Audited Financial Statements

University of Puerto Rico
Years Ended June 30, 2011 and 2010
With Report of Independent Auditors

Ernst & Young

University of Puerto Rico

Audited Financial Statements

Years Ended June 30, 2011 and 2010

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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, 2011 and 2010, 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, 2011 and 2010. Those financial statements were audited by other auditors whose reports thereon have been furnished to us. Our opinion, insofar as it relates to amounts included for the Hospital and the Company, is solely based on the reports of the other auditors.

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

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the University of Puerto Rico and the aggregate discretely presented component units of the University of Puerto Rico as of June 30, 2011 and 2010, and the respective changes in financial position and cash flows thereon for the years then ended in conformity with US generally accepted accounting principles.

In accordance with *Government Auditing Standards,* we have also issued our report dated March 28, 2012, 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's financial statements. The schedules of changes in sinking fund reserves included in page 66 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

March 28, 2012

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original of
this report.

Introduction

The following discussion presents an overview of the financial position and financial activities of the University of Puerto Rico (the University) for the years ended June 30, 2011, 2010 and 2009. 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.

Good Accreditation Standing

In fiscal year 2011, the University restored its good accreditation standing with 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, within the first 15 months of the 24 month period prescribed by the Commission for probationary actions. On June 26, 2010, the Commission had 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. After the April 2011 site visit, the Commission found seven of the ten units in full compliance and after the September 2011 site visit, it found the remaining three units in full compliance.

Financial Highlights

As of June 30, 2011, the University has total assets of $1.51 billion, total liabilities of $1.08 billion and net assets of $426.1 million. The University's net assets increased by $58.0 million or 16% when compared to prior year. The reason for this change is explained in the section entitled "Analysis of Financial Position and Changes in Financial Position." An overview of the statements is presented below along with a financial analysis of the transactions impacting the statements.

Condensed financial statements for the University as of and for the years ended June 30, 2011, 2010 and 2009 follow:

Condensed Statements of Net Assets (In thousands)

	June 30		
	2011	**2010**	**2009**
Assets			
Current assets	**$ 360,562**	$ 233,452	$ 285,485
Noncurrent assets:			
Due from Commonwealth of Puerto Rico	**24,720**	56,609	74,890
Capital assets	**965,895**	961,168	898,328
Other assets	**157,929**	172,950	220,961
Total assets	**1,509,106**	1,424,179	1,479,664
Liabilities			
Current liabilities	**184,902**	204,944	178,178
Noncurrent liabilities	**898,146**	851,142	933,537
Total liabilities	**1,083,048**	1,056,086	1,111,715
Net assets			
Invested in capital assets net of related debt	**337,279**	309,055	300,279
Restricted:			
Nonexpendable	**87,973**	78,591	63,746
Expendable	**65,152**	72,205	69,891
Unrestricted (deficit)	**(64,346)**	(91,758)	(65,967)
Total net assets	**$ 426,058**	$ 368,093	$ 367,949

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

	Year Ended June 30		
	2011	**2010**	**2009**
Operating revenues			
Tuition and fees, net	**$ 73,451**	$ 41,809	$ 50,624
Governmental grants and contracts	**161,547**	131,682	127,969
Patient services	**71,466**	51,449	55,532
Other operating revenues	**48,007**	40,118	33,968
Total operating revenues	**354,471**	265,058	268,093
Operating expenses			
Salaries and benefits	**860,079**	933,653	939,531
Scholarships and fellowships	**215,205**	211,831	176,636
Supplies and other services and utilities	**206,562**	198,742	207,598
Other operating expenses	**68,792**	78,585	87,544
Total operating expenses	**1,350,638**	1,422,811	1,411,309
Operating loss	**(996,167)**	(1,157,753)	(1,143,216)
Nonoperating revenues (expenses)			
Commonwealth appropriations	**839,372**	839,318	923,760
Federal Pell Grant program	**179,160**	179,165	141,101
Federal ARRA program	**15,000**	105,000	–
Other nonoperating revenues (expenses), net	**3,976**	1,066	(452)
Net nonoperating revenues	**1,037,508**	1,124,549	1,064,409
Income (loss) before other revenues	**41,341**	(33,204)	(78,807)
Capital appropriations	**5,580**	1,288	17,240
Additions to term and permanent endowments	**11,044**	9,251	3,494
Changes in net assets	**57,965**	(22,665)	(58,073)
Net Assets			
Beginning of year, as previously reported	**368,093**	367,949	426,022
Cumulative impact of change in accounting for intangible assets	**–**	22,809	–
Beginning of year, as adjusted	**368,093**	390,758	426,022
End of year	**$ 426,058**	$ 368,093	$ 367,949

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. The financial statement presentation required by GASB provides a comprehensive, entity-wide perspective of the University's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows.

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, 2011 and 2010. The net assets are displayed in three parts, invested in capital assets net of related debt, restricted and unrestricted. Restricted net assets may either be expendable or nonexpendable and are those assets that are restricted by law on third-party agreements or by an external donor. Unrestricted net assets, while they are generally designated for specific purposes, are available for use by the University to meet current expenses for any purposes. The statements of net assets, along with all of the University's basic financial statements, are prepared under the accrual basis of accounting, whereby revenues are recognized when the service is provided and expenses are recognized when others provide the service to the University, regardless of when cash is exchanged. Assets and liabilities included in the statements of net assets are classified as current or noncurrent.

Assets

Total assets amounted to $1.51 billion, $1.42 billion and $1.48 billion at June 30, 2011, 2010, and 2009, respectively, an increase of $84.9 million or 6% in 2011 and a decrease of $55.5 million or 4% in 2010 when compared with the prior year balances.

Current assets primarily consist of cash and cash equivalents, short-term investments and accounts receivable. As of June 30, 2011, cash and cash equivalents, investments and accounts receivable comprise approximately 29%, 36% and 33%, respectively, of the current assets; meanwhile 84% of the noncurrent assets are capital assets. As of June 30, 2010, investments and accounts receivable comprise approximately 51% and 47%, respectively, of the current assets; meanwhile 81% of noncurrent assets are capital assets.

Cash and cash equivalents (certificates of deposit) amounted to $108.0 million, $3.4 million and $8.2 million at June 30, 2011, 2010, and 2009, respectively. The improvement in the University's cash position of $104.6 million in 2011 mainly resulted from the advances taken from a line of credit obtained during the fiscal year 2011, the stabilization fee established by the Board of Trustees of the University starting in fiscal year 2011 and the strict cost control measures implemented during the fiscal year 2011 to address the University's budgetary deficit issues.

In October 2010, the University obtained a $100 million revolving line of credit facility with the Government Development Bank for Puerto Rico (GDB) for working capital purposes which improved the University's cash position at June 30, 2011. The balance outstanding under this line of credit amounted to $93.7 million at June 30, 2011.

Also, to address the University's budgetary deficit issues, on June 30, 2010, the Board of Trustees of the University established a stabilization fee to be charged to all students in addition to tuition charges and other fees already in place in the University. The stabilization fee amounts to $400 per student per semester and has no set termination date. The stabilization fee increased revenue from tuitions and fees by $41.3 million in the fiscal year ended June 30, 2011.

In addition, by virtue of Act No. 176 of November 2010, as amended by Act No. 46 of April 2011, the Commonwealth of Puerto Rico (the Commonwealth) 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. Proceeds of this fund received by the University in 2011 amounted to $30.0 million, of which $23.4 million were granted as scholarships during the fiscal year ended June 30, 2011. Unused fund balance at June 30, 2011 amounted to $6.6 million.

On the other hand, the ARRA funds, designated for operational purposes, decreased by $90.0 million in 2011. Management compensated the decreases in the ARRA funds with the line of credit with GDB, the stabilization fee and the cost control measures which resulted in a reduction of operating expenses by $72.2 million in 2011.

Total investments at June 30, 2011 amounted to $213.5 million, a decrease of $12.0 million or 5% as compared to a balance of $225.5 million at June 30, 2010. In 2010, total investments decreased by $41.0 million or 15% as compared to a balance of $266.5 million at June 30, 2009. The decreases in both periods were mainly due to the disposition of the investments designated to fund the University's construction projects.

Accounts receivable, net, including due from the Commonwealth of Puerto Rico decreased by $22.5 million or 13% from $167.2 million at June 30, 2010 to $144.7 million at June 30, 2011. In 2010, accounts receivable, net decreased by $77.3 million or 32% from $244.5 million at June 30, 2009. The decrease in 2011 mainly resulted from collections of $12.9 million in the due from Commonwealth and increased provisions for doubtful accounts of $8.8 million for the year ended June 30, 2011. The decrease in 2010 mainly resulted from the cancellation of a receivable from the Commonwealth of $51.2 million against a note payable and increased provisions for doubtful accounts of $26.4 million for the year ended June 30, 2010.

Capital assets increased by $4.7 million or less than 1% from $961.2 million at June 30, 2010, to $965.9 million at June 30, 2010. For 2010, capital assets increased by $62.9 million or 7 % from $898.3 million at June 30, 2009. The increase in both years mainly resulted from the University's investment in construction projects and other capital assets that amounted to $49.2 million in fiscal year 2011 and $84.7 million in fiscal year 2010, which was partially offset by the depreciation and amortization expense of $43.9 million in fiscal year 2011 and $43.7 million in fiscal year 2010. 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.

Liabilities

Total liabilities amounted to $1.08 billion, $1.06 billion and $1.11 billion at June 30, 2011, 2010, and 2009, respectively, an increase of $27.0 million or 3% in 2011 and a decrease of $55.6 million or 5% in 2010 when compared with the prior year balances.

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

Excess of outstanding checks over bank balance, accounts payable and accrued liabilities decreased by $37.9 million or 26% from $143.4 million at June 30, 2010 to $105.5 million at June 30, 2011. In 2010, these current liabilities increased by $20.2 million or 16% from $123.1 million at June 30, 2009. The decrease in 2011 is mainly related to the University's positive cash position in fiscal year 2011 which offset the excess of outstanding checks over bank balance of $10.9 million at June 30, 2010 and reduced the unpaid health and medical benefit costs, accounts payable to suppliers and other accounts payable. The increase in 2010 is mainly related to the increased costs in the health and medical benefits to employees and the increase of unpaid utilities.

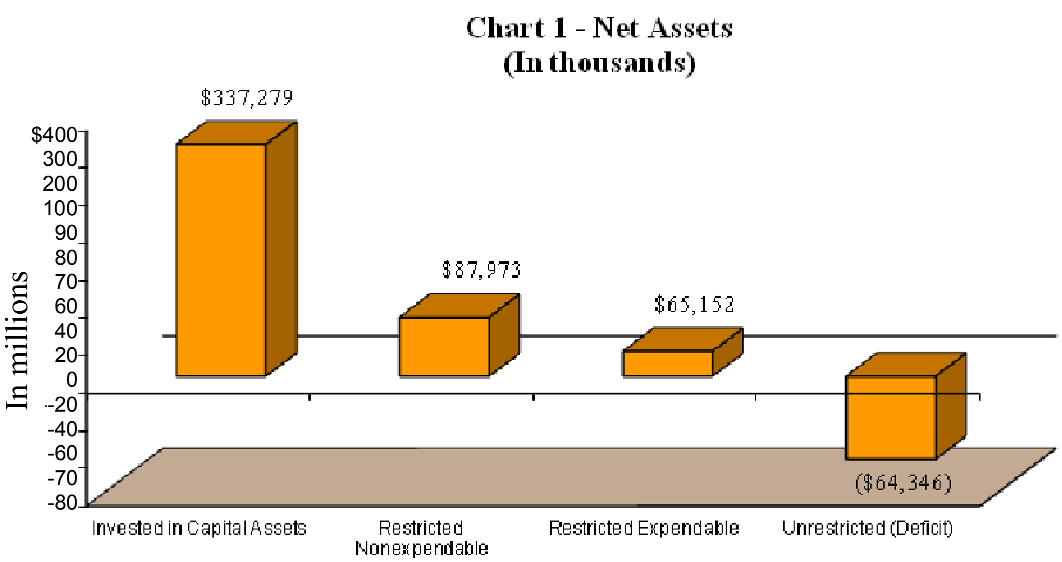
Long-term debt and capital lease obligations increased by $61.3 million or 9% from $666.1 million at June 30, 2010, to $727.4 million at June 30, 2011. In 2010, long-term debt and lease decreased by $72.4 million or 10% from $738.5 million at June 30, 2009. The increase in 2011 mainly resulted from a $100 million line of credit obtained from GDB in October 2010 which was partially offset by principal paid on capital debt and leases of $28.9 million during the fiscal year ended June 30, 2011. The balance outstanding under this line of credit amounted to $93.7 million at June 30, 2011. The decrease in 2010 mainly resulted from principal paid on capital debt and leases of $22.0 million and the cancellation of a note payable of $51.2 million against a receivable from the Commonwealth during the fiscal year ended June 30, 2010.

Compensated absences amounted to $156.7 million, $163.1 million and $169.7 million at June 30, 2011, 2010 and 2009, respectively, a decrease of $6.4 million or 4% in 2011 and of $6.6 million or 4% in 2010 when compared with prior year balances. Changes in compensated absences are mainly related to variations on the use of vacations by employees.

Net Assets

Net assets represent the residual interest in the University's assets after liabilities are deducted. Net assets amounted to $426.1 million, $368.1 million and $367.9 million at June 30, 2011, 2010, and 2009, respectively, an increase of $58.0 million or 16% in 2011 and of $144 thousand in 2010 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 at June 30, 2011 are shown in the following illustration:



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 earned 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 87% of the operating revenues and non-operating revenues of the University are Federal and Commonwealth appropriations, grants and contracts. The remainder consists primarily of tuition and fees and patient services.

Operating Revenues

Total operating revenues amounted to $354.5 million, $265.1 million and $268.1 million for the years ended June 30, 2011, 2010, and 2009, respectively, an increase of $89.4 million or 34% in 2011 and a decrease of $3.0 million or 1% in 2010. The changes in operating revenues mainly resulted from the changes in tuitions and fees, in governmental grants and contracts and in patient services revenues.

Tuitions and fees increased by $31.6 million or 76%, from $41.8 million in 2010 to $73.4 million in 2011, mainly as a result of the stabilization fee established by the Board of Trustees of the University on June 30, 2010 to address the University's budgetary deficit issues. This stabilization fee is charged to all students in addition to tuition charges and other fees already in place in the University. The stabilization fee amounts to $400 per student per semester and has no set termination date. This stabilization fee increased revenue from tuitions and fees by $41.3 million in fiscal year ended June 30, 2011. However, the positive effect of the stabilization fee on the revenue from tuitions and fees in 2011 was partially offset by the increase in the scholarship allowances of $22.8 million or 46%, from $49.7 million in 2010 to $72.6 million in 2011. In 2010, tuitions and fees decreased by $8.8 million or 17%, from $50.6 million in 2009, mainly is the result of higher scholarship allowances (about $6.0 million or 14% more than in fiscal year 2010) because of the increase in the Federal Pell Grant program. In 2011 and 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.

In 2011, revenues from governmental grants and contracts increased by $29.8 million or 23% from $131.7 million in 2010, to $161.5 million in 2011. In 2010, these revenues increased by $3.7 million or 3% from $128.0 million in 2009. The increase in 2011 mainly resulted from the increases in the federal and in the Commonwealth's grants and contracts for agricultural station services and other purposes. The increase in 2010 mainly resulted from the increase in the Commonwealth's grants and contracts.

Patient services amounted to $71.5 million, $51.4 million and $55.5 million for the years ended June 30, 2011, 2010, and 2009, respectively, an increase of $20.1 million or 39 % in 2011 and a decrease of $4.1 million or 7% in 2010. In 2011, patient service revenue increased as a result of more services rendered to patients and lower provision recorded for doubtful accounts. In 2010, patient service revenue decreased as a result of the increase in the provision for doubtful accounts.

Non-operating Revenues

Total non-operating revenues amounted to $1.04 billion, $1.12 billion and $1.06 billion for the years ended June 30, 2011, 2010, and 2009, respectively, a decrease of $87.0 million or 8% in 2011 and an increase of $60.1 million or 6% in 2010.

In 2011, the University received nonrecurring revenues from the American Reinvestment and Reconstruction Act (ARRA funds) of $15.0 million when in 2010 it received $105.0 million, a decrease of $90 million. No such funds were received in 2009.

In addition, the Commonwealth appropriations amounted to $839.4 million, $839.3 million and $923.8 million for the years ended June 30, 2011, 2010 and 2009. They remained flat in 2011 while in 2010 they decreased by $84.4 million or 9%.

Appropriations from the Commonwealth are the principal source of revenues of the University and are mainly supported by Act No. 2 of January 20, 1966, as amended. Under the Act, the Commonwealth appropriates for the University an amount equal to 9.60% of the average total amount of annual general funds revenues collected under the laws of the Commonwealth in the two fiscal years immediately preceding the current fiscal year (the Commonwealth formula appropriations). The non-operating revenues were negatively impacted by the continued reduction in the Commonwealth formula appropriations as a result of the reduction in the Commonwealth's general funds revenues. The Commonwealth formula appropriations amounted to $691.5 million, $729.1 million and $835.1 million for the years ended June 30, 2011, 2010, and 2009, respectively, a decrease of $37.6 million or 5% in 2011 and a decrease of $106.0 million or 13% in 2010.

In addition, the Commonwealth has appropriated amounts for general current obligations, for capital improvement programs, and for loans and financial assistance to students. These Commonwealth appropriations amounted to $147.9 million, $110.2 million and $88.7 million for the years ended June 30, 2011, 2010, and 2009, respectively, an increase of $37.7 million or 34% in 2011 and an increase of $21.5 million or 24% in 2010. The increase in 2011 mainly resulted from the appropriations received from the Special Scholarship Fund. By virtue of Act No. 176 of November 2010, as amended by Act No. 46 of April 2011, the Commonwealth of Puerto Rico 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. Proceeds of this fund received by the University in 2011 amounted to $30.0 million, of which $23.4 million were granted as scholarships during the fiscal year ended June 30, 2011. Unused fund balance at June 30, 2011 amounted to $6.6 million.

Federal Pell Grant program revenues amounted to $179.2 million in 2011 and 2010 and to $141.1 million in 2009. They remained flat in 2011, while in 2010 they increased by $38.1 million or 27%. The increase in 2010 was mainly due to the increase in the Federal Pell Grant assistance along with an increase in the number of eligible participants, as previously mentioned.

The following illustration presents the major sources of the University revenues (both operating and nonoperating) for the year ended June 30, 2011:

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

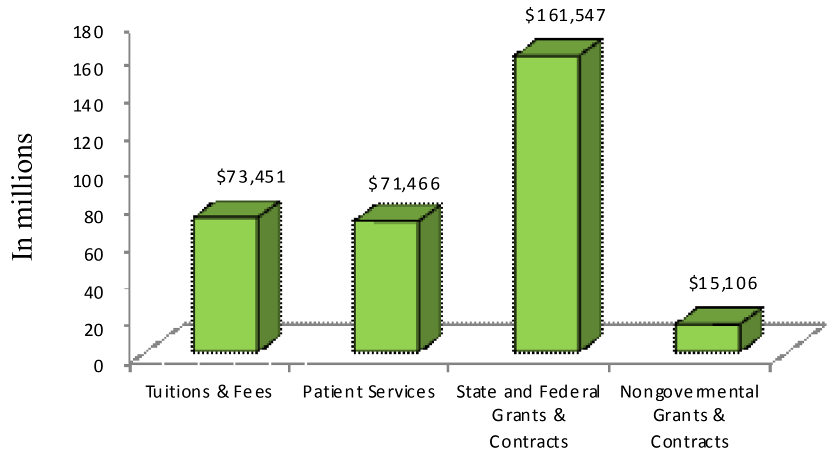
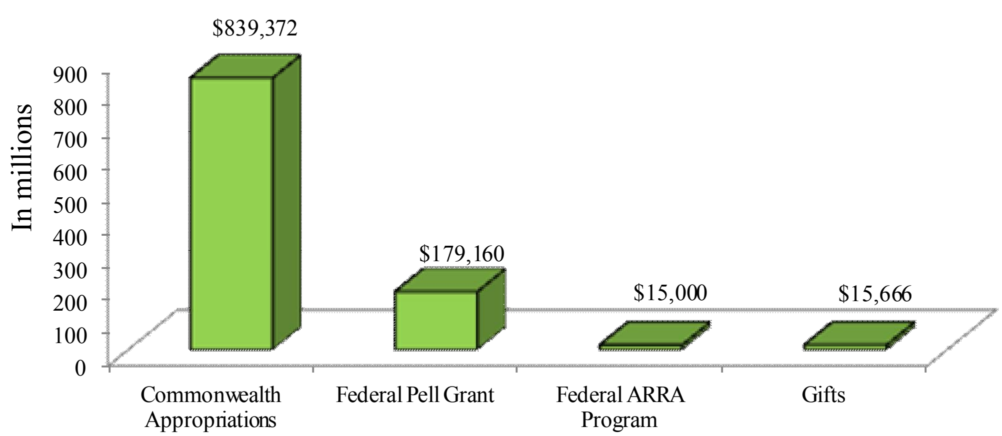
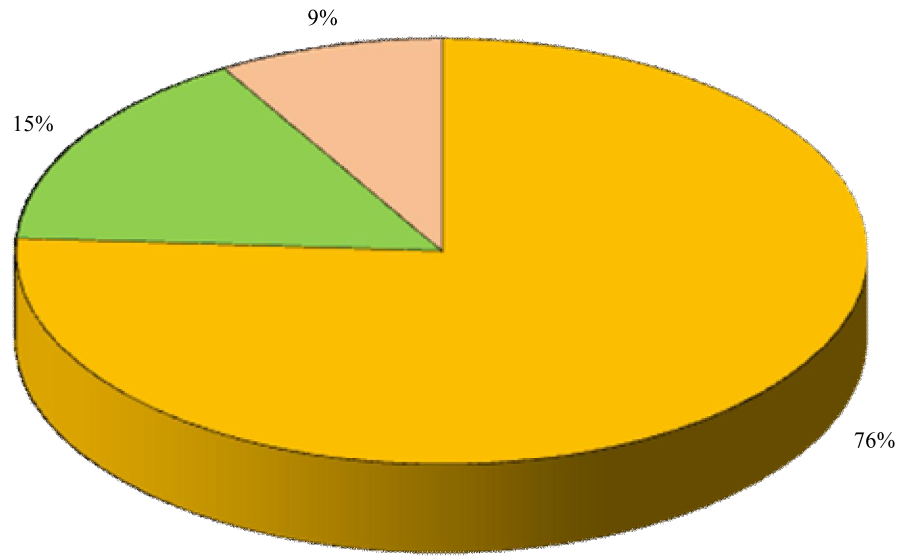


Chart 3 – Major Sources of Nonoperating Revenues (In thousands)



Federal grants represent 76% 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, 2011:

Chart 4 - Operating Grants Revenues
(Dollars in thousands)



Federal	$ 134,210	76%
Commonwealth	27,337	15%
Nongovernmental	15,106	9%
Total	$ 176,653	100%

Operating Expenses

The University's expenses are presented using natural expense classifications. Total operating expenses amounted to $1.35 billion, $1.42 billion and $1.41 billion for the years ended June 30, 2011, 2010, and 2009, respectively, a decrease of $72.2 million or 5% in 2011 and an increase of $11.5 million or 1% in 2010. The reduction in operating expenses is the result of the cost control measures taken by University in the fiscal years 2011 and 2010.

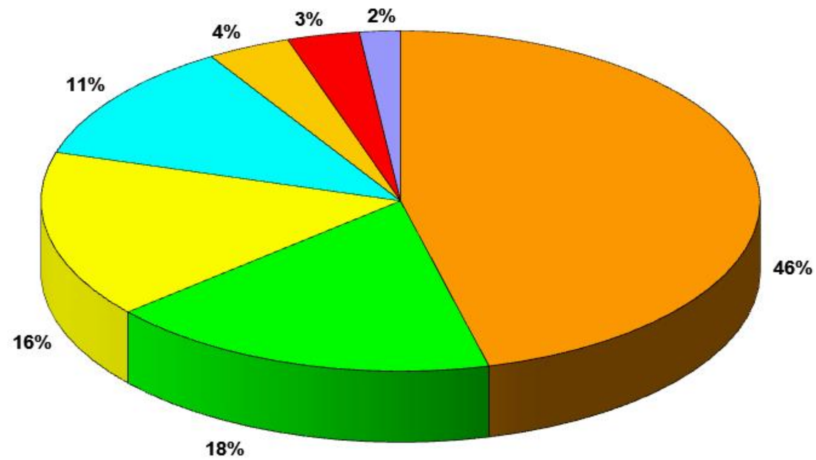
Salaries and benefits, the most significant component of operating expenses, amounted to $860.1 million, $933.6 million and $939.5 million for the years ended June 30, 2011, 2010 and 2009, respectively, a decrease of $73.6 million or 8% in 2011 and of $5.9 million or less than 1% in 2010. In 2011, these expenses decreased as a result of strict control measures taken by Management which includes the replacement of no more than 33% of retired employees, reductions in employees' benefits such as excess compensated absences, among others. In 2011, the University reduced about 800 positions of retired employees and of employees under contracted services. Notwithstanding that salary expense decreased in 2011, the University increased its contribution rate to the retirement plan from 11.4% to 13.0% which resulted in an increase of $10.0 million in the contribution benefit to the retirement plan. 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.

Scholarships and fellowships amounted to $215.2 million, $211.8 million and $176.6 million for the years ended June 30, 2011, 2010 and 2009, respectively, an increase of $3.4 million or 2% in 2011 and an increase of $35.2 million or 20% in 2010. The increase in 2011 mainly resulted from $24.0 million in scholarships granted under the Special Scholarship Fund approved by Act No. 176 of November 2010, as amended by Act No. 46 of April 2011. The increase in 2010 mainly resulted from the increase in the Federal Pell Grant assistance.

Supplies and other services and utilities amounted to $206.5 million, $198.7 million and $207.6 million for the years ended June 30, 2011, 2010 and 2009, respectively, an increase of $7.8 million or 4% in 2011 and a decrease of $8.9 million or 4% in 2010. The increase in 2011 mainly resulted from additional professional services. 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, 2011:

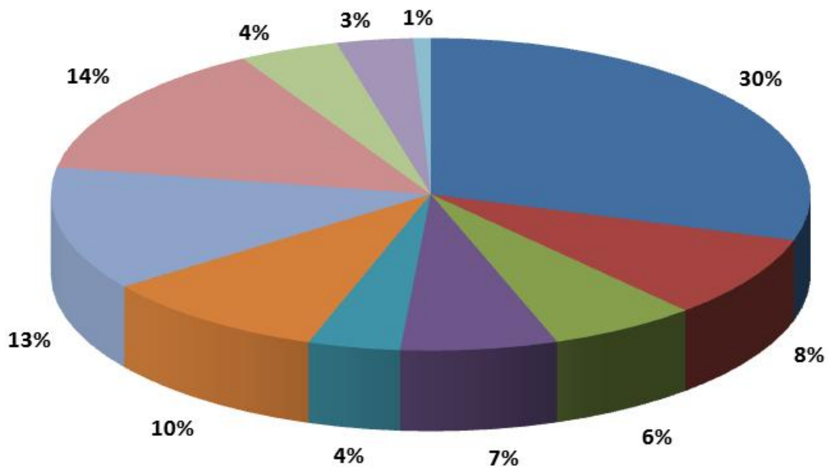
Chart 5 - Operating Expenses
(Dollars in thousands)



Salaries	$	621,981	46%
Benefits		238,098	18%
Scholarships and fellowships		215,205	16%
Supplies and other services		155,973	11%
Utilities		50,589	4%
Depreciation and amortization		43,921	3%
Other expenditures		24,871	2%
Total	$	1,350,638	100%

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, 2011:

Chart 6 – Expenses by Function
(Dollars in thousands)



Instruction	$	402,096	30%
Research		115,531	9%
Public service		84,916	6%
Academic support		90,163	7%
Student services		53,078	4%
Institutional support		131,147	10%
Operation and maintenance of plant		172,876	13%
Scholarships and fellowships		189,385	14%
Patient service		57,426	4%
Depreciation and amortization		43,921	3%
Other		10,099	1%
Total	$	1,350,638	100%

Operating Loss and Net Change in Net Assets

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

For the year ended June 30, 2010, the University reported an operating loss of $1.16 billion. After adding nonoperating revenue of $1.12 billion, primarily from the Commonwealth's appropriations and Federal Pell Grant program, 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 No. 51).

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.

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

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 schedules of changes in sinking fund reserves.

Subsequent Events

Subsequent events were evaluated through March --, 2012, the date the financial statements were available to be issued, to determine if such events should be recognized or disclosed in the 2011 financial statements.

In August 2011, the $5 million line of credit facility with the Government Development Bank for Puerto Rico was amended to increase its authorized balance to $75,000,000.

In October 2011, the $100 million line of credit facility with the Government Development Bank for Puerto Rico was amended to increase its authorized balance to $125,000,000, to extent the revolving status of the line from June 30, 2011 until October 1, 2012 and to convert the line of credit into a ten year term loan, with monthly equal principal payments plus interest starting on October 1, 2013. The maturity date of the line of credit was extended to October 1, 2022.

Capital Assets and Debt Administration

Significant capital assets additions for the year ended June 30, 2011 and 2010, 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).

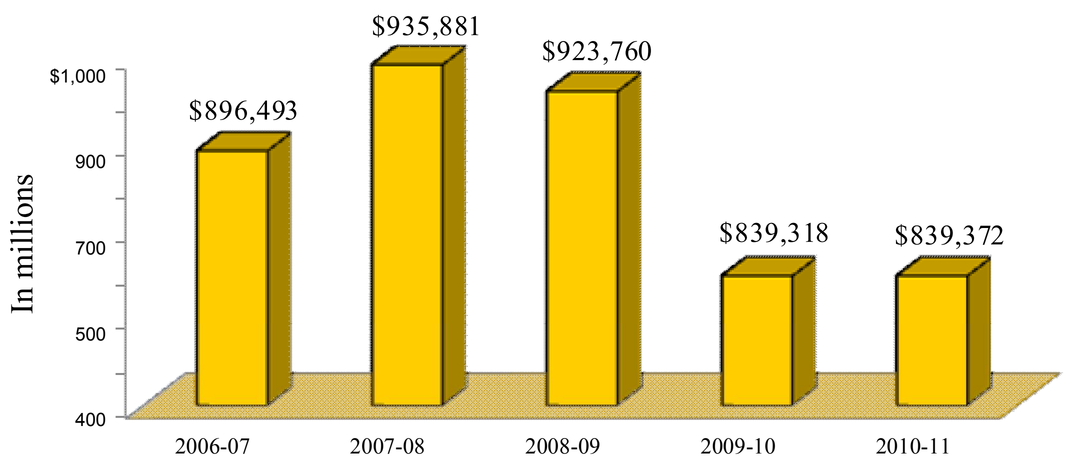
Puerto Rico uses the U.S. currency and forms part of the U.S. financial system. Factors affecting the U.S. economy usually have a significant impact on the performance of the Puerto Rico economy. These include exports, direct investment, the amount of federal transfer payments, the level of interest 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.

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.

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

The University and PRIDCO (Puerto Rico Industrial Development Company) entered into an agreement to create the "Fondo de Investigación del Centenario de la Universidad de Puerto Rico". As part of the agreement, the University will receive $40 million of which it has received $19,190,000. The University expects to collect the remaining balance.

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.

	June 30	
	2011	**2010**
Assets		
Current assets:		
Cash and cash equivalents	**$ 96,139,332**	$ –
Restricted cash and cash equivalents	**8,396,509**	–
Investments at fair value	**73,997,945**	64,175,315
Restricted investments at fair value	**54,649,613**	54,622,873
Accounts receivable (less allowances for doubtful accounts of $169,503,873 and $162,172,647 for 2011 and 2010, respectively)	**88,408,504**	98,032,981
Due from Commonwealth of Puerto Rico	**31,598,442**	12,570,127
Inventories	**3,518,775**	3,570,531
Prepaid expenses and deferred charges	**3,853,165**	479,932
Total current assets	**360,562,285**	233,451,759
Noncurrent assets:		
Restricted cash and cash equivalents	**3,479,692**	3,391,756
Restricted investments at fair value	**84,818,821**	106,756,499
Due from Commonwealth of Puerto Rico	**24,720,254**	56,608,186
Prepaid expenses and other assets	**66,317,282**	59,687,041
Notes receivable, net	**3,312,394**	3,115,767
Capital assets (net of accumulated depreciation and amortization):		
Land and other nondepreciable assets	**158,829,439**	253,000,134
Depreciable assets	**807,065,961**	708,167,573
Total noncurrents assets	**1,148,543,843**	1,190,726,956
Total assets	**1,509,106,128**	1,424,178,715
Liabilities		
Current liabilities:		
Excess of outstanding checks over bank balance	**–**	10,920,460
Accounts payable and accrued liabilities	**105,482,890**	132,465,972
Current portion of long-term debt	**45,056,638**	27,652,000
Obligation under capital lease, current portion	**1,383,308**	1,294,247
Other current liabilities	**32,979,704**	32,611,390
Total current liabilities	**184,902,540**	204,944,069
Noncurrent liabilities:		
Long-term debt, net of current portion	**616,290,379**	571,052,715
Obligation under capital lease, noncurrent portion	**64,693,128**	66,076,436
Other long-term liabilities	**217,162,554**	214,012,268
Total noncurrent liabilities	**898,146,061**	851,141,419
Total liabilities	**1,083,048,601**	1,056,085,488

(Continues)

University of Puerto Rico
Statements of Net Assets (continued)

	June 30	
	2011	**2010**
Net assets		
Invested in capital assets, net of related debt	**$ 337,279,006**	$ 309,054,671
Restricted, nonexpendable:		
Scholarship and fellowships	**33,093,435**	36,470,460
Research	**53,175,807**	38,195,830
Other	**1,703,227**	3,924,263
Restricted, expendable:		
Loans	**7,675,624**	7,859,602
Capital projects	**5,388,897**	12,441,640
Debt service	**52,087,812**	51,904,121
Unrestricted (deficit)	**(64,346,281)**	(91,757,360)
Total net assets	**$ 426,057,527**	$ 368,093,227

See accompanying notes.

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

	Year Ended June 30	
	2011	**2010**
Revenues		
Operating revenues:		
Tuitions and fees (net of scholarship allowances of $72,584,268 and $49,740,615 for 2011 and 2010, respectively)	**$ 73,451,284**	$ 41,809,483
Net patient services revenue and other	**71,465,562**	51,448,925
Federal grants and contracts	**134,209,649**	112,158,695
Commonwealth grants and contracts (net of allowances of $2,394,595 and $1,351,870 for 2011 and 2010, respectively)	**27,337,138**	19,522,590
Nongovernmental grants and contracts	**15,106,195**	21,578,616
Sales and services of educational departments	**8,991,008**	5,674,828
Auxiliary enterprises (net of scholarship allowances of $85,476 and $190,290 for 2011 and 2010, respectively)	**3,000,567**	3,570,176
Other operating revenues	**20,909,278**	9,294,349
Total operating revenues	**354,470,681**	265,057,662
Operating Expenses		
Salaries:		
Faculty	**345,848,868**	386,507,036
Exempt staff	**275,398,975**	298,298,168
Nonexempt wages	**733,512**	818,075
Benefits	**238,097,899**	248,029,695
Scholarships and fellowships	**215,204,518**	211,830,626
Supplies and other services	**155,972,533**	150,226,879
Utilities	**50,588,808**	48,515,157
Depreciation and amortization	**43,921,130**	43,737,024
Other expenses	**24,871,422**	34,848,901
Total operating expenses	**1,350,637,665**	1,422,811,561
Operating loss	**(996,166,984)**	(1,157,753,899)
Nonoperating revenues (expenses):		
Commonwealth appropriations	**839,372,106**	839,318,731
Federal Pell Grant program	**179,160,009**	179,164,782
Federal ARRA program	**15,000,000**	105,000,000
Gifts	**15,666,211**	18,305,621
Net investment income	**2,568,356**	1,919,924
Interest on capital assets - related debt	**(13,828,789)**	(19,905,665)
Interest on notes payable	**(1,787,458)**	–
Other nonoperating revenues, net	**1,357,205**	745,997
Net nonoperating revenues	**1,037,507,640**	1,124,549,390
Income (loss) before other revenues	**41,340,656**	(33,204,509)
Capital appropriations	**5,579,578**	1,288,035
Additions to term and permanent endowments	**11,044,066**	9,251,343
Change in net assets	**57,964,300**	(22,665,131)
Net Assets		
Beginning of year, as previously reported	**368,093,227**	367,949,039
Cumulative impact of change in accounting for intangible assets	**–**	22,809,319
Beginning of year, as adjusted	**368,093,227**	390,758,358
End of year	**$ 426,057,527**	$ 368,093,227

See accompanying notes.

University of Puerto Rico
Statements of Cash Flows

	Year Ended June 30	
	2011	2010
Cash flows from operating activities		
Tuition and fees	**$ 71,155,116**	$ 40,770,442
Grants and contracts	**186,752,877**	169,276,645
Patient services	**65,391,480**	45,786,745
Auxiliary enterprises	**3,000,567**	2,052,195
Sales and services educational departments and other	**29,900,284**	35,796,361
Payments to suppliers	**(216,840,623)**	(204,009,400)
Payments to employees	**(618,868,343)**	(685,130,701)
Payments for benefits	**(238,665,640)**	(246,290,184)
Payments for utilities	**(54,815,847)**	(35,415,752)
Payments for scholarships and fellowships	**(215,204,517)**	(211,830,626)
Loans issued to students, net of repayments	**(196,627)**	(367,707)
Other receipts (payments)	**405,590**	(3,929,934)
Net cash used in operating activities	**(987,985,683)**	(1,093,291,916)
Cash flows from noncapital financing activities		
Commonwealth appropriations	**852,231,723**	857,600,676
Federal ARRA program	**15,000,000**	105,000,000
Pell grant	**179,160,009**	179,164,782
Endowment gifts	**11,044,066**	9,251,343
Proceeds from noncapital debt	**93,705,769**	–
Interest paid on notes payable	**(1,334,547)**	–
Other non-operating revenues	**1,357,205**	745,998
Gifts and grants for other than capital purposes	**15,666,211**	18,305,620
Net cash provided by noncapital financing activities	**1,166,830,436**	1,170,068,419
Cash flows from capital and related financing activities		
Capital appropriations	**5,579,578**	1,288,035
Purchases of capital assets	**(49,217,333)**	(84,747,261)
Proceeds from sales of capital assets	**1,126,820**	–
Principal paid on capital debt and lease	**(28,946,245)**	(22,033,551)
Interest paid on capital debt and lease	**(17,420,460)**	(19,053,529)
Deposit with trustee	**(26,740)**	(99,656)
Net cash used in capital and related financing activities	**(88,904,380)**	(124,645,962)
Cash flows from investing activities		
Proceeds from sales and maturities of investments	**69,666,116**	92,548,050
Purchases of investments	**(57,551,068)**	(51,455,280)
Collections of interest and dividend income on investments	**2,568,356**	1,919,924
Net cash provided by investing activities	**14,683,404**	43,012,694
Net change in cash and cash equivalents	**104,623,777**	(4,856,765)
Cash and cash equivalents:		
Beginning of year	**3,391,756**	8,248,521
End of year	**$ 108,015,533**	$ 3,391,756

(Continues)

University of Puerto Rico
Statements of Cash Flows (continued)

	Year Ended June 30	
	2011	**2010**
Reconciliation of operating loss to net cash used in operating activities		
Operating loss	**$ (996,166,984)**	$ (1,157,753,899)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	**43,921,130**	43,737,024
Provision for doubtful accounts	**8,831,226**	26,470,074
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Grants and contracts receivables	**793,251**	(18,672,659)
Prepaid expenses, inventories and other	**(10,148,345)**	(4,843,149)
Increase (decrease) in:		
Excess of outstanding checks over bank balance	**(10,920,460)**	(12,720,956)
Accounts payable and accrued liabilities	**(27,408,513)**	30,004,819
Accrued salaries, wages, benefits and other liabilities	**3,113,012**	486,830
Net cash used in operating activities	**$ (987,985,683)**	$ (1,093,291,916)
Supplemental schedule of noncash investing, capital and financing activities:		
Note payable cancelled againt receivable from the Commonwealth's appropriations	**$ –**	$ 51,239,135

See accompanying notes.

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

	June 30	
	2011	**2010**
Assets		
Current assets:		
Cash and cash equivalents	**$ 3,142,686**	$ 573,729
Patient accounts receivable, net of allowance for doubtful accounts of $14,885,379 in 2011 and $17,449,667 in 2010	**13,215,573**	17,525,931
Accounts receivable - other	**1,118,160**	510,476
Inventories of supplies	**1,050,759**	1,120,998
Prepaid expenses	**250,963**	225,266
Estimated third-party payor settlements-Medicare	**2,079,005**	1,673,539
Total current assets	**20,857,146**	21,629,939
Property and equipment, net	**4,816,327**	5,622,711
Due from related parties	**137,650**	3,940,275
Total assets	**$ 25,811,123**	$ 31,192,925
Liabilities and deficiency in unrestricted net assets		
Current liabilities:		
Current portion of long-term debt and capital lease obligation	**$ 1,681,119**	$ 820,153
Accounts payable	**17,464,644**	24,421,905
Accrued payroll taxes and employee benefits	**1,502,296**	1,726,313
Accrued expenses	**2,013,275**	1,085,253
Total current liabilities	**22,661,334**	28,053,624
Long-term debt and capital lease obligation, net of current portion	**19,222,494**	19,070,938
Due to related parties	**42,041,174**	44,722,011
Accrued claim losses	**1,134,796**	1,029,596
Total liabilities	**85,059,798**	92,876,169
Deficiency in unrestricted net assets	**(59,248,675)**	(61,683,244)
Total liabilities and deficiency in unrestricted net assets	**$ 25,811,123**	$ 31,192,925

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	
	2011	**2010**
Unrestriced revenues and other support		
Net patient service revenue	**$ 47,408,444**	$ 47,347,178
Capital revenue	**3,185,174**	2,318,097
Other revenue	**1,624,509**	1,364,718
Total unrestricted revenues and other support	**52,218,127**	51,029,993
Expenses		
Salaries and benefits	**15,085,774**	17,633,685
Contracted services	**3,018,469**	3,380,700
Professional services	**3,287,431**	1,435,525
Supplies	**12,944,843**	10,873,319
Utilities	**2,708,728**	2,447,258
Interest	**1,133,234**	1,419,244
Provision for bad debts	**9,628,460**	6,701,855
Provision for claim losses	**150,000**	150,000
Depreciation and amortization	**1,634,396**	1,789,280
Other	**192,223**	1,686,111
Total expenses	**49,783,558**	47,516,977
Changes in unrestricted net assets	**2,434,569**	3,513,016
Deficiency in unrestricted net assets, at beginning of year	**(61,683,244)**	(65,196,260)
Deficiency in unrestricted net assets, at end of year	**$ (59,248,675)**	$ (61,683,244)

See accompanying notes.

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

	Year Ended June 30 2011	2010
Cash flows from operating activities		
Changes in unrestricted net assets	**$ 2,434,569**	$ 3,513,016
Adjustments to reconcile changes in unrestricted net assets to net cash provided by operating activities:		
Depreciation and amortization	**1,634,396**	1,789,280
Provision for bad debts	**9,628,460**	6,701,855
Provision for claim losses	**150,000**	150,000
Decrease (increase) in:		
Patient accounts receivable	**(5,318,102)**	(12,332,073)
Inventory of supplies	**70,239**	248,826
Prepaid expenses	**(25,697)**	20,961
Estimated third-party payor settlement-Medicare	**(405,466)**	(1,926,759)
Accounts receivable-other	**(569,861)**	(124,373)
Increase (decrease) in:		
Account payable	**(4,475,910)**	2,111,800
Accrued expenses, payroll taxes, employee benefits and other	**704,007**	473,101
Accrued claim losses	**(44,800)**	(12,000)
Total adjustments	**1,347,266**	(2,899,382)
Net cash provided by operating activities	**3,781,835**	613,634
Cash used in investing actitivies		
Purchases of property and equipment	**(268,937)**	(1,073,129)
Net cash flows from financing activities		
Payments on long-term debt, credit line and capital lease obligation	**(1,765,671)**	(769,822)
Proceeds from credit line	**88,800**	–
Advances to related parties	**(1,038,117)**	(983,315)
Repay from related parties	**1,115,847**	897,276
Other receipts from related parties	**655,200**	735,400
Net cash used in financing activities	**(943,941)**	(120,461)
Net change in cash and cash equivalents	**2,568,957**	(579,956)
Cash and cash equivalents, at beginning of year	**573,729**	1,153,685
Cash and cash equivalents, at end of year	**$ 3,142,686**	$ 573,729
Supplemental disclosures of cash flows information		
Interest paid	**$ 1,154,459**	$ 1,419,242
Supplemental schedule of noncash investing and financing activities		
Equipment acquired through financing	**$ 559,075**	$ –
Trade account payable converted into a long term debt	**$ 2,220,999**	$ –

See accompanying notes.

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

	June 30	
	2011	**2010**
Assets		
Current assets:		
Cash	**$ 1,721,322**	$ 2,221,066
Restricted cash	**1,322,158**	1,157,125
Restricted funds held by trustee	**14,621,673**	14,195,551
Net investment in direct financing lease	**66,230,945**	67,533,232
Property and equipment, net	**13,092**	22,018
Reimbursable tenant improvements unbilled, net of construction certifications payable of $127,745	**424,557**	–
Bond issuance costs, net of accumulated amortization of $790,920 in 2011 and $710,384 in 2010	**1,998,304**	2,078,840
Other assets	**274,951**	180,504
Total assets	**$ 86,607,002**	$ 87,388,336
Liabilities and net assets		
Liabilities:		
Construction contract and other development payables, retainage of $1,553,736 in 2011 and $1,582,078 in 2010	**$ 1,633,736**	$ 1,662,159
Operating trade accounts payable	**85,294**	61,467
Accrued interest payable	**1,970,469**	2,018,513
Accrued costs and expenses	**1,139,626**	1,134,637
Due to the University of Puerto Rico, net	**18,844**	187,352
Unearned student dormitories rental income	**–**	1,286
Commercial tenants and student dormitories security deposits	**127,491**	37,153
Bonds payable, net of discount of $236,856 in 2011 and $254,897 in 2010	**76,093,144**	77,760,103
Total liabilities	**81,068,604**	82,862,670
Net assets - Unrestricted	**5,538,398**	4,525,666
Total	**$ 86,607,002**	$ 87,388,336

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	
	2011	**2010**
Revenues:		
Income from investment in direct financing lease	**$ 4,398,634**	$ 4,481,121
Fixed management fee	**900,000**	900,000
Reimbursable expenditures fee	**2,382,513**	2,258,410
Total revenues	**7,681,147**	7,639,531
Expenses:		
Project operation and maintenance	**2,426,816**	2,211,182
General and administrative	**625,980**	664,822
Total expenses	**3,052,796**	2,876,004
Other income (expenses):		
Interest and other financing, related expenses	**4,040,222**	4,113,117
Interest income	**(424,603)**	(425,213)
Total other expenses, net	**3,615,619**	3,687,904
Changes in unrestricted net assets	**1,012,732**	1,075,623
Net assets - Unrestricted, beginning of year	**4,525,666**	3,450,043
Net assets - Unrestricted, end of year	**$ 5,538,398**	$ 4,525,666

See accompanying notes.

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

	Year Ended June 30	
	2011	**2010**
Cash flows from operating activities		
Changes in unrestricted net assets	**$ 1,012,732**	$ 1,075,623
Adjustments to reconcile changes in unrestricted net assets to net cash provided by operating activities:		
Depreciation	**8,926**	4,602
Bond discount amortization	**18,041**	19,025
Amortization of bonds issuances costs	**80,536**	80,631
Changes in operating assets and liabilities:		
Principal collected from direct financing lease	**1,302,287**	1,216,429
Net decrease in due from Unversity of Puerto Rico	**–**	596,783
Increase in other assets	**(94,447)**	(120,507)
Decrease in construction contract and other development payables	**(28,423)**	(43,199)
Increase (decrease) in operating trade accounts payable	**23,827**	(71,371)
Decrease in accrued interest payable	**(48,044)**	(33,413)
Increase in accrued costs and expenses	**4,989**	22,825
Decrease in unearned student dormitories rental income	**(1,286)**	(69,906)
Increase (decrease) in commercial tenants and student dormitories security deposits	**90,338**	(992)
Net cash provided by operating activities	**2,369,476**	2,676,530
Cash flows from investing activities		
Net increase in restricted funds held by trustee	**(426,122)**	(27,648)
Increase in reimbursable tenant improvements, net of related payables	**(424,557)**	–
Capital expenditures	**–**	(7,401)
Net cash used in investing activities	**(850,679)**	(35,049)
Cash flows from financing activities		
Principal payments on bonds payable	**(1,685,000)**	(1,620,000)
Net cash collected and receivables managed on behalf of the University of Puerto Rico	**(168,508)**	187,352
Net cash used in financing activities	**(1,853,508)**	(1,432,648)
Net change in cash	**(334,711)**	1,208,833
Cash, beginning of year	**3,378,191**	2,169,358
Cash, end of year	**$ 3,043,480**	$ 3,378,191
Supplemental disclosures of cash flows information:		
Interest paid	**$ 3,977,000**	$ 4,046,000

See accompanying notes.

1. Reporting Entity and Summary of Significant Accounting Policies

A. Reporting Entity

The University of Puerto Rico (the University) is a public corporation of the Commonwealth of Puerto Rico (the Commonwealth) governed by a seventeen-member Board of Trustees, of which fourteen 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 a term 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 discretely presented major component unit of the Commonwealth.

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

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

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

Servicios Médicos Universitarios, Inc.

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

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

Desarrollos Universitarios, Inc.

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

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

B. Measurement Focus and Basis of Accounting

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.

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 (non-operating activities).

Donated investments are recorded at their fair value at the date of donation. Investments of the Deferred Compensation Plan are valued at fair value 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, 2011 and 2010 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.

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

H. Inventories

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

I. Capital Assets

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

J. Impairment of Capital Assets

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

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

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

L. Deferred Compensation Plan

The University offers certain employees a non-qualified deferred compensation plan which was created pursuant to Certification No. 94 of the Council of Higher Education, dated February 13, 1984. The plan, managed by independent plan administrators, permits employees to defer a portion of their salary until

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

L. Deferred Compensation Plan (continued)

future years. At the employee's election, such amounts may be invested in mutual funds, which represent varying levels of risk and return. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to these amounts, are (until paid or made available to the employee or other beneficiary) solely the property and rights of the University (without being restricted to the provisions of benefits under the plan), subject only to the claims of the University's general creditors. Participants' rights under the plan are equal to that of general creditors of the University in an amount equal to the fair value of the deferred account for each participant. It is the opinion of the University's legal counsel that the University has no liability for the losses under the plan but does have the duty of care that would be required of an ordinary prudent investor. The University believes that it is unlikely that it will use the assets of the plan to satisfy the claims of general creditors in the future.

M. Compensated Absences

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

Employees accumulate sick leave generally at a rate of 1.5 days per month up to a maximum of 90 days. The University pays, annually, the excess of 90 days of accumulated sick leave to the employees. Upon retirement, an employee receives compensation for all accumulated unpaid sick leave at the then current rate, provided the employee has at least 10 years of service with the University. During the years ended June 30, 2011 and 2010, the cost of the excess of 90 days of the accumulated sick leave was approximately $9,744,000 and $11,379,000, respectively.

N. Classification of Net Assets

The University’s net assets are classified as follows:

- *Invested in capital assets, net of related debt* consist of the University’s total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent proceeds from issuance debt has been received but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

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

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

N. Classification of Net Assets (continued)

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

- *Unrestricted* net assets represent resources derived from student tuition and fees, state appropriations, hospital revenues, sales and services of educational activities and auxiliary enterprises. Auxiliary enterprises are substantially self-supporting activities that provide services for students, faculty and staff. While unrestricted net assets may be designated for specific purposes by action of management or the 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.

O. Classification of Revenues

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

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

Non-operating revenues include activities that have the characteristics of non-exchange transactions, such as gifts and contributions, Federal Pell Grants and other revenue sources that are defined as nonoperating revenues by GASB Statement No. 35 and GASB Statement No. 34, such as state appropriations, investment income and gifts. Gifts to the endowment fund are classified as other nonoperating revenues.

P. Scholarship Allowances and Student Financial Aid

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

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

Q. Net Patient Service Revenue

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

R. Grants and Contracts

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

S. Gifts and Pledges

Pledges of financial support from organizations and individuals representing unconditional promises to give are recognized in the financial statements once all eligibility requirements, including time requirements, have been met. In the absence of such promises, revenue is recognized when the gift is received. Endowment pledges generally do not meet eligibility requirements, as defined by GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange Transactions*, and are not recorded as assets until the related gift has been received. Unconditional promises that are expected to be collected in future years are recorded at the present value of the estimated future cash flows.

T. Pension

The University accounts for pension costs under the provisions of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers*. Under GASB Statement No. 27, pension expense is equal to the statutory required contribution to the employees' retirement system. A pension liability or asset is reported equal to the cumulative difference between annual required contributions and actual contributions.

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

U. Postemployment Benefits Other Than Pensions

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

2. Cash and Cash Equivalents and Cash Book Overdraft Position

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

	Unrestricted	Restricted	Total
Cash on hand	$ 776,708	$ –	$ 776,708
Cash equivalents- certificates of deposit with:			
Commercial banks	93,182,624	11,876,201	105,058,825
Economic Development Bank for Puerto Rico	2,180,000	–	2,180,000
Total cash equivalents	95,362,624	11,876,201	107,238,825
Total	$ 96,139,332	$ 11,876,201	$ 108,015,533

As of June 30, 2010, the carrying value of the University's restricted cash and cash equivalents amounted to $3,391,756 and consisted of certificates of deposit. The University's unrestricted cash and cash equivalents resulted in a book overdraft position of $(10,920,460) as of June 30, 2010.

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.

2. Cash and Cash Equivalents and Cash Book Overdraft Position (continued)

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, 2011) 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, 2011 and 2010, the cash deposited in the banks amounted to $133,182,213 and $24,706,355, respectively.

3. Investments

The University's investments held at June 30, 2011 and 2010 are summarized in the following table:

	2011	2010
U.S. Treasury notes	**$ 69,643,177**	$ 78,992,678
U.S. sponsored agencies bonds and notes	**4,277,522**	–
U.S. municipal bonds	**1,158,300**	–
Foreign government bonds	**861,208**	–
Mortgage-backed securities	**5,909,223**	–
Corporate bonds	**27,466,545**	26,738,927
Common stock and convertibles	**26,806,449**	20,675,773
External investment pools	**69,596,673**	60,092,390
Certificates of deposit	**7,053,784**	6,955,039
Guaranteed investment certificate	**620,184**	32,099,880
Money market funds	**73,314**	–
Total	**$ 213,466,379**	$ 225,554,687

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

3. Investments (continued)

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, 2011 and 2010, the account balance amounted to approximately $620,000 and $32 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 0.32%. 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, 2011 and 2010, the contract value, which represents amounts deposited plus interest credited less withdrawals, is equal to the fair value.

Credit Risk

Issuer credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. All of the University's investments in U.S. Treasury securities and mortgage-backed securities guaranteed by the Government National Mortgage Association carry the explicit guarantee of the U.S. government. As of June 30, 2011, the University's credit quality distribution for securities is as follows:

		Quality Rating		
	Carrying Value	AAA to A-	Unrated	No Risk
U.S. Treasury notes	$ 69,643,177	$ –	$ –	$ 69,643,177
U.S. sponsored agencies bonds and notes	4,277,522	4,277,522	–	–
U.S. municipal bonds	1,158,300	1,158,300	–	–
Foreign government bonds	861,208	861,208	–	–
Mortgage-backed securities	5,909,223	5,632,930	–	276,293
Corporate bonds	27,466,545	27,466,545	–	–
Guaranteed investment certificate	620,184	620,184	–	–
Common stock and convertibles	26,806,449	–	26,806,449	–
External investment pools	69,596,673	–	69,596,673	–
Money market funds	73,314	–	73,314	–
Certificates of deposit	7,053,784	–	7,053,784	–
Total	$ 213,466,379	$ 40,016,689	$ 103,530,220	$ 69,919,470

3. Investments (continued)

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, 2011, the custody of these investments is held by the trust department of a commercial bank in the name of the University and the portfolio is managed by a brokerage firm.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value is to changes in market interest rates. Expected maturities will differ from contractual maturities, because counterparties may have the right to call or prepay obligations with or without call or prepayment penalties. No investment in any one issuer other than the U.S. Government and the ING Life Insurance and Annuity Company – Fixed Account (external investment pool), represented 5% or more of the total investment portfolio at June 30, 2011.

The following table summarizes the type and maturity of investments held by the University at June 30, 2011:

	Within One Year	After One to Five Years	After Five to Ten Years	After Ten Years	No Stated Maturity Date	Total Fair Value
U.S. Treasury notes	$ 54,649,613	$ 6,524,443	$ 8,469,121	$ –	$ –	$ 69,643,177
U.S. sponsored agencies bonds and notes	-	908,082	2,270,903	1,098,537	–	4,277,522
U.S. municipal bonds	-	-	122,596	1,035,704	–	1,158,300
Foreign government bonds	-	861,208	–	–	–	861,208
Mortgage-baked securities	-	1,019,040	2,586,856	2,303,327	–	5,909,223
U.S. corporate bonds	5,744,261	11,623,254	10,004,807	94,223	–	27,466,545
Certificates of deposit	7,053,784	–	–	–	–	7,053,784
Guaranteed investment certificate	620,184	–	–	–	–	620,184
External investment pools	50,210,327	326,271	–	968,628	18,091,447	69,596,673
Money market funds	73,314	–	–	–	–	73,314
Common stock and convertibles	–	–	–	–	26,806,449	26,806,449
Total	$ 118,351,483	$ 21,262,298	$ 23,454,283	$ 5,500,419	$ 44,897,896	$ 213,466,379

At June 30, 2011, the University has variable rate interest investments amounted to $2,962,750, which reset in a semiannual basis at 100% of an interest rate index plus a spread.

4. Accounts Receivable

The University's accounts receivable as of June 30, 2011 and 2010 are as follows:

	2011	2010
Due from Commonwealth's:		
Agencies	**$ 27,735,523**	$ 23,613,848
Component units	**45,905,730**	52,417,346
Municipalities	**2,750,575**	2,710,813
Due from Federal Government	**24,557,612**	29,347,488
Due from Servicios Médicos Universitarios, Inc.	**34,496,756**	35,996,756
Due from medical plans	**82,217,203**	80,229,760
Other	**40,248,978**	35,889,617
	257,912,377	260,205,628
Less allowance for doubtful accounts	**(169,503,873)**	(162,172,647)
Accounts receivable, net	**$ 88,408,504**	$ 98,032,981

Due from Commonwealth of Puerto Rico

As of June 30, 2011 and 2010, the University has accounts receivable from Commonwealth of Puerto Rico (the Commonwealth) of $56,318,696 and $69,178,313, respectively. Due from Commonwealth as of June 30, 2011 includes $18,598,442 related to revenue from appropriations for fiscal years 2008 and 2009, which the Commonwealth agreed to pay to the University during fiscal year 2012 and $20,000,000 related to revenue from Commonwealth legislative scholarships for fiscal years 2008 and 2009, which the Commonwealth agreed to pay to the University in annual payments of $5.0 million.

In addition, due from Commonwealth includes a payment plan approved on September 7, 2004 in which the Commonwealth agreed to pay $94,710,382 to the University on behalf of the Puerto Rico Department of Health and the Commonwealth of Puerto Rico, over the course of ten years. As of June 30, 2011, the University has received $76,990,636 from this amount. The remaining balance of $17,720,254 will be received as follows: $8,000,000 in fiscal year 2012, $8,000,000 in fiscal year 2013, and $1,720,254 in fiscal year 2014.

4. Accounts Receivable (continued)

Due from Commonwealth of Puerto Rico (continued)

Due from the Commonwealth balance will be received as follows:

Fiscal year ended June 30,	Amount
2012	$ 31,598,442
2013	13,000,000
2014	6,720,254
2015	5,000,000
Total	$ 56,318,696

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

5. Capital Assets

Changes in the University's capital assets for the years ended June 30, 2011 and 2010 are as follows:

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

5. Capital Assets (continued)

	2010						
	Beginning Balance	Effect of Adoption GASB No. 51	Beginning Balance, As Adjusted	Additions	Transfers	Disposals	Ending Balance
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

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 was 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, 2011 and 2010, the carrying value of the University's assets recorded under capital leases amounted to approximately $85,393,000 and $88,404,000, respectively. Amortization expense on these assets amounted to approximately $3,011,000 in 2011 and 2010.

Capitalized interest on construction in progress amounted to approximately $7,655,000 and $11,243,000 for the years ended June 30, 2011 and 2010, respectively.

6. Notes Payable

In October 2010, the University obtained a $100 million line of credit facility with the Government Development Bank for Puerto Rico (GDB) for working capital purposes. 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. This line of credit matures on June 1, 2016 and bears interest per annum equal to prime rate plus 150 basis points, with a floor of 6% (6% at June 30, 2011). The balance outstanding under this line of credit amounted to $93,705,769 at June 30, 2011. The unused balance of this line of credit amounted to $6.3 million at June 30, 2011.

6. Notes Payable (continued)

As disclosed in Note 16, this line of credit was amended in October 2011 to increase its authorized balance to $125,000,000, to extend the revolving status of the line from June 30, 2011 until October 1, 2011 and to convert the line of credit into a ten year term loan, with monthly equal principal payments plus interest starting on October 1, 2013. The maturity date of the line of credit was extended to October 1, 2022.

In June 2011, the University obtained a $5.0 million non-revolving line of credit facility with GDB to complete certain construction projects of the University's Program for Permanent Improvements. This line of credit matures on January 31, 2013 and bears interest per annum equal to prime rate plus 150 basis points, with a floor of 6%. At June 30, 2011, no advances have been taken from this line of credit. As disclosed in Note 16, this line of credit was amended in August 2011 to increase its authorized balance to $75 million.

During fiscal year 2010, a non-revolving line of credit with GDB was cancelled against the receivable from the Commonwealth's appropriations for $51,239,135.

7. Noncurrent Liabilities

Changes in the University's noncurrent liabilities for the years ended June 30, 2011 and 2010 are as follows:

2011

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

7. Noncurrent Liabilities (continued)

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 payab	$ 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

Notes payable and bonds payable are further discussed in Notes 6 and 8-A, respectively.

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, 2011 and 2010:

Series	Balance as of June 30, 2011	Balance as of June 30, 2010	Annual Interest Rate (%)	Due Date June 30, 2011
C- Serial	**$ –**	$ 169,000	3.00%	–
D-Serial	**–**	218,000	3.75%	–
F - Term	**4,525,000**	6,000,000	5.50%	2012
N - Capital Appreciation Serial Bonds	**20,590,000**	31,050,000	5.75%	2012-2013
O - Serial	**2,315,000**	7,060,000	4.80%	2012
P - Serial	**229,095,000**	234,855,000	5.00%	2012-2026
P - Term	**47,645,000**	47,645,000	5.00%	2027-2030
Q - Serial	**109,270,000**	114,095,000	5.00%	2012-2026
Q - Term	**132,415,000**	132,415,000	5.00%	2027-2036
	545,855,000	573,507,000		
Plus unamortized premium	**27,299,914**	32,697,720		
Less:				
Unaccreted interest	**(430)**	(1,295)		
Future appreciated principal	**(1,765,522)**	(3,328,818)		
Deferred refunding loss	**$ (3,747,714)**	$ (4,169,892)		
	$ 567,641,248	$ 598,704,715		

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

8. Bonds Payable (continued)

B. Debt Service Requirement

At June 30, 2011, bonds payable require payments of principal and interest as follows:

Fiscal Year Ending June 30	Principal	Interest	Total
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	19,970,000	22,588,000	42,558,000
2017 to 2021	115,840,000	96,928,000	212,768,000
2022 to 2026	135,890,000	64,922,000	200,812,000
2027 to 2031	105,815,000	33,670,750	139,485,750
2032 to 2036	74,245,000	11,498,500	85,743,500
	$ 545,855,000	$ 329,177,995	$ 875,032,995

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, 2011 and 2010:

Pledged Revenues:	2011	2010
Tuition and other fees collected	**$ 86,413,916**	$ 78,524,637
Student fees collected	**4,455,726**	5,906,244
Stabilization Fee	**41,326,364**	–
Rental and other charges received for the right of use and occupancy of the facilities in the University system	**1,764,561**	1,559,611
Interest on investment of University funds, excluding funds invested pursuant to Article VI of the Trust Agreement	**306,052**	85,280
Funds paid to the University in respect to overhead allowance on federal research projects	**16,924,540**	15,818,290
Other income	**28,577,584**	27,007,597
Total	**$ 179,768,744**	$ 128,901,659

Interest earned on investments in the sinking fund reserve account amounted to $691,439 and $1,520,530 for the years ended June 30, 2011 and 2010, respectively.

8. Bonds Payable (continued)

C. Pledged Revenues (continued)

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.

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.

8. Bonds Payable (continued)

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.

Bonds payable at June 30, 2011 and 2010, consist of:

Description	Interest Rate	Maturity	2011 Face Amount	2010 Face Amount
Serial Bonds	4.25%	July 1, 2010	$ –	$ 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			**76,330,000**	78,015,000
Less unaccreted interest			**(236,856)**	(254,897)
Total			**$ 76,093,144**	$ 77,760,103

8. Bonds Payable (continued)

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

The activity of the principal balance of the bonds payable for the years ended June 30, 2011 and 2010, is as follows:

	2011	2010
Beginning Balance	**$ 78,015,000**	$ 79,635,000
Reductions	**(1,685,000)**	(1,620,000)
Ending Balance	**$ 76,330,000**	$ 78,015,000

At June 30, 2011, bonds payable require payment of principal and interest as follows:

Fiscal Year Ending June 30	Principal	Interest	Total
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	3,510,344	5,585,344
2016	2,190,000	3,387,155	5,577,155
2017 to 2021	12,945,000	14,848,625	27,793,625
2022 to 2026	16,700,000	10,961,750	27,661,750
2027 to 2031	21,315,000	6,117,000	27,432,000
2032 to 2034	15,525,000	801,500	16,326,500
Total	$ 76,330,000	$ 50,832,688	$ 127,162,688

Interest on the bonds is payable each January 1 and July 1. Bonds maturing after July 1, 2011 may be redeemed, at the option of the University in whole or in part, at a redemption price equal to 100% of the principal amount plus accrued interest, without premium. In addition, term bonds are subject to mandatory redemption in part commencing on July 1, 2022 to the extent of the sinking fund requirement for said bonds set forth below at a redemption price equal to 100% of the principal amount thereof plus accrued interest.

8. Bonds Payable (continued)

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

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

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, 2011 and 2010 on this capital lease is $66,076,436 and $67,370,683, respectively. The effective interest rate was determined at 6.60%.

9. Obligation under Capital Lease (continued)

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

Year Ending June 30,		Amount
2012	$	5,701,938
2013		5,697,312
2014		5,702,063
2015		5,700,344
2016		5,702,156
2017-2021		28,498,625
2022-2026		28,496,750
2027-2031		28,502,000
2032-2033		11,401,499
Total future minimum lease payments		125,402,687
Less amounts representing interest costs		(59,326,251)
Present value of minimum lease payments	$	66,076,436

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.

10. Commitments and Contingent Liabilities (continued)

A. Insurance (continued)

Changes in the claims liability amount for the years ended June 30, 2011 and 2010 were:

	2011	2010
Claims payable - July 1	**$ 23,425,232**	$ 27,355,166
Incurred claims and changes in estimates	**2,742,998**	(2,370,668)
Payments for claims and adjustments expenses	**(2,337,408)**	(1,559,266)
Claims payable - June 30	**$ 23,830,822**	$ 23,425,232

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. Management believes the impact will not be material to the University's financial statements.

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, 2011 and 2010 is as follows:

	2011	2010
Beginning Balance	**$ 19,891,091**	$ 20,660,913
Additions	**2,683,120**	–
Reductions	**(1,670,598)**	(769,822)
Ending Balance	**$ 20,903,613**	$ 19,891,091

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:

Fiscal Year Ending June 30	Amount
2012	$ 1,681,119
2013	1,810,317
2014	1,356,857
2015	1,087,054
2016	1,128,100
2017-2021	6,833,537
2022-2025	7,006,629
	$ 20,903,613

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

10. Commitments and Contingent Liabilities (continued)

C. Discretely Presented Component Units (continued)

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

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

11. University of Puerto Rico Retirement System

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

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

11. University of Puerto Rico Retirement System (continued)

Funding Policy and Annual Pension Cost

Contribution rates:	
University	13.0%
Plan members	7%-11%
Annual pension cost	$66,761,754
Contributions made	$70,761,490
Actuarial valuation date	6/30/2011
Actuarial cost method	Entry age normal (traditional)
Amortization method	Level percentage of payroll
Remaining amortization period	30 years constant (open basis)
Asset valuation method	Market value adjusted to reflect investment gain and losses over a five (5) year period. The actuarial value of assets at June 30, 2011 is $1,041,628,000.
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 applicable to salary cap or Certification 139, no postretirement benefit increases are assumed.
Mortality table	RP-2000 with projection

Fiscal Year Ending	Annual Pension Cost (APC)	Employer Contribution	Percentage of APC Contributed	Net Pension Obligation (Asset)
6/30/2011	$ 66,761,754	$ 70,761,490	106.0%	$ (59,088,385)
6/30/2010	$ 62,275,417	$ 71,176,599	114.3%	$ (55,088,649)
6/30/2009	$ 62,929,059	$ 72,605,262	115.4%	$ (46,187,467)

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 University's net OPEB obligation movement:

	2011	2010
ARC	**$ 9,651,667**	$ 9,651,667
Interest on the net OPEB obligation	**102,822**	57,584
Adjustments to the ARC	**(89,113)**	(49,907)
Annual OPEB cost (expense)	**9,665,376**	9,659,344
Employer contribution	**(9,772,691)**	(8,528,399)
Change in the net OPEB obligation	**(107,315)**	1,130,945
Net OPEB obligation- beginning of year	**2,570,557**	1,439,612
Net OPEB obligation- end of year	**$ 2,463,242**	$ 2,570,557
Percentage of annual OPEB cost contributed	**101.11%**	88.29%

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

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

Actuarial Valuation Date	July 1, 2009
Actuarial Accrued liability (AAL)	$ 189,417,225
Unfunded AAL	$ 189,417,225
Funded Ratio	0%

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

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
6/30/2011	$ 9,665,376	101.1%	$ 2,463,242
6/30/2010	$ 9,659,344	88.3%	$ 2,570,557
6/30/2009	$ 9,690,994	99.5%	$ 1,439,612

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.

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. As permitted by GASB Statement No. 45, the actuarial valuation is performed every two years.

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	$517 per retiree in fiscal 2011 increasing 4.0% per year
Payroll Growth	
Discount Rate	4%
	4%

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. Management Business Plan and Operation - Discretely Presented Component Unit

During most of the preceding years (up to June 30, 2009), the Hospital experienced significant operating losses having an accumulated net assets deficiency of $59,248,675 as of June 30, 2011. The Hospital has received advances from the University to cover its cash needs from operations. Most of these accumulated losses are mainly related to the fact that, as a former public hospital operated by the Puerto Rico Department of Health, it provides a significant amount of services to indigent population for which the Hospital does not obtain a payment. Most of these patients are indigent persons not subscribed to the Health Reform Program, homeless and resident aliens without medical insurance coverage, among others. The medical services provided to these persons were supposed to be paid to the Hospital by the Puerto Rico Department of Health. However, since the beginning of the operations, the Puerto Rico Department of Health has been unable to pay for such services. As shown in the accompanying financial statements, the Hospital has provided allowances for uncollectible accounts receivable in the approximated amount of $14,885,379 as of June 30 2011.

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, 2011.

The Hospital's management, with the assistance of its Board of Directors, are working with a management plan toward its operational activities as well as the Hospital's ability to get cash to comply with its current obligations.

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

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

- To officially open 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's 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.

- Continue development of an integrated information system to recover more efficiently the revenue charges for the services provided.
- Expansion of the Intensive Care Unit area with sixteen new beds. This will improve the service provided to the critical patients and as result of this an increase in patient days.
- Marketing of the ophthalmology, urology and orthopedic services.
- Increased the ambulatory surgery service.
- Refurbishing clinical wards included patients' rooms and other hospital general and common areas to improve the Hospital image and be able to attract insured patients sector.
- Refurbishing the emergency rooms facility.
- An implementation of an aggressive cost containment program, including the bottom line control with effective labor management.
- Develop quality improvement strategy that includes priorities to improve the delivery of health care services and the quality measures to be used in reporting to and payment under the federal health programs.

Some of these measures 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 $2,435,000 and $3,513,000 during the years ended June 30, 2011 and 2010, respectively.

The University has expressed its commitment to provide the Hospital with the necessary financial support, if needed, to continue its operations for at least one year after June 30, 2011.

14. Functional Information

The University's operating expenses by functional classification during the years ended June 30, 2011 and 2010 were as follows:

2011

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

2010

Functional Classification	Salaries and Benefits	Supplies and other Services	Scholarships and Fellowships	Utilities	Depreciation and Amortization	Other Expenses	Total
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
	$ 933,652,974	$ 150,226,879	$ 211,830,626	$ 48,515,157	$ 43,737,024	$ 34,848,901	$ 1,422,811,561

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.

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

15. Significant New Accounting Pronouncements (continued)

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

- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.* The objective of this Statement is to provide financial reporting guidance for deferred outflows of resources and deferred inflows of resources. The requirements of this Statement will improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. It alleviates uncertainty about reporting those financial statement elements by providing guidance where none previously existed. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2011.

15. Significant New Accounting Pronouncements (continued)

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

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

16. Subsequent Events

Subsequent events were evaluated through March 28, 2012, the date the financial statements were available to be issued, to determine if such events should be recognized or disclosed in the 2011 financial statements.

In August 2011, the $5 million line of credit facility with the Government Development Bank for Puerto Rico was amended to increment its authorized balance to $75 million.

In October 2011, the $100 million line of credit facility with the Government Development Bank for Puerto Rico was amended to increment its authorized balance to $125 million, to extend the revolving status of the line from June 30, 2011 until October 1, 2012 and to convert the line of credit into a ten year term loan, with monthly equal principal payments plus interest starting on October 1, 2013. The maturity date of the line of credit was extended to October 1, 2022.

Required Supplementary Information

Employees Retirement Plan

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAL) (b – a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered ((b – a) / c)
6/30/2011	$ 1,041,628,000	$ 2,542,444,021	$ 1,500,816,021	41.0%	$ 510,706,620	293.9%
6/30/2010	$ 1,028,918,000	$ 2,436,913,244	$ 1,407,995,244	42.2%	$ 540,867,018	260.3%
6/30/2009	$ 1,034,645,000	$ 2,331,619,466	$ 1,296,974,466	44.4%	$ 570,122,184	227.5%
6/30/2008	$ 1,024,987,000	$ 2,223,219,684	$ 1,198,232,684	46.1%	$ 542,603,556	220.8%
6/30/2007	$ 953,197,000	$ 2,068,102,695	$ 1,114,905,695	46.1%	$ 513,486,180	217.1%
6/30/2006	$ 869,211,000	$ 1,930,131,983	$ 1,060,920,983	45.0%	$ 484,886,628	218.8%

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)

	2011		
	Bond Service Account	**Bond Reserve Account**	**Total**
Additions:			
Transfer from Reserve Account	$ 87,258	$ –	$ 87,258
Transfer from unrestricted current funds	54,676,678	–	54,676,678
Interest earned on investments	136,071	555,368	691,439
Total receipts	54,900,007	555,368	55,455,375
Deductions:			
Payments of bond interest	33,335,995	–	33,335,995
Payments of bond principal	21,443,885	–	21,443,885
Net increase in fair value of investments	120,326	464,421	584,747
Transfer to Reserve Account	–	87,258	87,258
Total disbursements	54,900,206	551,679	55,451,885
Net increase for the year	(199)	3,689	3,490
Balances at beginning of year	199	54,681,921	54,682,120
Balance at end of year	$ –	$ 54,685,610	$ 54,685,610

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 investment	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 decrease 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

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

Board of Trustees
University of Puerto Rico

We have audited the financial statements of the business type activities and aggregate discretely presented component units of the University of Puerto Rico (the University) as of and for the year ended June 30, 2011, and have issued our report thereon dated March 28, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of Servicios Médicos Universitarios, Inc. (the Hospital) and Desarrollos Universitarios Inc. (the Company), as described in our report on the University's financial statements. This report does not include results of other auditor's testing of internal control over financial reporting or compliance and other matters that are reported on separately by other auditors. The financial statements of the Hospital and the Company were not audited in accordance with *Government Auditing Standards*.

Internal control over financial reporting

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

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

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 deficiencies described in the next paragraphs to be material weaknesses.

2011-1 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.

- The accounting and financial reporting operations of certain units of the University, specifically Recinto de Ciencias Médicas (RCM) and Recinto Universitario de Mayaguez (RUM), are not able to detect or prevent accounting errors effectively nor efficiently which results in multiple audit adjustments.

- As of June 30, 2011, the University had health insurance payable for approximately $16.4 million. Upon further audit procedures and our request for supporting evidence, it was determined that appropriate evidence was not available to support a significant amount of the account balance. As result, we proposed an audit adjustment to reduce the health insurance payable for $11.6 million.

Cause

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

Effect

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

Recommendations

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

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

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

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

2011-2 Accounting of Federal Grant Revenues (Servicios de Extensión Agrícola - RUM)

Criteria

A sound system of internal controls is essential in enabling the University to prepare timely and accurate financial statements by helping ensure that all financial transactions are properly recorded, appropriately supported, and subjected to supervisory review.

Condition

During fiscal year 2011, Servicios de Extensión Agrícola (SEA), a RUM division recorded $5.4 million of federal grant revenue which should have been recognized in prior fiscal years. Accounting for federal grants requires federal revenue to be recognized when a federal expenditure has been incurred. The SEA failed to recognize the associated revenue in the periods incurred.

In addition, Management did not request the reimbursement of these federal expenditures timely. For this reason we proposed an audit adjustment to increase the allowance for doubtful accounts related this account receivable by $7.5 million.

Cause

The monitoring and supervisory controls over these federal expenditures and revenues were not effective.

Effect

The lack of monitoring and supervisory controls led to significant adjustments in the University's financial statements.

Recommendations

Management should be more closely involved in the monitoring and review of the federal expenditures and revenues processes. Management should consider performing this process on a monthly basis in order to detect and correct errors on a timely basis, while enhancing the University's knowledge over its financial condition.

Compliance and other matters

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

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

Ernst & Young LLP

March 28, 2012

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