

AUDITED FINANCIAL STATEMENTS

University of Puerto Rico
Years Ended June 30, 2010 and 2009
With Report of Independent Auditors

University of Puerto Rico
 Audited Financial Statements
 Years Ended June 30, 2010 and 2009

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Report of Independent Auditors

Board of Trustees
University of Puerto Rico

We have audited the accompanying financial statements of the business-type activities and the aggregate discretely presented component units of the University of Puerto Rico (the University), a component unit of the Commonwealth of Puerto Rico, as of and for the years ended June 30, 2010 and 2009, which collectively comprise the University's financial statements, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the financial statements of Servicios Médicos Universitarios, Inc. (the Hospital) and Desarrollos Universitarios, Inc. (the Company), which represent 100% of the aggregate discretely presented component units, as of and for the years ended June 30, 2010 and 2009. Those financial statements were audited by other auditors whose reports thereon have been furnished to us. The Hospital's report included an explanatory paragraph stating that it has experienced recurring losses since it commenced operations and has a net capital deficiency, and this raises substantial doubt about its ability to continue as a going concern. Our opinion, insofar as it relates to amounts included for the Hospital and the Company, is solely based on the reports of the other auditors.

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

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the University of Puerto Rico and the aggregate discretely presented component units of the University of Puerto Rico as of June 30, 2010 and 2009, and the respective changes in financial position and cash flows thereon for the years then ended in conformity with US generally accepted accounting principles.

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

As discussed in Note 15 to the financial statements, the University adopted the Governmental Accounting Standards Board Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, effective July 1, 2009.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 20, 2011, 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.

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

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the University of Puerto Rico financial statements. The schedules of changes in sinking fund reserves included on page 64 are presented for purposes of additional analysis and are not a required part of the financial statements. The schedules of changes in sinking fund reserves have been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, are fairly stated in all material respects in relation to the financial statements taken as a whole.

Ernst & Young LLP

April 21, 2011

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this report.



University of Puerto Rico Management's Discussion and Analysis

Introduction

The following discussion presents an overview of the financial position and financial activities of the University of Puerto Rico (the University) for the years ended June 30, 2010, 2009 and 2008. This discussion and analysis was prepared by University management and should be read in conjunction with the financial statements and notes thereto, which follow.

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

Financial Highlights

As of June 30, 2010, the University has total assets of \$1.42 billion, total liabilities of \$1.06 billion and net assets of \$368.1 million. The University's net assets remained consistent when compared with the prior year. These changes are explained in the section entitled "Analysis of Financial Position and Changes in Financial Position." An overview of the statements is presented below along with a financial analysis of the transactions impacting the statements.

Condensed financial statements for the University as of and for the years ended June 30, 2010, 2009 and 2008 follow:

Condensed Statements of Net Assets (In thousands)			
	June 30		
	2010	2009	2008
Assets			
Current assets	\$ 233,452	\$ 285,485	\$ 299,997
Noncurrent assets:			
Due from Commonwealth of Puerto Rico	56,609	74,890	89,201
Capital assets	961,168	898,328	834,398
Other assets	172,950	220,961	271,533
Total assets	<u>1,424,179</u>	<u>1,479,664</u>	<u>1,495,129</u>
Liabilities			
Current liabilities	204,944	178,178	144,436
Noncurrent liabilities	851,142	933,537	924,671
Total liabilities	<u>1,056,086</u>	<u>1,111,715</u>	<u>1,069,107</u>
Net assets			
Invested in capital assets net of related debt	309,055	300,279	275,019
Restricted:			
Nonexpendable	78,591	63,746	65,447
Expendable	72,205	69,891	86,479
Unrestricted	(91,758)	(65,967)	(923)
Total net assets	<u>\$ 368,093</u>	<u>\$ 367,949</u>	<u>\$ 426,022</u>



**University of Puerto Rico
Management's Discussion and Analysis**

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

	Year Ended June 30		
	2010	2009	2008
Operating revenues			
Tuition and fees, net	\$ 41,809	\$ 50,624	\$ 51,286
Governmental grants and contracts	131,682	127,969	140,465
Patient services	51,449	55,532	48,666
Other operating revenues	40,118	33,968	37,860
Total operating revenues	265,058	268,093	278,277
Operating expenses			
Salaries and benefits	933,653	939,531	912,323
Scholarships and fellowships	211,831	176,636	160,492
Supplies and other services and utilities	198,742	207,598	209,246
Other operating expenses	78,585	87,544	69,222
Total operating expenses	1,422,811	1,411,309	1,351,283
Operating loss	(1,157,753)	(1,143,216)	(1,073,006)
Nonoperating revenues (expenses)			
Commonwealth appropriations	839,318	923,760	935,881
Federal Pell Grant program	179,165	141,101	121,234
Federal ARRA program	105,000	-	-
Other nonoperating revenues (expenses) , net	1,066	(452)	(5,072)
Net nonoperating revenues	1,124,549	1,064,409	1,052,043
Loss before other revenues	(33,204)	(78,807)	(20,963)
Capital appropriations	1,288	17,240	17,577
Additions to term and permanent endowments	9,251	3,494	2,688
Decrease in net assets	(22,665)	(58,073)	(698)
Net Assets			
Beginning of year, as previously reported	367,949	426,022	426,720
Cumulative impact of change in accounting for intangible assets	22,809	-	-
Beginning of year, as adjusted	390,758	426,022	426,720
End of year	\$ 368,093	\$ 367,949	\$ 426,022



University of Puerto Rico Management's Discussion and Analysis

Using the Financial Statements

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

Analysis of Financial Position and Changes in Financial Position

Statements of Net Assets

The statements of net assets present the assets, liabilities and net assets of the University as of June 30, 2010 and 2009. The net assets are displayed in three parts, invested in capital assets net of related debt, restricted and unrestricted. Restricted net assets may either be expendable or nonexpendable and are those assets that are restricted by law or by an external donor. Unrestricted net assets, while they are generally designated for specific purposes, are available for use by the University to meet current expenses for any purposes. The statements of net assets, along with all of the University's basic financial statements, are prepared under the accrual basis of accounting, whereby revenues are recognized when the service is provided by and expenses are recognized when others provide the service to the University, regardless of when cash is exchanged. Assets and liabilities included in the statements of net assets are classified as current or noncurrent.

Total assets amounted to \$1.42 billion, \$1.48 billion and \$1.50 billion at June 30, 2010, 2009, and 2008, respectively, a decrease of \$55.5 million or 4% in 2010 and a decrease of \$15.5 million or 1% in 2009 when compared with the prior year balances.

Current assets primarily consist of short-term investments and accounts receivable. As of June 30, 2010, investments and accounts receivable comprise approximately 51% and 47%, respectively, of the current assets, meanwhile 81% of the noncurrent assets are capital assets. As of June 30, 2009, investments and accounts receivable comprise approximately 39% and 59%, respectively, of the current assets, meanwhile 75% of noncurrent assets are capital assets.

Total investments at June 30, 2010 amounted to \$225.5 million, a decrease of \$41.0 million or 15% as compared to a balance of \$266.5 million at June 30, 2009. For 2009, total investments decreased by \$64.9 million or 20% as compared to a balance of \$331.4 million at June 30, 2008. The decreases in both periods were mainly due to the disposition of the investments to fund the University's construction projects.



University of Puerto Rico Management's Discussion and Analysis

Accounts receivable, net, including due from Commonwealth of Puerto Rico decreased by \$77.3 million or 32% from \$244.5 million at June 30, 2009 to \$167.2 million at June 30, 2010. In 2009, accounts receivable, net decreased by \$10.5 million or 4% from \$255.0 million at June 30, 2008. The decrease in 2010 mainly resulted from the cancellation of a receivable from the Commonwealth of \$51.2 million against a note payable and an increase in the provision for doubtful accounts of \$26.4 million for the year ended June 30, 2010. The decrease in 2009 mainly resulted from the change in the provision for doubtful accounts of \$27.6 million for the year ended June 30, 2009. The University has a receivable from the Commonwealth of \$48.6 million related to the revenue from appropriations for fiscal years 2008 and 2009. Although the University believes it has the legal right and it is entitled to receive these revenues, Management determined to apply an allowance for doubtful accounts equal to 50% of the outstanding balance at June 30, 2009. On April 2011, the University settled with the Commonwealth this receivable for \$18,598,441. The University will receive the amount during fiscal year 2012.

Capital assets increased by \$62.9 million or 7% from \$898.3 million at June 30, 2009, to \$961.2 million at June 30, 2010. For 2009, capital assets increased by \$63.9 million or 8 % from \$834.4 million at June 30, 2008. The increase in both years mainly resulted from the University's investment in construction projects and other capital assets that amounted to \$84.7 million in fiscal year 2010 and \$105.9 million in fiscal year 2009, which was partially offset by the depreciation and amortization expense of \$43.7 million in fiscal year 2010 and \$37.6 million in fiscal year 2009. In addition, the University adopted GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets* ("GASB Statement No. 51"), effective July 1, 2009. The financial reporting impact resulting from the implementation of GASB Statement No. 51 is the recognition within the University's financial statements of \$22.8 million in capital assets with a corresponding credit to net assets at July 1, 2009. For further details, refer to Note 15 of the accompanying financial statements.

Total liabilities amounted to \$1.06 billion, \$1.11 billion and \$1.07 billion at June 30, 2010, 2009, and 2008, respectively, a decrease of \$55.6 million or 5% in 2010 and an increase of \$42.6 million or 4% in 2009 when compared with the prior year balances.

Current liabilities consist primarily of the excess of outstanding checks over bank balance, accounts payable and accrued liabilities, the current portion of long-term debt and other liabilities. Noncurrent liabilities primarily consist of long-term debt and lease and compensated absences.

Excess of outstanding checks over bank balance, accounts payable and accrued liabilities increased by \$20.2 million or 16% from \$123.1 million at June 30, 2009 to \$143.4 million at June 30, 2010. In 2009, these current liabilities increased by \$30.0 million or 32% from \$93.1 million at June 30, 2008. The increases in both periods are mainly related to increased costs in the health and medical benefits to employees and the increase of unpaid utilities.



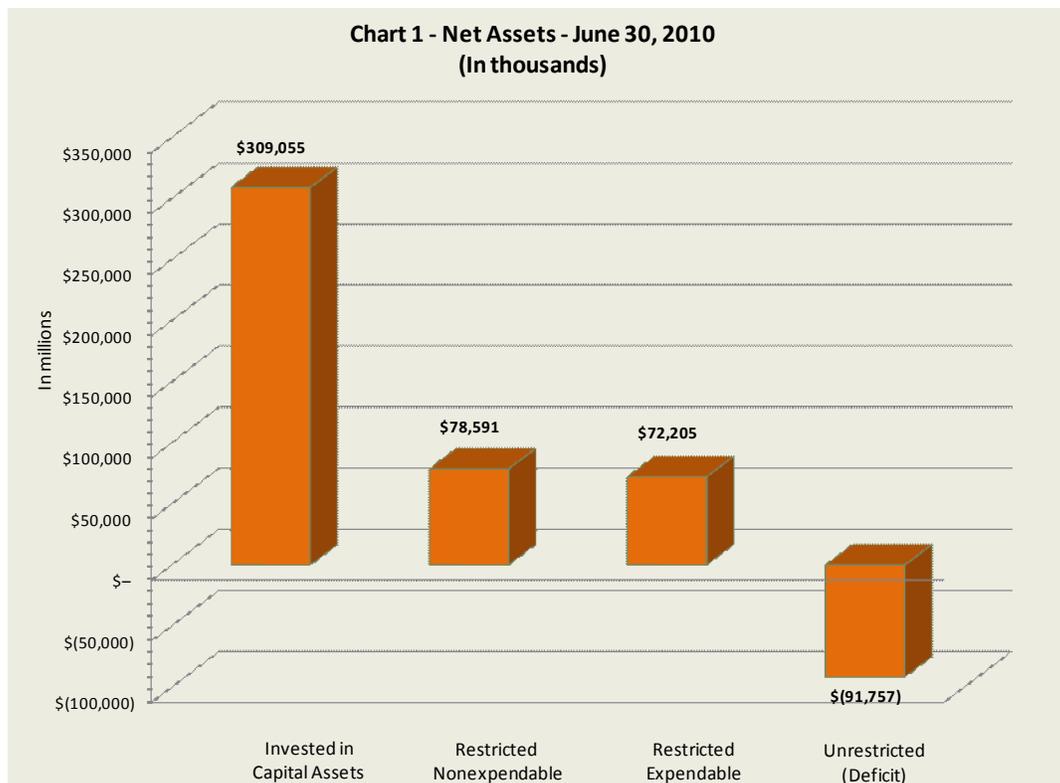
University of Puerto Rico Management's Discussion and Analysis

Long-term debt and capital lease obligation decreased by \$72.4 million or 10% from \$738.5 million at June 30, 2009, to \$666.1 million at June 30, 2010. In 2009, long-term debt and capital lease obligation decreased by \$5.2 million or 1% from \$743.7 million at June 30, 2008. In fiscal year 2010, the University cancelled a note payable of \$51.2 million against a receivable from the Commonwealth. In addition, the decreases in both years mainly resulted from principal paid on capital debt and capital lease obligation of \$22.0 million and \$23.1 million for the years ended June 30, 2010 and 2009, respectively.

Compensated absences amounted to \$163.1 million, \$169.7 million and \$159.1 million at June 30, 2010, 2009 and 2008, respectively, a decrease of \$6.6 million or 4% in 2010 and an increase of \$10.6 million or 7% in 2009 when compared with prior year balances. Changes in compensated absences are mainly related to variations on the use of vacations by employees.

Net assets represent the residual interest in the University's assets after liabilities are deducted. Net assets amounted to \$368.1 million, \$367.9 million and \$426.0 million at June 30, 2010, 2009, and 2008, respectively, an increase of \$144 thousand in 2010 and a decrease of \$58.1 million or 14% in 2009 when compared with the prior year balances. These changes are explained in the section entitled "*Statements of Revenues, Expenses and Changes in Net Assets*".

The major classifications of the net assets are shown in the following illustration:





University of Puerto Rico Management's Discussion and Analysis

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

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

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

Statements of Revenues, Expenses and Changes in Net Assets

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

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.

Approximately 90% 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.

Total operating revenues amounted to \$265.1 million, \$268.1 million and \$278.3 million for the years ended June 30, 2010, 2009, and 2008, respectively, a decrease of \$3.0 million or 1% in 2010 and a decrease of \$10.2 million or 4% in 2009. The changes in operating revenues mainly resulted from the decrease in tuition and fees revenues. In 2010, revenues from governmental grants and contracts increased by \$3.7 million or 3% from \$128.0 million in 2009, to \$131.7 million in 2010 mainly as a result of increases in Commonwealth's grants and contracts. In 2009, these revenues decreased by \$12.5 million or 9% from \$140.5 million in 2008 mainly as a result of decreases in the Federal grants and contracts.



University of Puerto Rico Management's Discussion and Analysis

Tuition and fees decreased by \$8.8 million or 17%, from \$50.6 million in 2009 to \$41.8 million in 2010, mainly is the result of higher scholarship allowances (about \$6.0 million more than in fiscal year 2009) because of the increase in the Federal Pell Grant program. In 2010, the Federal Pell Grant program increased the grant amount per student and reduced the grant qualification requirements which had the effect of increase the scholarship allowances. Patient services amounted to \$51.4 million, \$55.5 million and \$48.6 million for the years ended June 30, 2010, 2009, and 2008, respectively, a decrease of \$4.1 million or 7% in 2010 and an increase of \$6.9 million or 14% in 2009. In 2010, patient service revenue decreased as a result of the increase in the provision for doubtful accounts and in 2009 it increased as a result of more services rendered to patients.

Total non-operating revenues amounted to \$1.12 billion, \$1.06 billion and \$1.05 billion for the years ended June 30, 2010, 2009, and 2008, respectively, an increase of \$60.1 million or 6% in 2010 and an increase of \$12.4 million or 1% in 2009. In 2010, the University received nonrecurring revenues from the American Reinvestment and Reconstruction Act (ARRA funds) of \$105.0 million when in 2009 and 2008 no such funds were received. The increase in non-operating revenues was partially offset by the continued reduction in the Commonwealth appropriations which amounted to \$839.3 million, \$923.8 million and \$935.9 million for the years ended June 30, 2010, 2009, and 2008, respectively, a decrease of \$84.5 million or 9% in 2010 and a decrease of \$12.1 million or 1% in 2009 as a result of the reduction in the Commonwealth's general funds revenues.

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.

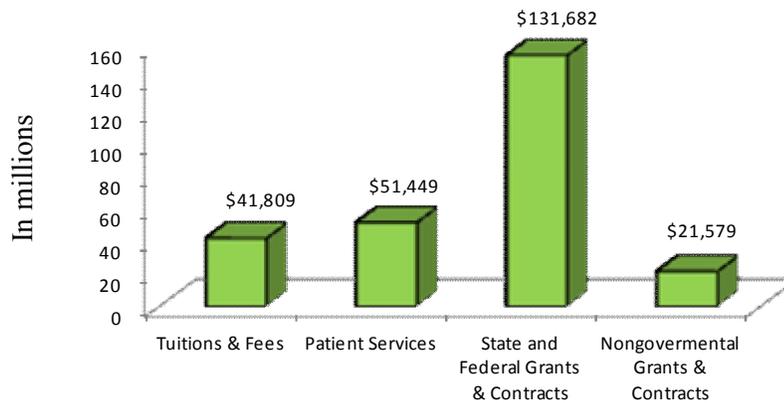
Federal Pell Grant program revenues amounted to \$179.2 million, \$141.1 million and \$121.2 million for the years ended June 30, 2010, 2009, and 2008, respectively, an increase of \$38.1 million or 27% in 2010 and an increase of \$19.9 million or 16% in 2009. The increases in both periods were mainly due to the increase in the Federal Pell Grant assistance along with an increase in the number of eligible participants as previously mentioned.



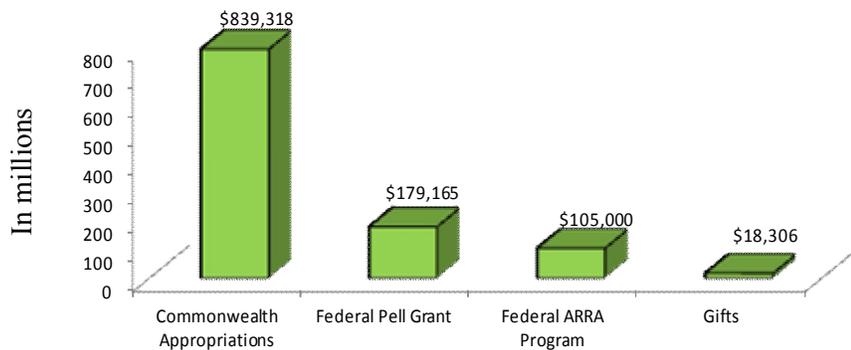
University of Puerto Rico Management's Discussion and Analysis

The following illustration presents the major sources of the University revenues (both operating and nonoperating) for the year ended June 30, 2010:

**Chart 2 – Major Sources of Operating Revenues
(In thousands)**



**Chart 3 – Major Sources of Nonoperating Revenues
(In thousands)**

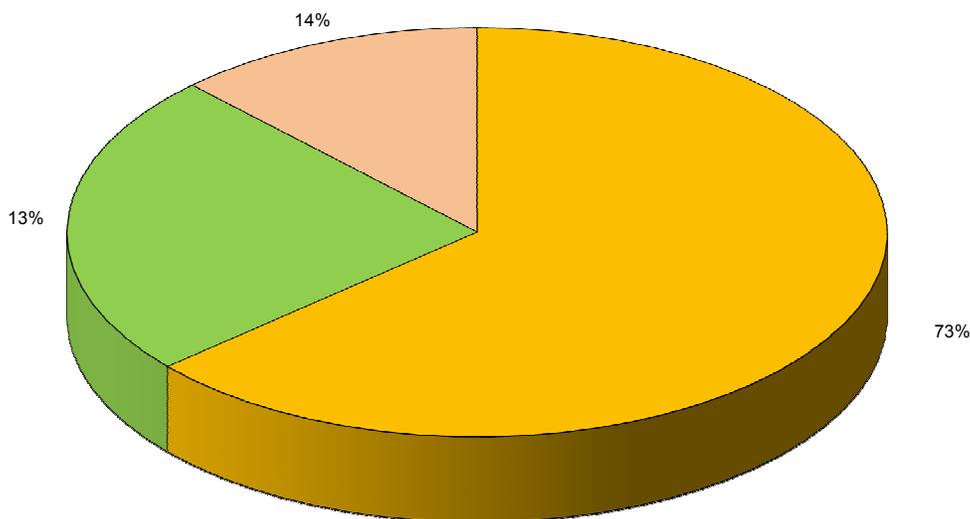




**University of Puerto Rico
Management's Discussion and Analysis**

Federal grants represent 73% 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, 2010:

**Chart 4 - Operating Grants Revenues
(Dollars in thousands)**



	Federal	\$ 112,159	73%
	Commonwealth	19,523	13%
	Nongovernmental	21,579	14%
	Total	\$ 153,261	100%

The University's expenses are presented using natural expense classifications. Total operating expenses amounted to \$1.42 billion, \$1.41 billion and \$1.35 billion for the years ended June 30, 2010, 2009, and 2008, respectively, an increase of \$11.5 million or 1% in 2010 and an increase of \$60.0 million or 4% in 2009. The reduction in the increasing path of operating expenses is the result of the cost control measures taken by University in the fiscal year 2010.

Salaries and benefits, the most significant component of operating expenses, amounted to \$933.6 million, \$939.5 million and \$912.3 million for the years ended June 30, 2010, 2009 and 2008, respectively, a decrease of \$5.9 million or less than 1% in 2010 and an increase of \$27.2 million or 3% in 2009. In 2010, these expenses decreased as a result of strict control measures taken by Management and the effect was partially offset by the increase in the medical plan expense. In 2009, these expenses increased mainly as a result of salary increases granted.



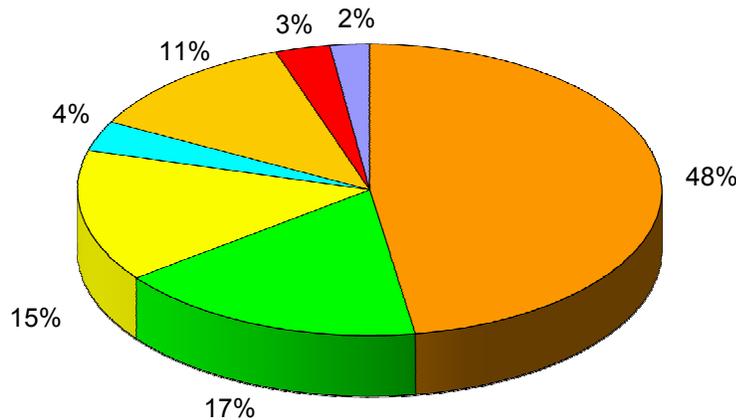
**University of Puerto Rico
Management's Discussion and Analysis**

Scholarships and fellowships amounted to \$211.8 million, \$176.6 million and \$160.5 million for the years ended June 30, 2010, 2009 and 2008, respectively, an increase of \$35.2 million or 20% in 2010 and an increase of \$16.1 million or 10% in 2009. The increases in both periods mainly resulted from the increase in the Federal Pell Grant assistance.

Supplies and other services and utilities amounted to \$198.7 million, \$207.6 million and \$209.2 million for the years ended June 30, 2010, 2009 and 2008, respectively, a decrease of \$8.9 million or 4% in 2010 and a decrease of \$1.6 million or less than 1% in 2009. In 2010, these expenses decreased as a result of strict control measures taken by University.

The following illustration presents the major University operating expenses, using natural classification for the year ended June 30, 2010:

**Chart 5 - Operating Expenses
(Dollars in thousands)**



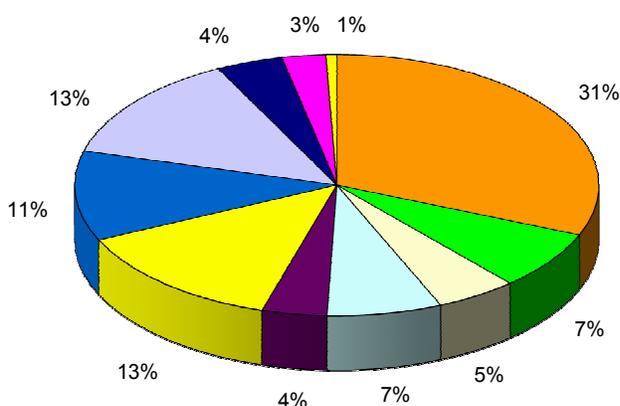
Salaries	\$ 685,623	48%
Benefits	248,030	17%
Scholarships and fellowships	211,831	15%
Supplies and other services	150,227	11%
Utilities	48,515	4%
Depreciation and amortization	43,737	3%
Other expenditures	34,849	2%
Total	\$ 1,422,812	100%



**University of Puerto Rico
Management's Discussion and Analysis**

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, 2010:

**Chart 6 - Expenses by Function
(Dollars in thousands)**



Instruction	\$	444,266	31%
Research		103,731	7%
Public service		71,076	5%
Academic support		100,563	7%
Student services		56,867	4%
Institutional support		190,634	13%
Operation and maintenance of plant		158,093	11%
Scholarships and fellowships		189,479	13%
Patient service		58,286	4%
Depreciation and amortization		43,737	3%
Other		6,080	1%
Total	\$	1,422,812	100%

For the year ended June 30, 2010, the University reported an operating loss of \$1.16 billion. After adding nonoperating revenues of \$1.12 billion, primarily from the Commonwealth's appropriations and Federal programs, and capital appropriations and additions to term and permanent endowments of \$10.5 million, the net assets decreased by \$22.7 million for the year ended June 30, 2010 (prior to effect of adopting GASB 51).



University of Puerto Rico Management's Discussion and Analysis

For the year ended June 30, 2009, the University reported an operating loss of \$1.14 billion. After adding nonoperating revenue of \$1.06 billion, primarily from the Commonwealth's appropriations and Federal Pell Grant program, and capital appropriations and additions to term and permanent endowments of \$20.7 million, the net assets decreased by \$58.1 million for the year ended June 30, 2009.

New Accounting Standard Adopted

Effective July 1, 2009, the University adopted GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets* ("GASB Statement No. 51"). This Statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This Statement also provides authoritative guidance that specifically addresses the nature of these intangible assets. Such guidance should be applied in addition to the existing authoritative guidance for capital assets.

The objective of this Statement is to establish accounting and financial reporting requirements for intangible assets to reduce inconsistencies relating to recognition, initial measurement, and amortization, thereby enhancing the comparability of the accounting and financial reporting of such assets among state and local governments. The Statement requires that an intangible asset be recognized in the Statement of Net Assets only if it is considered identifiable. Additionally, the Statement establishes a specified-conditions approach to recognizing intangible assets that are internally generated. Effectively, outlays associated with the development of such assets should not begin to be capitalized until certain criteria are met. Outlays incurred prior to meeting these criteria should be expensed as incurred. This Statement also provides guidance on recognizing internally generated computer software as an intangible asset. This guidance serves as an application of the specified-conditions approach described above to the development cycle of computer software. The Statement also establishes guidance specific to intangible assets related to amortization. Guidance is provided on determining the useful life of intangible assets when the length of their life is limited by contractual or legal provisions. If there are no factors that limit the useful life of an intangible asset, the Statement provides that the intangible asset be considered to have an indefinite useful life. Intangible assets with indefinite useful lives should not be amortized unless their useful lives are subsequently determined to no longer be indefinite due to a change in circumstances.

The financial reporting impact resulting from the implementation of GASB Statement No. 51 is the recognition within the University's financial statements of \$22.8 million in capital assets with a corresponding credit to net assets at July 1, 2009.

Statements of Cash Flows

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



University of Puerto Rico Management's Discussion and Analysis

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 ARRA program. Net cash provided by investing activities mainly results from the proceeds from sales and maturities of investments that was partially offset by the purchase of investments. The change in cash and cash equivalents was totally 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.

Required Supplementary Information and Other Financial Information

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 schedule of changes in sinking fund reserves.

Subsequent Events

On June 26, 2010, the Middle States Commission on Higher Education (the "Commission"), the regional accreditation entity of the eleven units that comprise the University of Puerto Rico system, placed on probation ten of the University's units for lack of evidence of compliance with two of fourteen accreditation standards. This action was prompted as a result of a student stoppage that interrupted operations of these units for up to 62 days, but less in most cases. The ten affected units will remain fully accredited while on probation. After a Monitoring Report submitted by the ten affected units in September 2010 and a subsequent evaluation visit, the Commission lifted probation over one of the questioned standards and added an additional standard therefore reviewing two of fourteen accreditation standards.

A second Monitoring Report was submitted to the Commission by the ten affected units on March 1, 2011 to further substantiate compliance with these two standards. Evaluation visits to the 11 Units of the University were conducted between March and April 2011 as a follow up to the probationary process as well as the regular decennial re-accreditation review for of the 5 units. Following these visits the evaluation teams reported that they will inform the Commission that 95% of all accreditation standards evaluated throughout the system were found in compliance, and significant progress was evidenced in the remaining 5%. The Commission will make its final determination on its June 2011 meeting. The University remains highly optimistic that probation will be lifted for all units after said meeting.



University of Puerto Rico Management's Discussion and Analysis

To address budgetary deficit issues, effective July 1, 2010, the Board of Trustees of the University of Puerto Rico 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 amounts to \$400 per student per semester with the expectation of increasing revenues by upwards of \$40 million per year. This stabilization fee has no set termination date.

By virtue of Law No. 176 of November 2010, as amended by Law No. 46 of April 2011, the Government of Puerto Rico has 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 is to provide financial aid to graduate and undergraduate students. The fund will be administered by the University.

In October 2010, the University obtained a \$100 million line of credit facility with the Government Development Bank for Puerto Rico for working capital purposes during the 2010-2011 academic year. The line of credit 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.

On April 2011, the University settled with the Commonwealth the Due from Commonwealth receivable for \$18,598,441. The University will receive the amount during fiscal year 2012.

Capital Assets and Debt Administration

Significant capital assets additions for the year ended June 30, 2010 and 2009, consist mainly of renovation and rehabilitation of existing facilities, restoration of historic buildings, and modifications of existing facilities in light of new technology, educational standards and the requirements of modern building codes.

Economic Outlook

The 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.

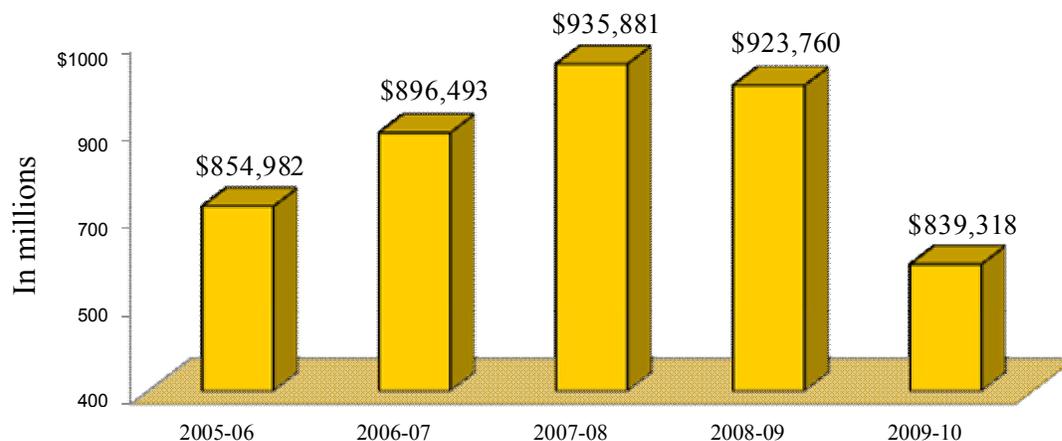


University of Puerto Rico Management's Discussion and Analysis

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.

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

Chart 7 – Commonwealth Appropriations ⁽¹⁾
(In thousands)



⁽¹⁾Includes restricted funds for special activities.

The University projects a reduction in its unrestricted revenues of approximately \$125 million. To address this reduction in revenues management has proposed a number of administrative and financial measures, among which are: stringent expense reductions in various areas and increases in student tuition and fees. After taking into consideration these measures, management's proposed budget for fiscal year 2010-2011 is balanced.

If economic conditions worsen more than expected, it could significantly reduce the Commonwealth's general funds 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.



University of Puerto Rico Management's Discussion and Analysis

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
Statements of Net Assets**

	June 30	
	2010	2009
Assets		
Current assets:		
Investments at fair value	\$ 64,175,315	\$ 56,708,474
Investments with bond trustees at fair value	54,622,873	54,523,217
Accounts receivable (less allowances for doubtful accounts of \$162,172,647 and \$135,702,573 for 2010 and 2009, respectively)	98,032,981	157,069,658
Due from Commonwealth of Puerto Rico	12,570,127	12,570,000
Inventories	3,570,531	3,328,069
Prepaid expenses and deferred charges	479,932	1,285,681
Total current assets	233,451,759	285,485,099
Noncurrent assets:		
Restricted cash and cash equivalents	3,391,756	8,248,521
Restricted investments at fair value	106,756,499	155,316,110
Due from Commonwealth of Puerto Rico (less allowance for doubtful accounts of \$24,310,258 for 2009)	56,608,186	74,890,131
Prepaid expenses and other assets	59,687,041	54,648,712
Notes receivable, net	3,115,767	2,747,660
Capital assets (net of accumulated depreciation and amortization):		
Land and other nondepreciable assets	253,000,134	220,956,659
Depreciable assets	708,167,573	677,371,256
Total noncurrents assets	1,190,726,956	1,194,179,049
Total assets	1,424,178,715	1,479,664,148
Liabilities		
Current liabilities:		
Excess of outstanding checks over bank balance	10,920,460	23,641,416
Accounts payable and accrued liabilities	132,465,972	99,510,983
Current portion of long-term debt	27,652,000	20,825,000
Obligation under capital lease, current portion	1,294,247	1,133,349
Other current liabilities	32,611,390	33,067,136
Total current liabilities	204,944,069	178,177,884
Noncurrent liabilities:		
Long-term debt, net of current portion	571,052,715	649,091,711
Obligation under capital lease, noncurrent portion	66,076,436	67,445,888
Other long-term liabilities	214,012,268	216,999,626
Total noncurrent liabilities	851,141,419	933,537,225
Total liabilities	1,056,085,488	1,111,715,109

(Continues)



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

	June 30	
	<u>2010</u>	<u>2009</u>
Net assets		
Invested in capital assets, net of related debt	\$ 309,054,671	\$ 300,279,478
Restricted, nonexpendable:		
Scholarship and fellowships	36,470,460	41,167,027
Research	38,195,830	18,858,765
Other	3,924,263	3,720,097
Restricted, expendable:		
Loans	7,859,602	6,961,155
Capital projects	12,441,640	11,060,521
Debt service	51,904,121	51,869,168
Unrestricted (deficit)	<u>(91,757,360)</u>	<u>(65,967,172)</u>
Total net assets	<u><u>\$ 368,093,227</u></u>	<u><u>\$ 367,949,039</u></u>

See accompanying notes.



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

	Year Ended June 30	
	2010	2009
Revenues		
Operating revenues:		
Tuitions and fees (net of scholarship allowances of \$49,740,615 and \$43,745,849 for 2010 and 2009, respectively)	\$ 41,809,483	\$ 50,624,310
Net patient services revenue and other	51,448,925	55,532,119
Federal grants and contracts	112,158,695	115,121,932
Commonwealth grants and contracts (net of allowances of \$1,351,870 and \$3,991,174 for 2010 and 2009, respectively)	19,522,590	12,846,721
Nongovernmental grants and contracts	21,578,616	10,362,071
Sales and services of educational departments	5,674,828	8,358,244
Auxiliary enterprises (net of scholarship allowances of \$190,290 and \$159,317 for 2010 and 2009, respectively)	3,570,176	5,937,430
Other operating revenues	9,294,349	9,310,445
Total operating revenues	265,057,662	268,093,272
Operating Expenses		
Salaries:		
Faculty	386,507,036	396,196,291
Exempt staff	298,298,168	307,134,306
Nonexempt wages	818,075	968,139
Benefits	248,029,695	235,232,465
Scholarships and fellowships	211,830,626	176,635,726
Supplies and other services	150,226,879	159,319,414
Utilities	48,515,157	48,278,972
Depreciation and amortization	43,737,024	37,551,456
Other expenses	34,848,901	49,992,272
Total operating expenses	1,422,811,561	1,411,309,041
Operating loss	(1,157,753,899)	(1,143,215,769)
Nonoperating revenues (expenses):		
Commonwealth appropriations	839,318,731	923,759,792
Federal Pell Grant program	179,164,782	141,101,415
Federal ARRA program	105,000,000	-
Gifts	18,305,621	14,855,593
Net investment income	1,919,924	1,949,771
Interest on capital assets - related debt	(19,905,665)	(21,627,870)
Other nonoperating revenues, net	745,997	4,369,609
Net nonoperating revenues	1,124,549,390	1,064,408,310
Loss before other revenues	(33,204,509)	(78,807,459)
Capital appropriations	1,288,035	17,240,100
Additions to term and permanent endowments	9,251,343	3,494,333
Decrease in net assets	(22,665,131)	(58,073,026)
Net Assets		
Beginning of year, as previously reported	367,949,039	426,022,065
Cumulative impact of change in accounting for intangible assets	22,809,319	-
Beginning of year, as adjusted	390,758,358	426,022,065
End of year	\$ 368,093,227	\$ 367,949,039

See accompanying notes.



University of Puerto Rico Statements of Cash Flows

	Year Ended June 30	
	2010	2009
Cash flows from operating activities		
Tuition and fees	\$ 40,770,442	\$ 50,034,298
Grants and contracts	169,276,645	145,784,375
Patient services	45,786,745	55,532,119
Auxiliary enterprises	2,052,195	5,937,430
Sales and services educational departments and other	35,796,361	20,668,689
Payments to suppliers	(204,009,400)	(157,366,987)
Payments to employees	(685,130,701)	(690,429,033)
Payments for benefits	(246,290,184)	(235,232,465)
Payments for utilities	(35,415,752)	(43,876,725)
Payments for scholarships and fellowships	(211,830,626)	(176,635,726)
Loans issued to students, net of repayments	(367,707)	(8,982,384)
Other payments	(3,929,934)	(8,344,900)
Net cash used in operating activities	(1,093,291,916)	(1,042,911,309)
Cash flows from noncapital financing activities		
Commonwealth appropriations	857,600,676	923,759,792
Federal ARRA program	105,000,000	-
Pell grant	179,164,782	141,101,415
Endowment gifts	9,251,343	3,494,333
Other non-operating revenues	745,998	8,189,404
Gifts and grants for other than capital purposes	18,305,620	14,855,593
Net cash provided by noncapital financing activities	1,170,068,419	1,091,400,537
Cash flows from capital and related financing activities		
Capital appropriations	1,288,035	17,240,100
Purchases of capital assets	(84,747,261)	(105,850,470)
Principal paid on capital debt and lease	(22,033,551)	(23,134,868)
Interest paid on capital debt and lease	(19,053,529)	(21,627,870)
Deposit with trustee	(99,656)	(37,595)
Net cash used in capital and related financing activities	(124,645,962)	(133,410,703)
Cash flows from investing activities		
Proceeds from sales and maturities of investments	92,548,050	66,643,097
Purchases of investments	(51,455,280)	(417,536)
Collections of interest and dividend income on investments	1,919,924	1,949,771
Net cash provided by investing activities	43,012,694	68,175,332
Net change in cash and cash equivalents	(4,856,765)	(16,746,143)
Cash and cash equivalents:		
Beginning of year	8,248,521	24,994,664
End of year	\$ 3,391,756	\$ 8,248,521

(Continues)



University of Puerto Rico
Statements of Cash Flows (continued)

	Year Ended June 30	
	<u>2010</u>	<u>2009</u>
Reconciliation of operating loss to net cash used in operating activities		
Operating loss	\$ (1,157,753,899)	\$ (1,143,215,769)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	43,737,024	37,551,456
Provision for doubtful accounts	26,470,074	27,603,562
Loss on disposal of capital assets	979,764	4,369,294
Changes in operating assets and liabilities:		
Grants and contracts receivables	(18,672,659)	(17,149,911)
Prepaid expenses, inventories and other	(4,843,149)	(12,261,010)
Excess of outstanding checks over bank balance	(12,720,956)	23,641,417
Accounts payable and accrued liabilities	29,025,055	27,151,446
Accrued salaries, wages, benefits and other liabilities	486,830	9,398,206
Net cash used in operating activities	<u>\$ (1,093,291,916)</u>	<u>\$ (1,042,911,309)</u>
Supplemental schedule of noncash investing, capital and financing activities:		
Note payable cancelled against receivable from the Commonwealth's appropriations	<u>\$ 51,239,135</u>	<u>\$ -</u>

See accompanying notes.



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

	June 30	
	2010	2009
Assets		
Current assets:		
Cash and cash equivalents	\$ 573,729	\$ 1,153,685
Patient accounts receivable, net of allowance for doubtful accounts of \$17,449,667 in 2010 and \$10,778,461 in 2009	17,525,931	11,895,713
Accounts receivable - other	510,476	386,103
Inventories of supplies	1,120,998	1,369,824
Prepaid expenses	225,266	246,227
Estimated third-party payor settlements-Medicare	1,673,539	-
Total current assets	21,629,939	15,051,552
Property and equipment, net	5,622,711	6,338,862
Due from related parties	3,940,275	3,854,237
Total assets	\$ 31,192,925	\$ 25,244,651
Liabilities and deficiency in unrestricted net assets		
Current liabilities:		
Current portion of long-term debt	\$ 820,153	\$ 820,153
Accounts payable	24,421,905	22,818,872
Estimated third-party payor settlements-Medicare	-	253,220
Accrued payroll taxes and employee benefits	1,726,313	1,316,437
Accrued expenses	1,085,253	1,022,029
Total current liabilities	28,053,624	26,230,711
Long-term debt, net of current portion	19,070,938	19,840,760
Due to related parties	44,722,011	43,477,844
Accrued claim losses	1,029,596	891,596
Total liabilities	92,876,169	90,440,911
Deficiency in unrestricted net assets	(61,683,244)	(65,196,260)
Total liabilities and deficiency in unrestricted net assets	\$ 31,192,925	\$ 25,244,651

See accompanying notes.



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

	Year Ended June 30	
	2010	2009
Unrestricted revenues and other support		
Net patient service revenue	\$ 47,347,178	\$ 44,951,695
Contributions	2,318,097	–
Other revenue	1,364,718	1,565,372
Total unrestricted revenues and other support	51,029,993	46,517,067
Expenses		
Salaries and benefits	17,633,685	16,963,996
Contracted services	3,380,700	4,996,041
Professional services	1,435,525	1,382,601
Supplies	10,873,319	13,003,957
Utilities	2,447,258	2,500,958
Interest	1,419,244	813,216
Provision for bad debts	6,701,855	6,501,411
Provision for claim losses	150,000	150,000
Depreciation and amortization	1,789,280	1,062,179
Other	1,686,111	1,726,202
Total expenses	47,516,977	49,100,561
Excess (deficiency) of revenue over expenses	3,513,016	(2,583,494)
Non-operating income		
Gain on debt relief from affiliate	–	2,724,769
Change in unrestricted net assets	3,513,016	141,275
Deficiency in unrestricted net assets, at beginning of year	(65,196,260)	(65,337,535)
Deficiency in unrestricted net assets, at end of year	\$ (61,683,244)	\$ (65,196,260)

See accompanying notes.



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

	Year Ended June 30	
	2010	2009
Cash flows from operating activities		
Change in unrestricted net assets	\$ 3,513,016	\$ 141,275
Adjustments to reconcile change in unrestricted net assets to net cash provided by operating activities:		
Depreciation and amortization	1,789,280	1,062,179
Provision for bad debts	6,701,855	6,501,411
Provision for claim losses	150,000	150,000
Gain from debt relief from affiliate	–	(2,724,769)
(Increase) decrease in operating assets:		
Patient accounts receivable	(12,332,073)	(3,871,932)
Inventory of supplies	248,826	235,847
Prepaid expenses	20,961	287,485
Accounts receivable-other	(124,373)	(153,835)
Increase (decrease) in operating liabilities:		
Account payable	1,603,033	311,594
Estimated third-party payor settlements-Medicare	(1,926,759)	(422,350)
Accrued expenses, payroll taxes, employee benefits and other	473,101	976,929
Accrued claim losses	(12,000)	(273,955)
Total adjustments	(3,408,149)	2,078,604
Net cash provided by operating activities	104,867	2,219,879
Cash used in investing activities		
Purchases of property and equipment	(1,073,129)	(2,723,745)
Net cash flows from financing activities		
Payments on long-term debt	(769,822)	–
Net advances from related parties	1,158,128	982,835
Net cash provided by financing activities	388,306	982,835
Net (decrease) increase in cash and cash equivalents	(579,956)	478,969
Cash and cash equivalents, at beginning of year	1,153,685	674,716
Cash and cash equivalents, at end of year	\$ 573,729	\$ 1,153,685
Supplemental disclosures of cash flows information		
Interest paid	\$ 1,419,242	\$ 660,397
Supplemental schedule of noncash investing and financing activities		
Debt restructure	\$ –	\$ 20,660,913
Debt relief from affiliate	\$ –	\$ 2,724,769

See accompanying notes.



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

	June 30	
	2010	2009
Assets		
Current assets:		
Cash	\$ 2,221,066	\$ 1,900,517
Restricted cash	1,157,125	268,841
Restricted funds held by trustee	14,195,551	14,167,903
Net investment in direct financing lease	67,533,232	68,749,661
Due from the University of Puerto Rico, net	-	596,783
Property and equipment, net	22,018	19,219
Bond issuance costs, net of accumulated amortization of \$710,384 in 2010 and \$629,753 in 2009	2,078,840	2,159,471
Other assets	180,504	59,997
Total assets	\$ 87,388,336	\$ 87,922,392
 Liabilities and net assets		
Liabilities:		
Construction contract and other development payables, retainage of \$1,582,078 in 2010 and \$1,600,076 in 2009	\$ 1,662,159	\$ 1,705,358
Operating trade accounts payable	61,467	132,838
Accrued interest payable	2,018,513	2,051,926
Accrued costs and expenses	1,134,637	1,111,812
Due to the University of Puerto Rico, net	187,352	-
Unearned student dormitories rental income	1,286	71,192
Commercial tenants and student dormitories security deposits	37,153	38,145
Bonds payable, net of discount of \$254,897 in 2010 and \$273,922 in 2009	77,760,103	79,361,078
Total liabilities	82,862,670	84,472,349
 Net assets - Unrestricted	4,525,666	3,450,043
Total	\$ 87,388,336	\$ 87,922,392

See accompanying notes.



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

	Year Ended June 30	
	2010	2009
Revenues:		
Income from investment in direct financing lease	\$ 4,481,121	\$ 4,558,327
Fixed management fee	900,000	900,000
Reimbursable expenditures fee	2,258,410	1,859,989
Total revenues	<u>7,639,531</u>	<u>7,318,316</u>
Expenses:		
Project operation and maintenance	2,211,182	1,919,816
General and administrative	664,822	577,375
Total expenses	<u>2,876,004</u>	<u>2,497,191</u>
Other income (expenses):		
Interest and other financing related expenses	(4,113,117)	(4,195,303)
Interest income	425,213	478,932
Total other expenses, net	<u>(3,687,904)</u>	<u>(3,716,371)</u>
Change in unrestricted net assets	1,075,623	1,104,754
Net assets - Unrestricted, beginning of year	<u>3,450,043</u>	<u>2,345,289</u>
Net assets - Unrestricted, end of year	<u>\$ 4,525,666</u>	<u>\$ 3,450,043</u>

See accompanying notes.



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

	Year Ended June 30	
	2010	2009
Cash flows from operating activities		
Changes in net assets	\$ 1,075,623	\$ 1,104,754
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Depreciation	4,602	5,881
Bond discount amortization	19,025	20,083
Amortization of bonds issuances costs	80,631	80,514
Changes in operating assets and liabilities:		
Principal collected from direct financing lease	1,216,429	1,141,037
Net decrease in due from University of Puerto Rico	596,783	543,199
Decrease in prepaid expenses	-	3,856
(Decrease) increase in other assets	(120,507)	9,318
Decrease in construction contract and other development payables	(43,199)	(78,050)
(Decrease) increase in operating trade accounts payable	(71,371)	84,420
Decrease in accrued interest payable	(33,413)	(38,626)
Increase in accrued costs and expenses	22,825	85,141
(Decrease) increase in unearned student dormitories rental income	(69,906)	2,116
Decrease in commercial tenants and student dormitories security deposits	(992)	(52,409)
Net cash provided by operating activities	2,676,530	2,911,234
Cash flows from investing activities		
Net increase in restricted funds held by trustee	(27,648)	(452,831)
Capital expenditures	(7,401)	-
Net cash used in investing activities	(35,049)	(452,831)
Cash flows from financing activities		
Principal payments on bonds payable	(1,620,000)	(1,545,000)
Net cash collected and receivables managed on behalf of the University of Puerto Rico	187,352	-
Net cash used in financing activities	(1,432,648)	(1,545,000)
Net change in cash	1,208,833	913,403
Cash, beginning of year	2,169,358	1,255,955
Cash, end of year	\$ 3,378,191	\$ 2,169,358

See accompanying notes.



University of Puerto Rico

Notes to the Financial Statements

1. Reporting Entity and Summary of Significant Accounting Policies

A. Reporting Entity

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

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

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

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

Servicios Médicos Universitarios, Inc.

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



University of Puerto Rico

Notes to Financial Statements (continued)

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

Desarrollos Universitarios, Inc.

Desarrollos Universitarios, Inc. (the Company) is 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 recognized when earned, and expenses are recorded when an obligation has been incurred. All significant transactions related to internal service activities such as publications, telecommunications and institutional computing have been eliminated where appropriate.

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



University of Puerto Rico

Notes to Financial Statements (continued)

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

B. Measurement Focus and Basis of Accounting (continued)

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 in the statements of net assets. Fair value is based on quoted market prices. The changes in the fair value of investments are reported in the statements of revenues, expenses and changes in net assets as a component of net investment income (nonoperating activities).

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

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

Restricted funds of Desarrollos Universitarios, Inc. held by trustee at June 30, 2010 and 2009 consist of money market funds and zero coupon bonds purchased with remaining maturities of six months or less.

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.



University of Puerto Rico

Notes to Financial Statements (continued)

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

H. 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.

I. 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.

J. Inventories

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

K. 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 debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.



University of Puerto Rico

Notes to Financial Statements (continued)

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

K. Classification of Net Assets (continued)

- *Restricted, nonexpendable* net assets consist of endowment and similar type funds which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to principal.
- *Restricted, expendable* net assets include resources that the University is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.
- *Unrestricted* net assets represent resources derived from student tuition and fees, state appropriations, hospital revenues, sales and services of educational activities and auxiliary enterprises. Auxiliary enterprises are substantially self-supporting activities that provide services for students, faculty and staff. While unrestricted net assets may be designated for specific purposes by action of management or the Board of Trustees, they are available for use, at the discretion of the governing board, to meet current expenses for any purpose. Substantially all unrestricted net assets are designated for academic and research programs and initiatives, and capital programs.

L. 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.

M. 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)

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

N. 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 plan 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.

O. Compensated Absences

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

Employees accumulate sick leave generally at a rate of 1.5 days per month up to a maximum of 90 days. The University pays, annually, the excess of 90 days of accumulated sick leave to the employees. Upon retirement, an employee receives compensation for all accumulated unpaid sick leave at the then current rate, provided the employee has at least 10 years of service with the University. During the years ended June 30, 2010 and 2009, the cost of the excess of 90 days of the accumulated sick leave was approximately \$11,379,000 and \$11,278,000, respectively.

P. 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.



University of Puerto Rico

Notes to Financial Statements (continued)

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

Q. Classification of Revenues

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

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

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

R. 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.

S. 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.



University of Puerto Rico

Notes to Financial Statements (continued)

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

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*. This statement establishes standards for the measurement, recognition and display of pension expense and related liabilities in financial statements of state and local governmental employers.

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.

Further details are disclosed in Note 12.

2. Deposits

All the operating cash of the University is pooled into one bank account. Cash balances by funds represent the cash that is allocated to each fund of the University.

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 Government Development Bank for Puerto Rico (GDB) and the Economic Development Bank for Puerto Rico (EDB), collateralize the amount deposited in excess of federal depository insurance (\$250,000 at June 30, 2010) with securities that are pledged with the Department of the Treasury.

The deposits at GDB and EDB, both public corporations of the Commonwealth of Puerto Rico, are uninsured and uncollateralized. These deposits are exposed to custodial credit risk.

As of June 30, 2010 and 2009, the carrying value of the University’s cash and cash equivalents resulted in a book overdraft position of \$(7,528,704) and \$(15,392,895), respectively, and the cash deposited in the banks amounted to \$24,706,355 and \$13,455,402, respectively.



University of Puerto Rico
Notes to Financial Statements (continued)

3. Investments

The University's investments held at June 30, 2010 and 2009 are summarized in the following table:

	<u>2010</u>	<u>2009</u>
Certificates of deposit	\$ 6,955,039	\$ 1,425,067
U.S. Treasury	78,992,678	77,259,314
Guaranteed investment certificate	32,099,880	94,771,515
Corporate bonds	26,738,927	22,627,552
Common stock and convertibles	20,675,773	17,484,516
Mutual funds	60,092,390	52,979,837
Total	<u>\$ 225,554,687</u>	<u>\$ 266,547,801</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 securities investments are held by the University.

Guaranteed Investment Certificate

The University maintains a Construction Fund account, related to the issuance of the Series Q University of Puerto Rico System Revenue Bonds. As of June 30, 2010 and 2009, the account balance amounted to approximately \$32 million and \$95 million, respectively. The account is held under a guaranteed investment certificate whereas the financial institution guarantees the University a fixed rate of return equal to 4.772%. As established in the contract, the financial institution has invested such funds in predetermined securities such as cash, U.S. Treasury and U.S. Government Agency securities. These securities are pledged and serve as collateral for the account balance. The fair value of the guaranteed investment certificate is determined based on the fair value of the underlying investments based on quoted market prices and then adjusted to contract value. As of June 30, 2010 and 2009, the contract value, which represents amounts deposited plus interest credited less withdrawals, is equal to the fair value.



University of Puerto Rico

Notes to Financial Statements (continued)

3. Investments (continued)

Credit Risk

Issuer credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. As of June 30, 2010, the University's credit quality distribution for securities is as follows:

	Carrying Value	Quality Rating		
		AAA to A-	Unrated	No Risk
Government agency securities	\$ 78,992,678	\$ -	\$ -	\$ 78,992,678
Guaranteed investment certificate	32,099,880	32,099,880	-	-
Corporate bonds	26,738,927	26,738,927	-	-
Common stock and convertibles	20,675,773	-	20,675,773	-
Mutual funds	60,092,390	-	60,092,390	-
Total	\$ 218,599,648	\$ 58,838,807	\$ 80,768,163	\$ 78,992,678

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, 2010, 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. As of June 30, 2010, the maturity of Corporate Bonds in each fund follows:

Maturities	Amount
1/Jul/10 - 15/May/44	\$ 4,889,940
29/Jul/10 - 15/May/44	1,395,575
29/Jul/10 - 15/May/44	6,860,078
19/Jul/11 - 25/Jub/16	4,243,910
29/Jun/11 - 12/Jul/35	182,873
29/Jun/11 - 12/Jul/35	500,313
29/Jul/11 - 12/Jul/35	8,645,537
9/Dic/11 - 20/Feb/29	20,701
	\$ 26,738,927



University of Puerto Rico
Notes to Financial Statements (continued)

4. Accounts Receivable

The University's accounts receivable as of June 30, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Commonwealth of Puerto Rico appropriations grants and contracts	\$ —	\$ 51,239,135
Other government agencies	79,307,252	75,194,534
Due from Federal Government	29,347,488	23,493,501
Due from medical plans	80,229,760	74,567,580
Due from Servicios Médicos Universitarios, Inc.	35,996,756	35,996,756
Other	35,324,372	32,280,725
	<u>260,205,628</u>	<u>292,772,231</u>
Less allowance for doubtful accounts	<u>(162,172,647)</u>	<u>(135,702,573)</u>
Accounts receivable, net	<u>\$ 98,032,981</u>	<u>\$ 157,069,658</u>

On September 7, 2004, the Commonwealth of Puerto Rico approved a resolution to pay \$94,710,382 to the University on behalf of the Puerto Rico Department of Health and the Commonwealth of Puerto Rico, over the course of ten years. As of June 30, 2010, the University has received \$69,420,509 from this amount. The remaining balance will be received as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2010-2011	\$ 7,570,127
2011-2012	8,000,000
2012-2013	8,000,000
2013-2014	1,719,746
Total	<u>\$ 25,289,873</u>

In fiscal year 2010, the University cancelled a note payable to GDB of \$51,239,135 against a receivable from the Commonwealth's appropriations. See Note 6.



University of Puerto Rico

Notes to Financial Statements (continued)

4. Accounts Receivable (continued)

Due from Commonwealth of Puerto Rico

As of June 30, 2010 and 2009, the University has accounts receivable from the Commonwealth of Puerto Rico (the Commonwealth) of \$69,178,313 and \$87,460,131, respectively, net of an allowance for doubtful accounts of \$24,310,258 in 2009. The outstanding balance as of June 30, 2009 includes \$48,620,517 related to revenue from appropriations for fiscal years 2008 and 2009, which the University has not received.

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

On April 2011, the University settled with the Commonwealth this receivable for \$18,598,441. The University will receive the amount during fiscal year 2012.

5. Capital Assets

Changes in the University's capital assets for the years ended June 30, 2010 and 2009 are as follows:

	2010						Ending Balance
	Beginning Balance	Effect of Adoption GASB No. 51	Beginning Balance, As Adjusted	Additions	Transfers	Disposals	
Capital assets not being depreciated:							
Land	\$ 42,438,639	\$ -	\$ 42,438,639	\$ -	\$ -	\$ -	\$ 42,438,639
Construction in progress	178,518,020	-	178,518,020	72,329,653	(39,701,435)	(584,743)	210,561,495
	220,956,659	-	220,956,659	72,329,653	(39,701,435)	(584,743)	253,000,134
Other capital assets:							
Land improvements	31,733,888	-	31,733,888	-	1,368,219	-	33,102,107
Building, fixed equipment, improvements and infrastructure	786,506,901	-	786,506,901	-	38,078,465	-	824,585,366
Equipment, software and library materials	235,915,397	26,834,493	262,749,890	12,417,608	254,751	(4,835,531)	270,586,718
Building and equipment under capital lease	99,298,249	-	99,298,249	-	-	-	99,298,249
	1,153,454,435	26,834,493	1,180,288,928	12,417,608	39,701,435	(4,835,531)	1,227,572,440
Less accumulated depreciation and amortization for:							
Land improvements	(15,947,119)	-	(15,947,119)	(1,163,076)	-	-	(17,110,195)
Buildings, fixed equipment, improvements and infrastructure	(277,254,243)	-	(277,254,243)	(19,436,863)	-	-	(296,691,106)
Equipment, software and library materials	(174,998,147)	(4,025,174)	(179,023,321)	(20,126,169)	-	4,440,510	(194,708,980)
Building and equipment under capital lease	(7,883,670)	-	(7,883,670)	(3,010,916)	-	-	(10,894,586)
	(476,083,179)	(4,025,174)	(480,108,353)	(43,737,024)	-	4,440,510	(519,404,867)
Other capital assets, net of accumulated depreciation	677,371,256	22,809,319	700,180,575	(31,319,416)	39,701,435	(395,021)	708,167,573
Capital assets, net	\$ 898,327,915	\$ 22,809,319	\$ 921,137,234	\$ 41,010,237	\$ -	\$ (979,764)	\$ 961,167,707



University of Puerto Rico

Notes to Financial Statements (continued)

5. Capital Assets (continued)

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

As disclosed in Note 15, the University adopted GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets* (“GASB Statement No. 51”) effective July 1, 2009. The financial reporting impact resulting from the implementation of GASB Statement No. 51 is the recognition within the University’s financial statements of \$22.8 million in capital assets with a corresponding credit to net assets at July 1, 2009.

As of June 30, 2010 and 2009, the carrying value of the University’s assets recorded under capital leases amounted to approximately \$88,404,000 and \$91,415,000, respectively. Amortization expense on these assets amounted to approximately \$3,011,000 in 2010 and 2009.

Capitalized interest on construction in progress amounted to approximately \$11,243,000 and \$5,082,000 for the years ended June 30 2010 and 2009, respectively.

6. Lines of Credit

As of June 30, 2009, the University had available a non-revolving line of credit agreement with GDB for the total authorized amount of \$60 million and an outstanding balance due from the Commonwealth of \$51,239,135. During fiscal year 2010, this line of credit was cancelled against the receivable from the Commonwealth’s appropriations.



University of Puerto Rico
Notes to Financial Statements (continued)

7. Noncurrent Liabilities

Changes in the University's noncurrent liabilities for the years ended June 30, 2010 and 2009 are as follows:

	2010						
	Beginning Balance	Additions	Reductions	Other	Ending Balance	Less Due Within One Year	Noncurrent Liabilities
Long-term debt:							
Notes payable	\$ 51,239,135	\$ -	\$ (51,239,135)	\$ -	\$ -	\$ -	\$ -
Bonds payable	618,677,576	2,321,773	(20,825,000)	(1,469,634)	598,704,715	27,652,000	571,052,715
Total long-term	\$ 669,916,711	\$ 2,321,773	\$ (72,064,135)	\$ (1,469,634)	\$ 598,704,715	\$ 27,652,000	\$ 571,052,715
Other long-term liabilities:							
Deferred compensation payable	\$ 52,979,837	\$ 7,112,553	\$ -	\$ -	\$ 60,092,390	\$ -	\$ 60,092,390
Claims liability	27,355,166	-	(1,559,266)	(2,370,668)	23,425,232	1,559,266	21,865,966
Compensated absences	169,731,759	24,701,771	(31,327,494)	-	163,106,036	31,052,124	132,053,912
Capital lease obligation	68,579,237	-	(1,208,554)	-	67,370,683	1,294,247	66,076,436
Total other long-term liabilities	\$ 318,645,999	\$ 31,814,324	\$ (34,095,314)	\$ (2,370,668)	\$ 313,994,341	\$ 33,905,637	\$ 280,088,704

	2009						
	Beginning Balance	Additions	Reductions	Other	Ending Balance	Less Due Within One Year	Noncurrent Liabilities
Long-term debt:							
Notes payable	\$ 36,061,717	\$ 15,177,418	\$ -	\$ -	\$ 51,239,135	\$ -	\$ 51,239,135
Bonds payable	637,904,830	2,774,265	(21,455,000)	(546,519)	618,677,576	20,825,000	597,852,576
Total long-term	\$ 673,966,547	\$ 17,951,683	\$ (21,455,000)	\$ (546,519)	\$ 669,916,711	\$ 20,825,000	\$ 649,091,711
Other long-term liabilities:							
Deferred compensation payable	\$ 54,046,130	\$ -	\$ (1,066,293)	\$ -	\$ 52,979,837	\$ -	\$ 52,979,837
Claims liability	19,124,747	9,000,000	(1,739,642)	970,061	27,355,166	1,739,642	25,615,524
Compensated absences	159,139,516	38,996,490	(28,404,247)	-	169,731,759	31,327,494	138,404,265
Capital lease obligation	69,712,586	-	(1,133,349)	-	68,579,237	1,133,349	67,445,888
Total other long-term liabilities	\$ 302,022,979	\$ 47,996,490	\$ (32,343,531)	\$ 970,061	\$ 318,645,999	\$ 34,200,485	\$ 284,445,514

Bonds payable are further discussed in Note 8-A.



University of Puerto Rico

Notes to Financial Statements (continued)

8. Bonds Payable

A. Bonds

The University has issued revenue bonds designated as “University System Revenue Bonds”, the proceeds of which have been used mainly to finance new activities in connection with its educational facilities construction program and to cancel and refinance previous debts incurred. The following is the balance of bonds payable as of June 30, 2010 and 2009:

Series	Balance as of June 30, 2010	Balance as of June 30, 2009	Annual Interest Rate (%)	Due Date
C - Serial	\$ 169,000	\$ 329,000	3.00%	1972-2011
D - Serial	218,000	428,000	3.75%	1973-2011
F - Term	6,000,000	7,400,000	5.50%	1973-2012
N - Capital Appreciation Serial Bonds	31,050,000	41,505,000	5.65-5.75%	1996-2013
O - Serial	7,060,000	7,060,000	4.5-3.75%	1996-2012
P - Serial	234,855,000	238,860,000	5.00%	2010-2018
P - Term	47,645,000	47,645,000	5.00%	2027-2030
Q - Serial	114,095,000	118,690,000	5.00%	2008-2017
Q - Term	132,415,000	132,415,000	5.00%	2027-2036
	<u>573,507,000</u>	<u>594,332,000</u>		
Plus unamortized premium	32,697,720	34,168,650		
Less:				
Unaccrued interest	(1,295)	(2,589)		
Future appreciated principal	(3,328,818)	(5,372,598)		
Deferred refunding loss	(4,169,892)	(4,447,887)		
	<u>\$ 598,704,715</u>	<u>\$ 618,677,576</u>		

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

B. Debt Service Requirement

At June 30, 2010, bonds payable require payments of principal and interest as follows:

Fiscal Year Ending June 30	Principal	Interest	Total
2011	\$ 27,652,000	\$ 27,127,880	\$ 54,779,880
2012	27,040,000	26,281,245	53,321,245
2013	29,930,000	25,306,500	55,236,500
2014	18,110,000	24,444,250	42,554,250
2015	19,015,000	23,538,750	42,553,750
2016 to 2020	110,330,000	102,444,500	212,774,500
2021 to 2025	140,815,000	71,962,750	212,777,750
2026 to 2030	113,575,000	39,349,500	152,924,500
2031 to 2035	70,710,000	15,034,000	85,744,000
2036 to 2037	16,330,000	816,250	17,146,250
	<u>\$ 573,507,000</u>	<u>\$ 356,305,625</u>	<u>\$ 929,812,625</u>



University of Puerto Rico

Notes to Financial Statements (continued)

8. Bonds Payable (continued)

C. Pledged Revenues

The bonds are general obligations of the University and are collateralized by the pledge of, and a first lien on, all revenues derived or to be derived by the University, except for appropriations and contributions, as defined in the Trust Agreement governing the bonds issued. In the event that the pledged revenues are insufficient to pay the principal of and the interest on, the bonds, the University agrees to provide any additional required monies from other funds available to the University for such purposes, including funds appropriated by the Commonwealth of Puerto Rico. The University's revenues pledged were as follows for the years ended June 30, 2010 and 2009:

Pledged Revenues:	2010	2009
Tuition and other fees collected	\$ 78,524,637	\$ 78,857,654
Student fees collected	5,906,244	6,223,498
Rental and other charges received for the right of use and occupancy of the facilities in the University system	1,559,611	1,726,954
Bookstore receipts (gross sales less cost of books and supplies sold)	-	13,855
Interest on investment of University funds, excluding funds invested pursuant to Article VI of the Trust Agreement	85,280	262,266
Funds paid to the University in respect to overhead allowance on federal research projects	15,818,290	14,996,424
Other income	27,007,597	27,494,281
Total	<u>\$ 128,901,659</u>	<u>\$ 129,574,932</u>

Interest earned on investments in the sinking fund reserve account amounted to \$3,065,386 and \$2,919,404 for the years ended June 30, 2010 and 2009, respectively.

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

The funds for retirement of indebtedness consist of a sinking fund which includes three separate accounts designated 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)

8. Bonds Payable (continued)

C. 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.

D. Bonds Payable – Discretely Presented Component Unit

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



University of Puerto Rico

Notes to Financial Statements (continued)

8. Bonds Payable (continued)

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

Bonds payable at June 30, 2010 and 2009, consist of:

Description	Interest Rate	Maturity	2010 Face Amount	2009 Face Amount
Serial Bonds	4.13%	July 1, 2009	\$ —	\$ 1,620,000
Serial Bonds	4.25%	July 1, 2010	1,685,000	1,685,000
Serial Bonds	5.63%	July 1, 2011	1,760,000	1,760,000
Serial Bonds	5.63%	July 1, 2012	1,860,000	1,860,000
Serial Bonds	5.63%	July 1, 2013	1,960,000	1,960,000
Serial Bonds	5.63%	July 1, 2014	2,075,000	2,075,000
Serial Bonds	5.63%	July 1, 2015	2,190,000	2,190,000
Serial Bonds	5.63%	July 1, 2016	2,315,000	2,315,000
Serial Bonds	5.63%	July 1, 2017	2,445,000	2,445,000
Serial Bonds	5.63%	July 1, 2018	2,580,000	2,580,000
Serial Bonds	5.63%	July 1, 2019	2,725,000	2,725,000
Serial Bonds	5.00%	July 1, 2020	2,880,000	2,880,000
Serial Bonds	5.00%	July 1, 2021	3,020,000	3,020,000
Serial Bonds	5.00%	July 1, 2033	50,520,000	50,520,000
Total			78,015,000	79,635,000
Less unaccrued interest			(254,897)	(273,922)
Total			\$ 77,760,103	\$ 79,361,078

The activity of the principal balance of the bonds payable for the years ended June 30, 2010 and 2009, is as follows:

	2010	2009
Beginning Balance	\$ 79,635,000	\$ 81,180,000
Additions	—	—
Reductions	(1,620,000)	(1,545,000)
Ending Balance	\$ 78,015,000	\$ 79,635,000



University of Puerto Rico

Notes to Financial Statements (continued)

8. Bonds Payable (continued)

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

At June 30, 2010, 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>
2011	\$ 1,685,000	\$ 3,940,938	\$ 5,625,938
2012	1,760,000	3,841,938	5,601,938
2013	1,860,000	3,737,313	5,597,313
2014	1,960,000	3,627,063	5,587,063
2015	2,075,000	3,510,342	5,585,342
2016 to 2020	12,255,000	15,558,781	27,813,781
2021 to 2025	5,900,000	12,781,000	18,681,000
2026 to 2030	—	12,630,000	12,630,000
2031 to 2034	50,520,000	5,052,000	55,572,000
Total	<u>\$ 78,015,000</u>	<u>\$ 64,679,375</u>	<u>\$ 142,694,375</u>

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

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



University of Puerto Rico

Notes to Financial Statements (continued)

8. Bonds Payable (continued)

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

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

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

On December 22, 2009, the Company and the University submitted an amended Certificate of Substantial Completion with updated financial information through June 30, 2008 and the appropriated wording. With letter dated February 8, 2011, the Trustee stated that they are not aware of any defaults under the loan agreement or the bonds.

On June 17, 2009, the Trustee issued a Notice of Non-Compliance to the University for failure to pay amounts due to the Company under the Management Agreement, specifically the Fixed Management Fee, the Reimbursable Expenditures Fee and the Capitalization Fee. The University has substantially reduced amounts due in arrears for the Fixed Management Fee and the Reimbursable Expenditures Fee and management of the Company does not expect an event of default to arise out of this matter. With regards to the unpaid Capitalization fee, it is uncertain whether the Trustee will notify an event of default in writing and take full advantage of all of its contractual rights. The Trustee acknowledged that corrective action was diligently pursued and that these were no events of default with these bonds on the previous noncompliance issue with regards to Section 3.04 of the Loan Agreement with AFICA regarding allowed uses of funds in the Construction Fund with a letter dated February 8, 2011.

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, 2010 and 2009 on this capital lease is \$67,370,683 and \$68,579,237, respectively. The effective interest rate was determined at 6.60%.



University of Puerto Rico

Notes to Financial Statements (continued)

9. Obligation under Capital Lease (continued)

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

<u>Year Ending June 30,</u>	<u>Amount</u>
2011	\$ 5,700,938
2012	5,701,938
2013	5,697,312
2014	5,702,063
2015	5,700,344
2016-2020	28,503,781
2021-2025	28,496,750
2026-2030	28,497,750
2031-2033	17,102,749
Total future minimum lease payments	<u>131,103,625</u>
Less amounts representing interest costs	(63,732,942)
Present value of minimum lease payments	<u>\$ 67,370,683</u>

10. Commitments and Contingent Liabilities

A. Insurance

The University is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. 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)

10. Commitments and Contingent Liabilities (continued)

A. Insurance (continued)

Changes in the claims liability amount in fiscal years 2010 and 2009 were:

	2010	2009
Claims payable - July 1	\$ 27,355,166	\$ 19,124,747
Incurring claims and changes in estimates	(2,370,668)	9,970,061
Payments for claims and adjustments expenses	(1,559,266)	(1,739,642)
Claims payable - June 30	\$ 23,425,232	\$ 27,355,166

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

B. Federal Assistance Programs

The University participates in a number of federal financial assistance programs. These programs are subject to audits in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, or to compliance audits by grantor agencies. The amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time.

C. Discretely Presented Component Units

Servicios Médicos Universitarios, Inc. (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, to extend the maturity date to June 30, 2025. As part of the loan agreement, the Hospital was required to make a down payment of \$2,700,000. The activity of the principal balance of the long-term debt for the years ended June 30, 2010 and 2009 is as follows:

	2010	2009
Beginning Balance	\$ 20,660,913	\$ 17,000,000
Additions	-	3,660,913
Reductions	(769,822)	-
Ending Balance	\$ 19,891,091	\$ 20,660,913



University of Puerto Rico

Notes to Financial Statements (continued)

10. Commitments and Contingent Liabilities (continued)

C. Discretely Presented Component Units (continued)

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

<u>Fiscal Year Ending June 30</u>	<u>Amount</u>
2011	\$ 820,153
2012	873,776
2013	930,905
2014	991,768
2015	1,056,611
2016-2020	6,414,172
2021-2025	8,803,706
	<u>\$ 19,891,091</u>

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 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.



University of Puerto Rico

Notes to Financial Statements (continued)

10. Commitments and Contingent Liabilities (continued)

C. Discretely Presented Component Units (continued)

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

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

The System issues stand-alone audited financial statements and can be obtained from the System's administrative offices.

Funding Policy and Annual Pension Cost

Contribution rates:	
University	11.4%
Plan members	7%-11%
Annual pension cost	\$62,275,417
Contributions made	\$71,176,599
Actuarial valuation date	6/30/2010
Actuarial cost method	Entry age normal (traditional)
Amortization method	Level percentage of payroll
Remaining amortization period	30 years constant (open basis)
Asset valuation method	5-year smoothed market
Actuarial assumptions:	
Investment rate of return*	8.00%
Projected salary increases*	5%
*Includes inflation at	3.50%
Postretirement benefit increases	3% every two (2) years, subject to the approval of the University's Board of Trustees.



University of Puerto Rico

Notes to Financial Statements (continued)

11. University of Puerto Rico Retirement System (continued)

Fiscal Year Ending	Annual Pension Cost (APC)	Employer Contribution	Percentage of APC Contributed	Net Pension Obligation (Asset)
6/30/2010	\$ 62,275,417	\$ 71,176,599	114.3%	\$ (55,088,649)
6/30/2009	\$ 62,929,059	\$ 72,605,262	115.4%	\$ (46,187,467)
6/30/2008	\$ 58,814,476	\$ 81,553,088	138.7%	\$ (36,511,264)

The net pension asset has been recorded in prepaid expense and other assets. 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.

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

The University provides post-employment health care benefits for its retired employees. Substantially all of the employees may become eligible for this benefit if they reach normal retirement age while working for the University. Health care benefits are provided through insurance companies whose premiums are paid by the retiree and by the University up to maximum of \$125 per month for each retiree. The cost of providing such benefits are recognized when paid.

GASB Statement No. 45 requires employers to accrue the cost of postemployment benefits other than pensions while employees who will receive these benefits are providing services to the employer.

The University does not pre-fund its postemployment benefits 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.

The Annual OPEB Cost is calculated based on the Annual Required Contribution of the employer (ARC), an amount actuarially determined in accordance with the provisions of GASB Statement No. 45. The ARC represents a level of funding that, if paid on ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty years. The following table shows the components of the University's annual OPEB cost for the fiscal year 2009-2010 and 2008 - 2009:

	2010	2009
Annual OPEB cost (or ARC)	\$ 9,659,344	\$ 9,690,994
Actuarial Accrued liability (AAL)	\$ 189,417,225	\$ 186,689,632
Unfunded AAL	\$ 189,417,225	\$ 186,689,632
Funded Ratio	0%	0%



University of Puerto Rico

Notes to Financial Statements (continued)

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

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

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
6/30/2010	\$ 9,659,344	88.3%	\$ 2,570,557
6/30/2009	\$ 9,690,994	99.5%	\$ 1,439,612
6/30/2008	\$ 9,691,698	85.6%	\$ 1,394,231

During fiscal years 2010 and 2009, the University made contributions of \$8,528,399 and \$9,645,723, respectively.

The following table shows the components of the University’s annual OPEB cost for the year ended June 30, 2010:

ARC	\$ 9,651,667
Interest on the net OPEB obligation	57,584
Adjustments to the ARC	<u>(49,907)</u>
Annual OPEB cost (expense)	<u>\$ 9,659,344</u>

OPEB Actuarial Valuation – The University’s other Post-Employment Benefits Program actuarial valuation was conducted by Deloitte Consulting, LLP as of July 1, 2009, members of the American Academy of Actuaries. The valuation was performed in accordance with GASB Statement No. 45 requirements.

Significant Actuarial Methods and Assumptions:

Actuarial Valuation Date	July 1, 2009
Actual Cost Method	Projected Unit Credit
Amortization Method	Level Dollar amortization over 30 Years
Medical Subsidy	85%
Tuition Remission	\$497 per retiree in fiscal 2010 increasing 4.0% per year
Payroll Growth	
Discount Rate	4%
	4%



University of Puerto Rico

Notes to Financial Statements (continued)

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

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.

13. Going Concern - Discretely Presented Component Unit

During most of the preceding years, the Hospital has experienced significant operating losses having an accumulated net assets deficiency of \$61,683,244 as of June 30, 2010. 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 and aliens without medical insurance coverage. The medical services provided to these persons were supposed to be paid to the Hospital by the Puerto Rico Department of Health. However, since the beginning of the operations, the 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 approximate amount of \$17,450,000 as of June 30 2010.

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, 2010.

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

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

- Extension of the medical privileges in the Hospital to faculty members within the Hospital's primary and secondary market area.



University of Puerto Rico

Notes to Financial Statements (continued)

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

- Development of new business within the Hospital's building, for example space rentals for physicians and others.
- Marketing of the Ob-Gyn and pediatrics services.
- Marketing of the ophthalmology services, including a new physician that has a specialization in cornea diagnosis and treatment.
- To build a new Imaging Center with the acquisition of a new generation 8 channel light performance MRI 1.5T System with the existing C.T.
- Increasing the Hospital operating cash flow by improving the reimbursement rate through more aggressive negotiations with medical insurance companies and restructuring the billing and collection department with the acquisition and implementation of a new accounting, billing and collection, and emergency room tracking and clinical documentation information systems, in order to reduce to at minimum denied reimbursement for services provided.
- Refurbishing pediatrics, Ob-Gyn, Surgery and other hospital general and common areas to improve the hospital image and be able to attract insured patients sector.
- Expansion of the Intensive Care Unit area with twelve new beds. This will improve service provided to critical patients and as result of this an increase in patient days.
- Establishment of a new Information technology system to recover more efficiently the revenue charges for the services provided.
- An implementation of an aggressive cost containment program.

Some of these measures have had an impact in the Hospital's operations and as a result, the Hospital's operations reported an excess of revenue over expenses of approximately \$3,513,000 during the year ended June 30, 2010 in comparison with a loss of approximately \$2,583,000 in prior year.

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



University of Puerto Rico

Notes to Financial Statements (continued)

14. Functional Information

The University's operating expenses by functional classification during the years ended June 30, 2010 and 2009 were as follows:

Functional Classification	2010							Total
	Salaries and Benefits	Supplies and other Services	Scholarships and Fellowships	Utilities	Depreciation and Amortization	Other Expenses		
Instruction	\$ 422,805,042	\$ 10,844,522	\$ 8,259,472	\$ 189,681	\$ -	\$ 2,167,391	\$ 444,266,108	
Research	57,774,851	18,563,207	14,553,005	694,195	-	12,146,071	103,731,329	
Public service	49,671,297	17,528,548	918,800	1,522,553	-	1,434,555	71,075,753	
Academic support	78,163,791	19,353,626	747,096	79,703	-	2,219,323	100,563,539	
Student service	46,193,644	9,712,232	325,656	2,742	-	632,554	56,866,828	
Institutional support	144,117,430	31,392,332	278,590	4,012,642	-	10,833,455	190,634,449	
Operation & maintenance	89,148,806	25,756,494	285	41,976,290	-	1,210,740	158,092,615	
Student aid	2,662,156	500,389	186,259,662	690	-	56,174	189,479,071	
Independent operation	36,252	39,026	7,103	-	-	633	83,014	
Patient service	41,876,245	15,525,670	459,698	23,374	-	400,685	58,285,672	
Auxiliary enterprises	1,203,460	1,010,833	21,259	13,287	-	264,241	2,513,080	
Depreciation and amortization	-	-	-	-	43,737,024	-	43,737,024	
Other	-	-	-	-	-	3,483,079	3,483,079	
	<u>\$ 933,652,974</u>	<u>\$ 150,226,879</u>	<u>\$ 211,830,626</u>	<u>\$ 48,515,157</u>	<u>\$ 43,737,024</u>	<u>\$ 34,848,901</u>	<u>\$ 1,422,811,561</u>	

Functional Classification	2009							Total
	Salaries and Benefits	Supplies and Other Services	Scholarships and Fellowships	Utilities	Depreciation and Amortization	Other Expenses		
Instruction	\$ 433,771,643	\$ 13,857,816	\$ 8,827,308	\$ 92,553	\$ -	\$ 2,463,138	\$ 459,012,458	
Research	58,723,262	20,379,750	13,917,260	754,502	-	12,300,693	106,075,467	
Public service	50,958,025	14,643,335	1,183,942	587,171	-	972,274	68,344,747	
Academic support	83,291,660	19,450,719	711,755	64,079	-	2,281,898	105,800,111	
Student service	47,558,655	7,576,576	336,247	6,701	-	1,060,423	56,538,602	
Institutional support	129,644,721	46,529,634	243,130	3,651,065	-	3,052,765	183,121,315	
Operation & maintenance	92,260,270	28,258,046	65	43,070,039	-	3,386,984	166,975,404	
Student aid	2,319,398	544,312	150,996,286	291	-	121,616	153,981,903	
Independent operation	32,755	64,897	9,394	-	-	374	107,420	
Patient service	39,050,247	2,064,653	389,857	22,323	-	397,845	41,924,925	
Auxiliary enterprises	1,920,565	5,949,676	20,482	30,248	-	209,291	8,130,262	
Depreciation and amortization	-	-	-	-	37,551,456	-	37,551,456	
Other	-	-	-	-	-	23,744,971	23,744,971	
	<u>\$ 939,531,201</u>	<u>\$ 159,319,414</u>	<u>\$ 176,635,726</u>	<u>\$ 48,278,972</u>	<u>\$ 37,551,456</u>	<u>\$ 49,992,272</u>	<u>\$1,411,309,041</u>	



University of Puerto Rico

Notes to Financial Statements (continued)

15. Significant New Accounting Pronouncements

New Accounting Standard Adopted

In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets* (“GASB Statement No. 51”). This Statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This Statement also provides authoritative guidance that specifically addresses the nature of these intangible assets. Such guidance should be applied in addition to the existing authoritative guidance for capital assets.

The objective of this Statement is to establish accounting and financial reporting requirements for intangible assets to reduce inconsistencies relating to recognition, initial measurement, and amortization, thereby enhancing the comparability of the accounting and financial reporting of such assets among state and local governments. The Statement requires that an intangible asset be recognized in the Statement of Net Assets only if it is considered identifiable. Additionally, the Statement establishes a specified-conditions approach to recognizing intangible assets that are internally generated. Effectively, outlays associated with the development of such assets should not begin to be capitalized until certain criteria are met. Outlays incurred prior to meeting these criteria should be expensed as incurred. This Statement also provides guidance on recognizing internally generated computer software as an intangible asset. This guidance serves as an application of the specified-conditions approach described above to the development cycle of computer software. The Statement also establishes guidance specific to intangible assets related to amortization. Guidance is provided on determining the useful life of intangible assets when the length of their life is limited by contractual or legal provisions. If there are no factors that limit the useful life of an intangible asset, the Statement provides that the intangible asset be considered to have an indefinite useful life. Intangible assets with indefinite useful lives should not be amortized unless their useful lives are subsequently determined to no longer be indefinite due to a change in circumstances.

The financial reporting impact resulting from the implementation of GASB Statement No. 51 is the recognition within the University’s financial statements of \$22.8 million in capital assets with a corresponding credit to net assets at July 1, 2009. The University determined that it was not practical restating the financial statements of all periods presented.



University of Puerto Rico

Notes to Financial Statements (continued)

15. Significant New Accounting Pronouncements(continued)

Future Adoption of Accounting Pronouncements

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

The GASB has issued the following accounting standards that have effective dates after June 30, 2010:

- GASB Statement No. 59, *Financial Instruments Omnibus*. The objective of this Statement is to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. This statement is effective for periods beginning after June 15, 2010.
- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*. The objective of this Statement is to improve financial reporting by addressing issues related to service concession arrangements (SCAs), which are a type of public-private or public-public partnership. As used in this Statement, an SCA is an arrangement between a transferor (a government) and an operator (governmental or nongovernmental entity) in which: (i) the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset (a facility) in exchange for significant consideration; and (ii) the operator collects and is compensated by fees from third parties. This statement 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*. The objective of this Statement is to improve financial reporting for a governmental financial reporting entity. The requirements of Statement No. 14, *The Financial Reporting Entity*, and the related financial reporting requirements of Statement No. 34, *Basis Financial Statements and Management's Discussion and Analysis for State and Local Governments*, were amended to better meet user needs and to address reporting entity issues have arisen since the issuance of those Statements. This statement 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*. The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements. (i) Financial Accounting Standard Board (FASB) Statements and Interpretations; (ii) Accounting Principles Board Opinions; and (iii) Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure. This statement is effective for periods beginning after December 15, 2011.

The impact of these statements on the University's financial statements has not yet been determined.



University of Puerto Rico

Notes to Financial Statements (continued)

16. Subsequent Events

On June 26, 2010, the Middle States Commission on Higher Education (the “Commission”), the regional accreditation entity of the eleven units that comprise the University of Puerto Rico system, placed on probation ten of the University’s units for lack of evidence of compliance with two of fourteen accreditation standards. This action was prompted as a result of a student stoppage that interrupted operations of these units for up to 62 days, but less in most cases. The ten affected units will remain fully accredited while on probation. After a Monitoring Report submitted by the ten affected units in September 2010 and a subsequent evaluation visit, the Commission lifted probation over one of the questioned standards and added an additional standard therefore reviewing two of fourteen accreditation standards.

A second Monitoring Report was submitted to the Commission by the ten affected units on March 1, 2011 to further substantiate compliance with these two standards. Evaluation visits to the 11 Units of the University were conducted between March and April 2011 as a follow up to the probationary process as well as the regular decennial re-accreditation review for of the 5 units. Following these visits the evaluation teams reported that they will inform the Commission that 95% of all accreditation standards evaluated throughout the system were found in compliance, and significant progress was evidenced in the remaining 5%. The Commission will make its final determination on its June 2011 meeting. The University remains highly optimistic that probation will be lifted for all units after said meeting.

To address budgetary deficit issues, on June 30, 2010, the Board of Trustees of the University of Puerto Rico 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 amounts to \$400 per student per semester with the expectation of increasing revenues upwards of \$40 million per year. This stabilization fee has no set termination date.

By virtue of Law No. 176 of November 2010, as amended by Law No. 46 of April 2011, the Government of Puerto Rico has 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 is to provide financial aid to graduate and undergraduate students. The fund will be administered by the University.

In October 2010, the University obtained a \$100 million line of credit facility with the Government Development Bank for Puerto Rico for working capital purposes during the 2010-2011 academic year. The line of credit 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.

On April 2011, the University settled with the Commonwealth the Due from Commonwealth receivable for \$18,598,441. The University will receive the amount during fiscal year 2012.

Required Supplementary Information



University of Puerto Rico
Schedule of Funding Progress
(Unaudited)

Employees Retirement Plan

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial 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)
6/30/2010	\$ 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%
6/30/2006	\$ 869,211,000	\$ 1,930,131,983	\$ 1,060,920,983	45.0%	\$ 484,886,628	218.8%
6/30/2005	\$ 820,501,000	\$ 1,848,175,710	\$ 1,027,674,710	44.4%	\$ 460,956,060	222.9%

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)
7/1/2009	\$ -	\$ 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)

	2010		
	Bond Service Account	Bond Reserve Account	Total
Additions:			
Transfer from Reserve Account	\$ 70,793	\$ –	\$ 70,793
Transfer from unrestricted current funds	48,397,362	–	48,397,362
Interest earned on investments	56,650	1,463,880	1,520,530
Total receipts	48,524,805	1,463,880	49,988,685
Deductions:			
Payments of bond interest	33,574,076	–	33,574,076
Payments of bond principal	14,898,479	–	14,898,479
Net increase in fair value of investments	52,053	1,378,161	1,430,214
Transfer to Reserve Account	–	70,792	70,792
Total disbursements	48,524,608	1,448,953	49,973,561
Net increase for the year	197	14,927	15,124
Balances at beginning of year	2	54,666,994	54,666,996
Balance at end of year	\$ 199	\$ 54,681,921	\$ 54,682,120

	2009		
	Bond Service Account	Bond Reserve Account	Total
Additions:			
Transfer from Reserve Account	\$ 546,022	\$ –	\$ 546,022
Transfer from unrestricted current funds	49,048,784	–	49,048,784
Interest earned on investment	449,909	2,469,496	2,919,405
Total receipts	50,044,715	2,469,496	52,514,211
Deductions:			
Payments of bond interest	33,862,135	–	33,862,135
Payments of bond principal	15,809,918	–	15,809,918
Net decrease in fair value of investments	372,660	1,742,929	2,115,589
Transfer to Reserve Account	–	546,022	546,022
Total disbursements	50,044,713	2,288,951	52,333,664
Net increase for the year	2	180,545	180,547
Balances at beginning of year	–	54,486,449	54,486,449
Balance at end of year	\$ 2	\$ 54,666,994	\$ 54,666,996

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 as of and for the year ended June 30, 2010, and have issued our report thereon dated April 21, 2011. 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

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

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

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

2010-1 Financial Statement Close Process

Criteria

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

Condition

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

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

Cause

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

Effect

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

Recommendations

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

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

Compliance and other matters

As part of obtaining reasonable assurance about whether University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule.

This report is intended solely for the information and use of management, the Board of Trustees, federal awarding agencies and the Central Government of Puerto Rico and is not intended to be and should not be used by anyone other than these specified parties.

Ernst & Young LLP

April 21, 2011

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this report.

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