC)	\$ 72,186,223	\$ 68,486,552
Interest on the net pension asset	(4,727,071)	(4,407,092)
Adjustments to ARC	<u>2,877,043</u>	<u>2,682,294</u>
Annual OPEB cost (expense)	70,336,195	66,761,754
Employer contribution	<u>75,139,790</u>	<u>70,761,490</u>
Change in the net pension asset	4,803,595	3,999,736
Prepaid pension asset.- beginning of year	<u>59,088,385</u>	<u>55,088,649</u>
Prepaid pension asset.- end of year	<u>\$ 63,891,980</u>	<u>\$ 59,088,385</u>
 Percentage of annual OPEB cost contributed	<u>106.83%</u>	<u>105.99%</u>

Prepaid pension asset has been recorded in prepaid pension asset and other assets in the University’s accompanying statements of net assets.

The three-year trend information is as follows:

Fiscal Year Ending	Annual Pension Cost (APC)	Employer Contribution	Percentage of APC Contributed	Net Pension Obligation (Asset)
6/30/2012	\$ 70,336,195	\$ 75,139,790	106.8%	\$ (63,891,980)
6/30/2011	\$ 66,761,754	\$ 70,761,490	106.0%	\$ (59,088,385)
6/30/2010	\$ 62,275,417	\$ 71,176,599	114.3%	\$ (55,088,649)



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

11. University of Puerto Rico Retirement System (continued)

Funded Status and Funding Progress – The following table shows the University’s funded status of the System as of June 30, 2012, the most recent actuarial valuation date:

Actuarial Accrued Liability (AAL)	\$ 2,617,989,147
Actuarial Value of Assets	<u>1,039,441,000</u>
Unfunded AAL (UAAL)	<u>\$ 1,578,548,147</u>
Funded Ratio	<u>39.7%</u>
Covered Payroll	<u>\$ 499,027,788</u>
UAAL as a Percentage of Covered Payroll	<u>316.3%</u>

The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

The projections of benefits for financial reporting purposes do not explicitly incorporate the potential effects of legal or contractual funding limitations.

Actuarial Methods and Assumptions –The actuarial methods and assumptions as of the latest actuarial valuation follow:

Actuarial valuation date	6/30/2012
Actuarial cost method	Entry age normal (traditional)
Amortization method	Level percentage of payroll
Remaining amortization period	30 years constant (open basis)
Asset valuation method	Market value adjusted to reflect investment gain and losses over a five (5) year period.
Actuarial assumptions:	
Investment rate of return*	8.00%
Projected salary increases*	5.00%
*Includes inflation at	3.50%
Postretirement benefit increases	3% every two (2) years applicable to salary cap or Certification 139, no postretirement benefit increases are assumed.
Mortality table	RP-2000 with projection



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

12. Post-Employment Benefits Other Than Pensions (OPEB)

Program Description and Membership – The University provides post-employment benefits other than pension for its retired employees (the “OPEB Program”). Substantially all of the employees may become eligible for these benefits if they are eligible to retire under the University of Puerto Rico Retirement System (30 years of service, age 58 with 10 years of service or age 55 with 25 years of service). Employees are also eligible on disability with 10 years of service. The cost of providing such benefits are recognized when paid.

The University provides the following OPEB:

- **Medical Subsidy:** Fixed subsidy of \$125 per month (\$1,500 per year) per participant (\$0 for spouse) is paid by the University for the life of the participant at retirement to insurance companies whose premiums are paid by the retiree and by the University or directly to the participant with proof of coverage.
- **Tuition Remission:** Tuition fees for classes at the University are waived for life after retirement.

At June 30, 2012, membership in the OPEB Program consisted of the following:

Retirees and beneficiaries currently receiving benefits	7,447
Current participating employees	<u>11,168</u>
Total membership	<u>18,615</u>

Funding Policy and Annual OPEB Cost – The required contribution is based on projected pay-as-you-go financing requirements. Benefits are actuarially calculated by an independent actuary.

The Annual OPEB Cost is calculated based on the annual required contribution of the employer (the “ARC”). The ARC is determined in accordance with plan provisions, demographic participant data, actuarial assumptions, actuarial cost method, and other actuarial methods prescribed by GASB Statement No. 45. While pre-funding is not required, the ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty years. The ARC will generally increase with benefit cost increases and participant growth; in addition, gains/losses resulting from demographic and/or assumption changes will also impact the ARC.



University of Puerto Rico

**Notes to Financial Statements (continued)
June 30, 2012**

12. Post-Employment Benefits Other Than Pensions (OPEB) (continued)

The following tables show the components of the University's annual OPEB cost for the fiscal years ended June 30, 2012 and 2011, the amount actually contributed to the OPEB Program, the change in the University's net obligation and the funded status of the OPEB Program.

	<u>2012</u>	<u>2011</u>
ARC	\$ 10,128,465	\$ 9,651,667
Interest on the net OPEB obligation	98,530	102,822
Adjustments to ARC	<u>(85,392)</u>	<u>(89,113)</u>
Annual OPEB cost (expense)	10,141,603	9,665,376
Employer contribution	<u>(10,029,846)</u>	<u>(9,772,691)</u>
Change in the net OPEB obligation	111,757	(107,315)
Net OPEB obligation- beginning of year	<u>2,463,242</u>	2,570,557
Net OPEB obligation- end of year	<u>\$ 2,574,999</u>	<u>\$ 2,463,242</u>
Percentage of annual OPEB cost contributed	<u>98.90%</u>	<u>101.11%</u>

Net OPEB obligations have been recorded in accounts payable and accrued liabilities in the University's accompanying statements of net assets.

The following table shows the University's funded status of the OPEB Program:

Actuarial Valuation Date	July 1, 2011
Actuarial Accrued liability (AAL)	<u>\$ 197,323,686</u>
Unfunded AAL	<u>\$ 197,323,686</u>
Funded ratio	<u>0%</u>

The three-year trend information is as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
6/30/2012	\$ 10,141,603	98.9%	\$ 2,574,999
6/30/2011	\$ 9,665,376	101.1%	\$ 2,463,242
6/30/2010	\$ 9,659,344	88.3%	\$ 2,570,557



University of Puerto Rico

Notes to Financial Statements (continued)
June 30, 2012

12. Post-Employment Benefits Other Than Pensions (OPEB) (continued)

OPEB Actuarial Valuation – The University’s OPEB Program actuarial valuation was conducted by Deloitte Consulting LLP as of July 1, 2011, members of the American Academy of Actuaries. As permitted by GASB Statement No. 45, the actuarial valuation is performed every two years.

Significant Actuarial Methods and Assumptions:

Table with 2 columns: Actuarial Method/Assumption and Value/Assumption. Rows include: Actuarial Valuation Date (July 1, 2011), Actual Cost Method (Projected Unit Credit), Amortization Method (Level Dollar amortization over 30 Years), Medical Subsidy (85%), Tuition Remission (\$497 per retiree in fiscal 2012, increasing 4.0% per year), Mortality (RP-2000 Healthy Combined Mortality Table for healthy, RP-2000 Healthy Combined Mortality Table, lives set forward 10 years for disabled lives), Payroll Growth (4%), and Discount Rate (4%).

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

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future, and actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about the actuarial value of program assets relative to the actuarial accrued liability for benefits.

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

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



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

13. Management Business Plan and Operation - Discretely Presented Component Unit

During most of the preceding years (up to June 30, 2009), the Hospital experienced significant operating losses having an accumulated net assets deficiency of \$20,418,990 as of June 30, 2012. 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 Puerto Rico 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, homeless and resident 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, the Puerto Rico Department of Health has been unable to pay for such services. As shown in the accompanying financial statements, the Hospital has provided allowances for uncollectible accounts receivable in the approximated amount of \$24,037,203 as of June 30 2012.

The Hospital's management believes that all these factors had a material impact in the Hospital's results of operations during its years of operations and, consequently, has resulted in the accumulated deficit at June 30, 2012.

The Hospital's management, with the assistance of its Board of Directors, is working with a management plan toward its operational activities as well as the Hospital's ability to generate sufficient cash flows to cover its current obligations.

Some of these measures had an impact in the Hospital's operations and as a result, the Hospital's operations reported an income before other revenues of approximately \$3,294,000 and \$2,903,000 during the years ended June 30, 2012 and 2011, respectively.

The University has expressed its commitment to provide the Hospital with the necessary financial support, if needed, to continue its operations. During the year ended June 30, 2012, the University forgave amounts due by the Hospital of \$34,496,756. This amount is presented in the Hospital's Statement of Activities and Changes in Unrestricted Net Assets for the year ended June 30, 2012 as a Contribution from the University of Puerto Rico.



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

14. Functional Information

The University's operating expenses by functional classification during the years ended June 30, 2012 and 2011 were as follows:

2012							
Functional Classification	Salaries and Benefits	Scholarships and Fellowships	Supplies and other Services	Utilities	Depreciation and Amortization	Other Expenses	Total
Instruction	\$ 371,243,905	\$ 7,508,214	\$ 21,616,847	\$ 1,692,724	\$ -	\$ 839,171	\$ 402,900,861
Research	55,693,981	17,903,923	26,587,888	892,748	-	7,209,386	108,287,926
Public service	47,422,479	1,477,919	6,164,090	1,858,240	-	555,527	57,478,255
Academic support	66,352,678	878,245	17,762,673	98,031	-	1,896,247	86,987,874
Student service	40,849,116	570,791	10,306,767	7,220	-	1,923,474	53,657,368
Institutional support	118,345,663	747,590	30,425,801	2,329,318	-	3,313,539	155,161,911
Operation & maintenance	81,292,467	5,577	25,961,353	51,123,707	-	977,536	159,360,640
Student aid	2,869,135	174,380,779	1,231,910	435	-	144,627	178,626,886
Independent operation	36,073	9,788	55,719	-	-	12,989	114,569
Patient service	41,847,866	397,476	22,414,908	22,478	-	3,344,781	68,027,509
Auxiliary enterprises	967,414	78,602	2,182,107	2,310	-	230,757	3,461,190
Depreciation and amortization	-	-	-	-	46,473,333	-	46,473,333
Other	834,369	-	-	-	-	-	834,369
	\$ 827,755,146	\$ 203,958,904	\$ 164,710,063	\$ 58,027,211	\$ 46,473,333	\$ 20,448,034	\$ 1,321,372,691

2011							
Functional Classification	Salaries and Benefits	Scholarships and Fellowships	Supplies and other Services	Utilities	Depreciation and Amortization	Other Expenses	Total
Instruction	\$ 381,034,096	\$ 8,330,607	\$ 11,470,578	\$ 207,213	\$ -	\$ 1,053,349	\$ 402,095,843
Research	58,562,681	16,929,661	24,124,214	665,785	-	15,248,777	115,531,118
Public service	48,788,342	1,951,412	29,508,182	2,260,367	-	2,407,258	84,915,561
Academic support	70,501,131	998,539	16,744,465	261,993	-	1,656,614	90,162,742
Student service	42,628,220	447,149	8,987,773	8,737	-	1,006,335	53,078,214
Institutional support	105,990,193	302,188	20,839,230	2,775,314	-	1,240,077	131,147,002
Operation & maintenance	103,791,274	1,544	24,618,057	44,346,510	-	118,947	172,876,332
Student aid	2,848,635	185,814,778	674,373	541	-	46,193	189,384,520
Independent operation	36,165	9,967	41,462	-	-	657	88,251
Patient service	38,772,457	387,658	16,508,105	27,144	-	1,730,718	57,426,082
Auxiliary enterprises	908,129	6,108	2,456,094	35,204	-	362,497	3,768,032
Depreciation and amortization	-	-	-	-	43,921,130	-	43,921,130
Other	6,217,931	24,907	-	-	-	-	6,242,838
	\$ 860,079,254	\$ 215,204,518	\$ 155,972,533	\$ 50,588,808	\$ 43,921,130	\$ 24,871,422	\$ 1,350,637,665

15. Subsequent Events

Subsequent events were evaluated through August 22, 2013, the date the financial statements were available to be issued, to determine if such events should be recognized or disclosed in the 2012 financial statements.

In January 2013, the \$75 million line of credit facility with the Government Development Bank for Puerto Rico was amended to extend the maturity date to January 31, 2014.



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

15. Subsequent Events (continued)

On April 7, 2013, Act No. 7 amended Act No. 2 of January 20, 1966, as amended, to revise the formula for the Commonwealth appropriations, 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 preceding the current fiscal year. Act No.7 is effective on July 1, 2013.

In addition, Act No. 7 of April 7, 2013 derogated Act No. 176 of November 2010, as amended by Act No. 46 of April 2011, in which the Commonwealth of Puerto Rico had committed to transfer 10% of the Additional Lottery's net annual income with a guaranteed minimum amount of \$30 million per academic year, for the creation of a Special Scholarship Fund for the University of Puerto Rico. The purpose of the fund was to provide financial aid to graduate and undergraduate students.

On January 26, 2013, Board of Trustees of the University approved Certification No. 41 (2012-2013) which derogated the stabilization fee established by the Board of Trustees of the University on June 30, 2010 to address the University's budgetary deficit issues. This stabilization fee was charged to all students in addition to tuition charges and other fees already in place in the University. The stabilization fee amounted to \$400 per student per semester. Board of Trustees Certification No. 41 is effective on July 1, 2013.

On April 30, 2013, Act No. 13 derogated Article 3 of Act No. 1 of 1966, as amended, and established a new Article 3 of Act No. 1 that, among other matters, defines the composition, faculties and duties of the Governing Board of the University of Puerto Rico (the "Governing Board"), the new governing body of the University. Act No. 13 substitutes the Board of Trustees of the University with the Governing Board composed of thirteen members, of which nine members are appointed by the Governor of Puerto Rico and confirmed by the Senate of Puerto Rico. The remaining members of the Governing Board consist of two tenured professors and two full-time students. The Secretary of the Department of Education of the Commonwealth becomes ex-officio member of the Governing Board.

16. The Hospital's Restatement

Subsequent to the issuance of the Hospital's 2011 financial statements, management of the Hospital identified several errors in such previously issued financial statements. During 2006, the Hospital entered into an agreement with an affiliate, in which it established that the affiliate will provide certain patient services under the Hospital's premises, and will pay the Hospital 30% of total collections received for such services. During the year ended June 30, 2012, the Hospital discovered that total service revenues recorded corresponding to this agreement were understated by \$1,038,875, from which \$468,117 corresponded to 2011 and \$570,758 to prior years.



University of Puerto Rico

Notes to Financial Statements (continued) June 30, 2012

16. The Hospital's Restatement (continued)

The Hospital accounted for the correction of this error as a prior year adjustment and restated the fiscal year 2011 financial statements as follows:

	<u>As Previously Reported</u>	<u>As Restated</u>
Statement of Financial Condition as of June 30, 2011:		
Due to related parties	\$ 42,041,174	\$ 41,002,299
Deficiency in unrestricted net assets	(59,248,675)	(58,209,800)
Statement of Activities and Changes in Unrestricted Net Assets for the Year Ended June 30, 2011:		
Net patient service revenue	\$ 47,408,444	\$ 47,876,561
Deficiency in unrestricted net assets, at beginning of year	(61,683,244)	(61,112,486)
Statement of Cash Flows for the Year Ended June 30, 2011:		
Cash flows from operating activities :		
Changes in unrestricted net assets	\$ 2,434,569	\$ 2,902,686
Decrease in accounts receivable	(569,861)	(649,122)
Decrease in accounts payable	(4,475,910)	(4,864,766)

Required Supplementary Information



University of Puerto Rico
Schedules of Funding Progress
(Unaudited)

Employees Retirement Plan

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered ((b - a) / c)
6/30/2012	\$ 1,039,441,000	\$ 2,617,989,147	\$ 1,578,548,147	39.7%	\$ 499,027,788	316.3%
6/30/2011	\$ 1,041,628,000	\$ 2,542,444,021	\$ 1,500,816,021	41.0%	\$ 510,706,620	293.9%
6/30/2010	\$ 1,028,918,000	\$ 2,436,913,244	\$ 1,407,995,244	42.2%	\$ 540,867,018	260.3%
6/30/2009	\$ 1,034,645,000	\$ 2,331,619,466	\$ 1,296,974,466	44.4%	\$ 570,122,184	227.5%
6/30/2008	\$ 1,024,987,000	\$ 2,223,219,684	\$ 1,198,232,684	46.1%	\$ 542,603,556	220.8%
6/30/2007	\$ 953,197,000	\$ 2,068,102,695	\$ 1,114,905,695	46.1%	\$ 513,486,180	217.1%

Postemployment Benefits Other Than Pensions Program

Actuarial Valuation Date	Actual value of Assets (a)	Actual Accrued Liability (AAL) (b)	UAAL (b - a)	Funded Ratio (a / b)
7/1/2011	\$ -	\$ 197,323,686	\$ (197,323,686)	0%
7/1/2009	\$ -	\$ 189,417,225	\$ (189,417,225)	0%
7/1/2007	\$ -	\$ 184,232,820	\$ (184,232,820)	0%

Other Financial Information



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

	2012		
	Bond Service Account	Bond Reserve Account	Total
Additions:			
Transfer from Reserve Account	\$ 28,825	\$ –	\$ 28,825
Transfer from unrestricted current funds	53,289,191	–	53,289,191
Interest earned on investments	34,944	199,827	234,771
Total receipts	<u>53,352,960</u>	<u>199,827</u>	<u>53,552,787</u>
Deductions:			
Payments of bond interest	26,281,245	–	26,281,245
Payments of bond principal	27,040,000	–	27,040,000
Net increase in fair value of investments	31,715	183,125	214,840
Transfer to Reserve Account	–	28,825	28,825
Total disbursements	<u>53,352,960</u>	<u>211,950</u>	<u>53,564,910</u>
Net increase for the year	–	(12,123)	(12,123)
Balances at beginning of year	–	54,685,610	54,685,610
Balance at end of year	<u>\$ –</u>	<u>\$ 54,673,487</u>	<u>\$ 54,673,487</u>

	2011		
	Bond Service Account	Bond Reserve Account	Total
Additions:			
Transfer from Reserve Account	\$ 87,258	\$ –	\$ 87,258
Transfer from unrestricted current funds	54,676,678	–	54,676,678
Interest earned on investments	136,071	555,368	691,439
Total receipts	<u>54,900,007</u>	<u>555,368</u>	<u>55,455,375</u>
Deductions:			
Payments of bond interest	33,335,995	–	33,335,995
Payments of bond principal	21,443,885	–	21,443,885
Net increase in fair value of investments	120,326	464,421	584,747
Transfer to Reserve Account	–	87,258	87,258
Total disbursements	<u>54,900,206</u>	<u>551,679</u>	<u>55,451,885</u>
Net increase for the year	(199)	3,689	3,490
Balances at beginning of year	199	54,681,921	54,682,120
Balance at end of year	<u>\$ –</u>	<u>\$ 54,685,610</u>	<u>\$ 54,685,610</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, 2012, and have issued our report thereon dated August 22, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of Servicios Médicos Universitarios, Inc. (the Hospital) and Desarrollos Universitarios Inc. (the Company), as described in our report on the University's financial statements. This report does not include results of other auditor's testing of internal control over financial reporting or compliance and other matters that are reported on separately by other auditors. The financial statements of the Hospital and the Company were not audited in accordance with *Government Auditing Standards*.

Internal control over financial reporting

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

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

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

2012-1 Financial Statement Close Process

Criteria

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

Condition

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

- Multiple audit/post-closing entries that were not initially identified by the University's internal controls were required to properly record revenues and expense activity, accounts receivable activity, cash activity, prepaid expenses activity and certain liabilities. These entries were considered material to the financial statements.
- The compilation of financial data and reconciliation processes are not completed in a timely manner. The lack of procedures and controls in these areas result in inefficiencies during the financial statements preparation process.

- The accounting and financial reporting operations of certain units of the University, specifically the Medical Sciences Campus and the Mayagüez Campus, are not able to detect or prevent accounting errors effectively nor efficiently which results in multiple audit adjustments.

Cause

The lack of adequate controls during the implementation of the new accounting system has resulted in an ineffective and inefficient financial statements close process. In addition, the lack of integration between the units and the central administration finance and accounting functions has an adverse impact in the financial reporting of the University as a whole.

Effect

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

Recommendations

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

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

The University should consider changing or reinforcing the organizational structure to improve monitoring controls over the accounting and financial reporting functions of units. The accounting and financial reporting responsibilities should be centralized and units should respond directly, timely and effectively to the Central Administration Finance Director and Controller.

An effective control environment requires that those in charge of governance monitor the accounting and financial reporting functions effectively. By implementing these recommendations the monitoring of the accounting and financial reporting activities of the University will be reinforced.

Compliance and other matters

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

This report is intended solely for the information and use of management, the Board of Trustees, others within the entity, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

August 22, 2013

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