

UPR RIO PIEDRAS CAMPUS
UNIVERSITY OF PUERTO RICO



**Supplemental Information Report to the
Middle States Commission on Higher Education**

Luis Ferrao Delgado, Ph.D.
Interim Chancellor

Leticia M. Fernández,

Interim Dean for Academic Affairs

Sonia Balet Dalmau, Ph.D.
MSCHE Liaison Officer

Due January 2, 2019

Subject of Supplemental Report

To request a supplemental information report due January 2, 2019, providing the audited financial statement and single audit for June 30th, 2017. The date of the next evaluation will be determined upon reaffirmation of accreditation.



January 2, 2019

Dr. Elizabeth H. Sibolski
President
Middle State Commission on Higher Education (MSCHE)

Dear Doctor Sibolski:

Your letter of November 20, 2018 officially notified the Rio Piedras Campus of the University of Puerto Rico (UPRRP) of the actions taken by the MSCHE in its meeting of November 15, 2018. These actions led to the request to UPRRP of a supplemental information report due January 2, 2019, providing the audited financial statement and single audit for June 30th, 2017.

UPRRP has submitted all required documents to comply with the auditing processes, as requested by the firm of external auditors Ernst & Young (E&Y) for the review of the consolidated financial statement of the 11 campuses of the University of Puerto Rico System. Currently, the Audited Financial Report FY 17 is in the final stage of review at the E&Y headquarters.

The draft of the Financial Report FY 17 uploaded herein as part of the Supplemental Information Report to MSCHE of January 2, 2019 includes: a) Financial Statements FY17; b) Required Supplementary Information and Supplemental Schedules for the Years ended June 30, 2017 and 2016 with Report of Independent Auditor.

The University of Puerto Rico Central Administration and the 11 campuses are committed to providing all required information to demonstrate compliance with MSCHE Requirement of Affiliation 11 and Standard VI (Planning Resources and Institutional Improvement). The UPR Audited Financial Report FY 17 duly certified and signed by E&Y will be uploaded as soon as received during January 2019.

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Rectoría

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Patrono con Igualdad de Oportunidades en el Empleo M/M/V/I

Dr. Elizabeth H. Sibolski

Page 2

January 2, 2019

We appreciate the value-added of this accreditation process to our university, the oldest and most prestigious academic institution in Puerto Rico

Cordially,



Dr. Luis A. Ferrao

Acting Chancellor

- c Dr. Idna Corbett, Vice President, Institutional Field Relations, MSCHE
- Dr. Hilda Colón Plumey, Vice President, Institutional Field Relations, MSCHE
- Ms. Erin Mattson, Senior Director for Accreditation Services

FINANCIAL STATEMENTS, REQUIRED
SUPPLEMENTARY INFORMATION AND
SUPPLEMENTAL SCHEDULES

University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Years Ended June 30, 2017 and 2016
With Report of Independent Auditors

DRAFT

University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)

Financial Statements, Required Supplementary Information
and Supplemental Schedules

Years Ended June 30, 2017 and 2016

Contents

Report of Independent Auditors.....	1
Management’s Discussion and Analysis (Unaudited).....	4
Financial Statements as of and for the Years Ended June 30, 2017 and 2016:	
Statements of Net Position (Deficit).....	54
Statements of Revenues, Expenses and Changes in Net Position (Deficit).....	55
Statements of Cash Flows.....	56
Notes to Financial Statements	58
Required Supplementary Information (Unaudited)	
Schedule of Changes in the University’s Net Pension Liability and Related Ratios.....	152
Schedule of the University’s Contributions – Pension Plan	153
Notes to Schedule of University’s Contributions – Pension Plan.....	154
Schedule of Funding Progress - Postemployment Benefits Other Than Pensions Program.....	157
Other Financial Information (Unaudited)	
Schedules of Changes in the University’s Sinking Fund Reserve.....	158
Report on Internal Control and on Compliance	
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	159

Report of Independent Auditors

Governing Board
University of Puerto Rico

Report on the Financial Statements

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, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the University's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Desarrollos Universitarios, Inc., a blended component unit of the University, which financial statements reflect total assets constituting ___% and 1.21% in 2017 and 2016, respectively, total net position constituting ___% and 0.43% in 2017 and 2016, respectively, and total revenues constituting ___% and 0.05% in 2017 and 2016, respectively, of the related University's totals. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Desarrollos Universitarios, Inc., is based solely on the report of the other auditors. We also did not audit the financial statements of Servicios Médicos Universitarios, Inc. (the "Hospital"), University of Puerto Rico Parking System, Inc. and Material Characterization Center, Inc. (collectively, the "Companies"), which represent 100% of the aggregate discretely presented component units, as of and for the years ended June 30, 2017 and 2016. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to amounts included for the aggregate discretely presented component units, is based solely on the reports of the other auditors. The financial statements of the Hospital and the Companies were not audited in accordance with *Government Auditing Standards*. 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.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and aggregate discretely presented component units of the University as of June 30, 2017 and 2016, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

The University's Ability to Continue as a Going Concern

The accompanying financial statements have been prepared assuming that the University will continue as a going concern. As discussed in Note 2 to the financial statements, the University is highly dependent on the Commonwealth of Puerto Rico (the Commonwealth) appropriations to finance its operations. The financial difficulties experienced by the Commonwealth, including the uncertainty as to its ability to fully satisfy its obligations, raises substantial doubt about the University's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 4 through 53, schedule of changes in the university's net pension liability and related ratios on page 152, schedule of university's contributions – pension plan on page 153 and the schedule of funding progress-postemployment benefits other than pensions program on page 157 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary and Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the University's basic financial statements. The other financial information on page 159 (the Schedules), as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The Schedules have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on the Schedules.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our report dated _____, 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* in considering the University's internal control over financial reporting and compliance.

_____, 2018

Stamp No. _____
affixed to
original of
this report.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

Introduction

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

The University is a public corporation of the Commonwealth of Puerto Rico (the Commonwealth) governed by a fourteen-member Governing Board, of which eight members are appointed by the Governor of Puerto Rico and confirmed by the Senate of Puerto Rico for a term of six years. The remaining members of the Governing Board consist of two tenured professors and two full-time students. The Secretary of the Department of Education of the Commonwealth and the Executive Director of the Puerto Rico Fiscal Agency and Financial Advisory Authority or their designees become ex-officio members of the Governing Board. The terms for the students 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 University is the oldest and largest institution of higher education in Puerto Rico with a history of academic excellence. Commonwealth appropriations are the principal source of the University revenues. Additional revenues are derived from tuitions, federal grants, patient services, auxiliary enterprises, interest income, and other sources.

The University capacity to attract federal funding for research, training, public service and other endeavors to advance its mission and priorities is certainly a premier strength. A broad range of federal agencies currently sponsors the University research activity in the Sciences, Health Sciences, Engineering, Technology and the Arts. Efforts continue to increase and diversify sources of funding.

The University of Puerto Rico system includes all the campuses at Río Piedras, Mayagüez, Medical Sciences, Cayey, Humacao, Ponce, Bayamón, Aguadilla, Arecibo, Carolina and Utuado, and the Central Administration. The Middle States Commission on Higher Education is the regional accreditation entity of the eleven campuses of the University.

The financial reporting entity consists of the University and its Component Units which are legally separate organizations for which the University is financially accountable. The University of Puerto Rico consists of the University and its blended component unit. The definition of the reporting entity is based primarily on the notion of financial accountability. The University is financially accountable for the organizations that make up its legal entity. It is also financially accountable for legally separate organizations if its officials appoint a voting majority of an organization’s governing body and either it is able to impose its will on that organization or there is a potential for the organization to provide specific financial benefits to, or to impose specific financial burdens on the University. The University may also be financially accountable for organizations that are fiscally dependent on it if there is a potential for the organizations to provide specific financial benefits to the University or impose specific financial burdens on the University regardless of whether the organizations have separate elected governing boards, governing boards



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

appointed by higher levels of government or jointly appointed boards. The University is financially accountable for all of its Component Units.

Most Component Units are included in the financial reporting entity by discrete presentation. One of the component units, despite being legally separate from the University, is so integrated with the University that it is in substance part of the University. This component unit is blended with the University.

Blended Component Unit: Desarrollos Universitarios, Inc. (“DUI”), a blended component unit, although legally separate, is reported as if it was part of the University because its debt is expected to be repaid entirely or almost entirely with resources of the University.

DUI was organized on January 22, 1997, under the laws of the Commonwealth of Puerto Rico, as a not-for-profit organization. DUI 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. DUI developed the Plaza Universitaria Project, which consists of a student housing facility, a multi-story parking building and an institution building to house administrative, student service and support functions, and, to a lesser extent, to lease commercial space.

Discretely Presented Component Units: All discretely presented component units are legally separate from the primary government. These entities are reported as discretely presented component units because the University appoints a majority of these organization's boards, is able to impose its will on them, or a financial benefit/burden situation exists. They include the following:

1. Servicios Médicos Universitarios, Inc. (“the Hospital” or “SMU”)
2. University of Puerto Rico Parking System, Inc. (“UPRPS”)
3. Materials Characterization Center, Inc. (“MCC”)

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.

UPRPS was organized on May 5, 2000, under the laws of the Commonwealth of Puerto Rico, as a not-for-profit organization. UPRPS was organized to operate the parking facilities of the University system. UPRPS operates the parking facilities of the Medical Sciences and Río Piedras campuses.

MCC was organized on April 15, 1999, under the laws of the Commonwealth of Puerto Rico, as a not-for-profit organization. MCC was organized to provide a much-needed accessible and reliable center to chemically and physically characterize materials from the pharmaceutical as well as other manufacturing endeavors. MCC is administrated in conjunction with the College of Natural Sciences of the Río Piedras Campus of the University.

The financial statements of the discretely presented component units have a June 30 year-end, except for MCC, which has a December 31 year-end.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

An annual audit of each organization's financial statements is conducted by independent certified public accountants. Financial statements and information relating to the component units may be obtained from their respective administrative officers.

The following discussion presents an overview of the financial position and financial activities of the University and its blended component unit (hereafter referred as the "University") for the years ended June 30, 2017 and 2016. It excludes its discretely presented component units. This discussion and analysis should be read in conjunction with the basic financial statements of the University, including the notes thereto.

Financial Highlights

As of June 30, 2017, the University had total assets of \$1.50 billion, total deferred outflows of resources of \$222.1 million, total liabilities of \$2.92 billion, total deferred inflows of resources of \$172.9 million and net deficit of \$1.37 billion. As of June 30, 2016, the University had total assets of \$1.42 billion, total deferred outflows of resources of \$104.6 million, total liabilities of \$2.73 billion, total deferred inflows of resources of \$301.4 million and net deficit of \$1.50 billion. As of June 30, 2015, the University had total assets of \$1.47 billion, total deferred outflows of resources of \$90.8 million, total liabilities of \$3.10 billion, total deferred inflows of resources of \$107.1 million and net deficit of \$1.64 billion.

The University's net deficit position decreased by \$128.4 million or 9% in fiscal year 2017 and by \$137.6 million or 8% in fiscal year 2016, when compared to prior year balances. In fiscal year 2017, total nonoperating revenues, net which amounted to approximately \$1.11 billion exceeded the operating loss which amounted to approximately \$984.8 million. In fiscal year 2016, total nonoperating revenues, net which amounted to approximately \$1.03 billion exceeded the operating loss which amounted to approximately \$889.9 million. In fiscal year 2015, total nonoperating revenues, net which amounted to approximately \$1.07 billion exceeded the operating loss which amounted to approximately \$1.01 billion.

In fiscal year 2017, nonoperating revenues, net increased by approximately \$85.7 million or 8%, when compared to prior year balance mainly as a result of the impairment losses on deposits with governmental bank and on capital assets which reduced the nonoperating revenues, net by approximately \$71.1 million in fiscal year 2016; meanwhile, in fiscal year 2017, those losses were not incurred. Also, in fiscal year 2017, the Commonwealth appropriations and Federal Pell Grant program revenues which amounted to approximately \$934.4 million and \$189.4 million, respectively increased by approximately \$1.9 million and \$10.6 million, when compared to prior year balances. In fiscal year 2016, the Commonwealth appropriations and Federal Pell Grant program revenues which amounted to approximately \$932.5 million and \$178.7 million, respectively, decreased by approximately \$4.9 million and increased by approximately \$11.5 million, respectively, when compared to prior year balances.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

The change in the net operating loss in fiscal years 2017 and 2016 was mainly caused by the change in the pension cost. In fiscal year 2017, the University recognized a pension cost of approximately \$42.7 million; meanwhile, in fiscal years 2016 and 2015, it recognized a pension credit of approximately \$49.4 million and a pension cost of approximately \$66.3 million, respectively, in accordance with Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions - an Amendment of GASB Statement No. 27* (GASB Statement No. 68) which caused an increase in benefits of \$92.1 million in fiscal year 2017 and a decrease in benefits of \$115.7 million in fiscal year 2016, when compared with prior year balances.

In fiscal year 2015, the University's net position decreased by \$2.17 billion and reached a deficit position of \$1.64 billion as of June 30, 2015 when compared to a net position of \$531.1 million as of June 30, 2014, mainly as a result of the adoption of GASB Statement No. 68, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an Amendment of GASB Statement No. 68* (GASB Statement No. 71) which resulted in a noncash impact that established a net pension liability of \$2.24 billion at July 1, 2014, decreasing the net position by such amount. The reasons for the change in net position are explained in the section entitled "Analysis of Net Position and Changes in Net Position." An overview of the statements is presented below along with a financial analysis of the transactions impacting the statements.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

Condensed financial statements for the University as of and for the years ended June 30, 2017, 2016 and 2015, follows:

	Condensed Statements of Net Position (Deficit) (In thousands)		
	June 30		
	2017	2016	2015
Assets:			
Current assets:			
Cash and cash equivalents	\$ 304,138	\$ 185,270	\$ 103,133
Investments	45,436	69,148	68,531
Accounts receivable, net	17,001	15,690	21,046
Due from Federal Government, net	33,584	32,449	38,346
Due from related parties, net	12,972	12,536	91,319
Other assets	4,663	6,353	4,101
Total current assets	417,794	321,446	326,476
Noncurrent assets:			
Investments	199,523	190,170	213,502
Capital assets, net	866,457	896,843	923,827
Other assets	14,985	13,358	9,210
Total noncurrent assets	1,080,965	1,100,371	1,146,539
Total assets	1,498,759	1,421,817	1,473,015
Deferred outflows of resources	222,111	104,604	90,768
Total assets and deferred outflows of resources	1,720,870	1,526,421	1,563,783
Liabilities:			
Current liabilities:			
Accounts payable and accrued liabilities	82,007	64,830	73,293
Long-term debt	100,861	100,061	58,031
Other long-term liabilities	27,442	29,543	41,283
Total current liabilities	210,310	194,434	172,607
Non-current liabilities, net of current portion:			
Long-term debt	466,700	492,892	565,417
Other long-term liabilities:			
Net pension liability	2,006,703	1,796,727	2,104,040
Other liabilities	238,722	243,794	255,012
Total noncurrent liabilities	2,712,125	2,533,413	2,924,469
Total liabilities	2,922,435	2,727,847	3,097,076
Total deferred inflows of resources	172,913	301,418	107,138
Total liabilities and deferred inflows of resources	3,095,348	3,029,265	3,204,214
Net position (deficit):			
Net investment in capital assets	390,426	393,465	397,005
Restricted:			
Nonexpendable	115,180	107,597	105,131
Expendable	59,049	74,819	77,027
Unrestricted (deficit)	(1,939,133)	(2,078,725)	(2,219,594)
Total net position (deficit)	\$ (1,374,478)	\$ (1,502,844)	\$ (1,640,431)



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

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

	Year Ended June 30		
	2017	2016	2015
Operating revenues:			
Tuition and fees, net	\$ 47,666	\$ 48,476	\$ 47,215
Governmental grants and contracts, net	96,541	106,875	115,403
Patient services, net	75,801	61,830	57,765
Other operating revenues, net	33,524	29,172	39,800
Total operating revenues	253,532	246,353	260,183
Operating expenses:			
Salaries and benefits	805,017	701,436	822,537
Scholarships and fellowships	193,434	185,522	185,442
Supplies and other services and utilities	181,630	178,041	196,888
Other operating expenses	58,245	71,284	61,339
Total operating expenses	1,238,326	1,136,283	1,266,206
Operating loss	(984,794)	(889,930)	(1,006,023)
Nonoperating revenues (expenses):			
Commonwealth and other appropriations	934,418	932,503	937,357
Federal Pell Grant program	189,364	178,729	167,213
Impairment loss on deposits with governmental bank	-	(69,807)	(21,668)
Other nonoperating expenses, net	(10,631)	(13,938)	(13,318)
Net nonoperating revenues	1,113,151	1,027,487	1,069,584
Income before other revenues	128,357	137,557	63,561
Capital appropriations	-	-	2,266
Additions to term and permanent endowments	9	30	6
Change in net position	128,366	137,587	65,833
Net position (deficit):			
Beginning of year	(1,502,844)	(1,640,431)	531,095
Cumulative effect of change in accounting for pension costs	-	-	(2,237,359)
End of year	\$ (1,374,478)	\$ (1,502,844)	\$ (1,640,431)

Refer to the next section "Overview of the Basic Financial Statements" - *New Accounting Standards Adopted*, for the changes in the financial statements as required by GASB Statement No. 68 and GASB Statement No. 71.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

Going Concern

The discussion in the following paragraphs regarding the University's financial and liquidity risks provides the necessary background and support for management's evaluation as to whether there is substantial doubt about the University's ability to continue as a going concern for 12 months beyond the date of the financial statements or for an extended period if there is currently known information that may raise substantial doubt shortly thereafter. GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, establishes that the continuation of a legally separate governmental entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. Information that may significantly contradict the going concern assumption would relate to a governmental entity's inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of governmental operations, restructuring of debt, submission to the oversight of a separate fiscal assistance authority or financial review board, or similar actions. Indicators such as negative trends in operating losses and negative cash flows, possible financial difficulties such as nonpayment or default of debt and/or restructurings or noncompliance with capital or reserve requirements, and internal or external matters impacting the governmental entity's ability to meet its obligations as they become due, are factors that are considered in this evaluation.

The University faces significant risks and uncertainties, including liquidity risk, which is the risk of not having sufficient liquid financial resources to meet obligations when they come due. The risks and uncertainties facing the University together with other factors further described below, have led management to conclude that there is substantial doubt as to the ability of the University to continue as a going concern in accordance with GASB Statement No. 56.

The University is highly dependent on the Commonwealth's appropriations to finance its operations. The financial difficulties being experienced by the Commonwealth have significant adverse impacts on the University, given its reliance on Commonwealth's appropriations and lack of available funding alternatives at reasonable interest rates.

The Commonwealth Going Concern

The Commonwealth and several of its component units face significant risks and uncertainties, including liquidity risk.

The Commonwealth has incurred recurring deficits, has a negative financial condition, has experienced further deterioration of its economic condition, has not been able to access the credit markets, and has stated that substantial doubt exists about the Commonwealth's ability to continue as a going concern. Additionally, the Commonwealth is currently restructuring its obligations in an orderly fashion under Title III of the U.S. Congress Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) which was signed by the U.S. President on June 30, 2016.

PROMESA grants the Commonwealth and its component units access to an orderly mechanism to restructure their debts in exchange for significant federal oversight over the Commonwealth's finances. In broad terms, PROMESA seeks to provide Puerto Rico with fiscal and economic discipline through the creation of a control board (the Oversight Board), relief from creditor lawsuits through the enactment of a



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

temporary stay on litigation, and two alternative methods to adjust unsustainable debt.

PROMESA contains two methods to adjust Puerto Rico's debts. The first method is a streamlined process to achieve modifications of financial indebtedness with the consent of a supermajority of affected financial creditors (Title VI of PROMESA). This method has benefits such as potential speed relative to a traditional restructuring through a formal in-court process. The second method is a court-supervised debt-adjustment process, which is modeled on Chapter 9 of the U.S. Bankruptcy Code (Title III of PROMESA). This process includes the so-called "cram-down" power, which may provide Puerto Rico with flexibility in debt adjustment, but it also gives the oversight board total control over the adjustment process and includes certain provisions designed to protect creditor interests.

The Commonwealth is in the midst of a profound fiscal, economic and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations. Further stressing the Commonwealth's liquidity is the vulnerability of revenue streams during times of major economic downturns and large health care, pension and debt service costs. As the Commonwealth's tax base has shrunk and its revenues affected by prevailing economic conditions, health care, pension and debt service costs have become an increasing portion of the Commonwealth's General Fund budget, which has resulted in reduced funding available for other essential services, including appropriations to the University. The Commonwealth's high level of debt and unfunded pension liabilities and the resulting required allocation of revenues to service debt and pension obligations have contributed to significant budget deficits during the past several years, which deficits the Commonwealth has financed, further increasing the amount of its debt.

These matters and the Commonwealth's liquidity constraints, among other factors, have adversely affected its credit ratings and its ability to obtain financing at reasonable interest rates, if at all. As a result, the Commonwealth had relied more heavily on short-term financings and interim loans from the GDB, and other component units of the Commonwealth, which reliance has constrained the liquidity of the Commonwealth in general and the GDB in particular, and increased near-term refinancing risk. These factors have also resulted in delays in the repayment by the Commonwealth and its component units of outstanding GDB lines of credit, which delays have limited GDB's ability to continue providing liquidity to the Commonwealth and certain other component units, such as the University, and have caused GDB to fail to make a principal payment on its debt obligations. Similarly, and pursuant to a series of legislations and executive orders during fiscal year 2016, and further explained below, the Commonwealth and certain other public corporations, such as the University, also delayed the debt service payments on some of its debts, including the general obligation bonds of the Commonwealth.

The Commonwealth's Primary Government reflects a net position deficit/fund balance deficit of approximately \$67 billion as of June 30, 2015 (the most recent audited financial information). The Commonwealth's General Fund shown a fund balance (deficit) of approximately \$2.1 billion as of June 30, 2015.

On April 6, 2016, the Commonwealth enacted Act No. 21, known as the Puerto Rico Emergency Moratorium and Rehabilitation Act (the Moratorium Act or Act No. 21) under which, the Commonwealth and certain of its component units suspended their respectively debt service payments. In particular, the Commonwealth suspended the payment of \$779 million in debt service on general obligation bonds due in July 1, 2016 (net of \$352 million of capitalized interest fund and escrow accounts).



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

The Moratorium Act also created a new Fiscal Agency and Financial Advisory Authority (FAFAA), as an independent public corporation to assume GDB's role as fiscal agent, financial advisor and reporting agent for the Commonwealth, its component units, including the University, and municipalities. FAFAA has also been assigned the tasks of overseeing matters related to the restructuring or adjustment of the Commonwealth's financial liabilities, coordinating liability management or other transactions with respect to such obligations, and ensuring compliance with fiscal plans and budgets approved by the Oversight Board pursuant to PROMESA.

On May 1, 2017, PROMESA Stay expired, permitting the substantial litigation brought by bondholders and other creditors against the Commonwealth and its component units to resume. As a result, on May 3, 2017, the Oversight Board of PROMESA filed a petition for relief under Title III of PROMESA. Title II of PROMESA incorporates the automatic stay provision of Bankruptcy Code section 362 and 922, which are made applicable to the Title III cases pursuant to PROMESA section 301 (a).

On April 19, 2018 (recertified on May 30, 2018 and amended on June 29, 2018 and October 23, 2018), the Oversight Board of PROMESA certified its fiscal plan for the Commonwealth. There is no certainty that the Certified Commonwealth Fiscal Plan (as revised and amended) will be fully implemented or if implemented will ultimately provide the intended results. All these plans and measures, and the Commonwealth's ability to reduce its deficit and to achieve a balanced budget in the future fiscal years depends on a number of factors and risks, some of which are not wholly within its control.

The University Going Concern

The University only had an unrestricted deficit position and a total net deficit position of approximately \$1.94 billion and \$1.38 billion, respectively. The University only has had operating losses (without considering nonoperating revenues and expenses such as: Commonwealth appropriations, Federal Pell Grant program and other revenues and depreciation, interest and other expenses) during fiscal years 2017, 2016 and 2015 of \$984.8 million, \$890.1 million and \$1.0 billion, respectively.

The University is highly dependent on the Commonwealth appropriations to finance its operations and had historically relied on the GDB for liquidity. Approximately 68% of the University's total revenues (operating revenues and nonoperating revenues, net) are derived from the Commonwealth's appropriations which amounted to approximately \$934.4 million, \$932.5 million and \$937.4 million for the years ended June 30, 2017, 2016 and 2015, respectively.

Appropriations received by the University from the Commonwealth are mainly supported by Act No. 2 of January 20, 1966, as amended ("Act 2"). Under Act 2, the Commonwealth appropriates for the University an amount equal to 9.60% of the average total amount of annual general fund revenues collected under the laws of the Commonwealth in the two fiscal years immediately preceding the current fiscal year (the Commonwealth formula appropriations). On June 17, 2014, the Legislature of the Commonwealth enacted Act No. 66-2014 (the "Fiscal Sustainability Act"). The Fiscal Sustainability Act is a temporary fiscal emergency law designed to address the fiscal condition of the Commonwealth. Among other things, the Fiscal Sustainability Act froze the benefit under the formula-based appropriation of the University at \$833.9 million for the three fiscal years ended June 30, 2017, 2016 and 2015. 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 \$39.2 million, \$36.0



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

million and \$39.9 million for the years ended June 30, 2017, 2016, and 2015, respectively. Also, the Commonwealth appropriations include revenues received under the Gambling Law (slot machines and others) from the Puerto Rico Tourism Company, a component unit of the Commonwealth, which amounted to \$61.5 million, \$62.6 million and \$63.5 million for the years ended June 30, 2017, 2016 and 2015, respectively.

Moreover, the University has limited ability to raise operating revenues due to the economic and political related challenges of maintaining enrollment and increasing tuition. The University's ability to continue receiving similar operational support from the Commonwealth and obtaining external financing is uncertain.

Pursuant to a series of legislations and executive orders during fiscal year 2016, as further explained below, the University delayed the \$4.0 million monthly deposits of pledged revenues to the trustee of the University revenue bonds and the \$475,000 monthly basic lease payments to the trustee of the DUI's AFICA Bonds during almost the entire fiscal year 2017. In addition, the University stopped the debt service payments of the GDB credit facilities.

On June 30, 2016, the Governor of Puerto Rico signed Executive Order No. OE-2016-030 (EO 30) and Executive Order No. OE-2016-031 (OE 31) which (i) declared the Commonwealth and several of its instrumentalities, including the University, to be in a state of emergency and announced the commencement of an emergency period (as such term is defined in Section 103 of the Act No. 21) for the Commonwealth and such instrumentalities, including the University, (ii) extended the state of emergency that had been previously declared for several of the Commonwealth's instrumentalities, (iii) implemented a suspension on transfer obligations of the Commonwealth and certain of its instrumentalities, including the University, with respect to the transfer of funds to and from such entities (pursuant to Section 201 of Act No. 21), and (iv) implemented a suspension on the payment obligations of debt issued or guaranteed by the Commonwealth, as well as the payment obligations of certain of its instrumentalities, including the University. The measures were in place until January 29, 2017.

Specifically to the University, EO 31 established the following: (i) designated any of the University's obligations, pursuant to the Trust Agreement, dated June 1, 1971, as amended, to transfer Pledged Revenues (as such term is defined in the Trust Agreement) to the Trustee as an enumerated obligation (as such term is defined in Section 103 of the Act No. 21); and suspended such obligations of the University to transfer Pledged Revenues to the Trustee, and (ii) designated any obligation of the University pursuant to the Lease Agreement with DUI, dated December 21, 2010, as a covered obligation (as such term is defined in Section 103 of the Act No. 21); and suspended the payment of such obligation of the University. EO 31 did not suspend the payment obligations of the University with respect to any other obligation. In compliance with EO 31, the University suspended the monthly payments to the trustee of the Trust Agreement that govern the University System Revenue Bonds and the monthly payments of the Lease Agreement with DUI from July 2016 to May 2017.

On August 5, 2016 and monthly thereafter until April 2017, the trustee of the DUI's AFICA Bonds notified to the University that it failed to make the basic lease payment to the trustee since July 25, 2016 and that a default under the lease agreement with DUI constitutes an event of default under the DUI's AFICA Bonds Trust Agreement. As such, the University was in default of this obligation until April 2017. The trustee was not seeking any indebtedness from, enforce any judgment, or obtain possession of, or exercise control over,



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

any property of or from, the Commonwealth or any of its instrumentalities, including DUI and the University, or exercise any act that is stayed by PROMESA, the Act No. 21, or the Executive Orders related thereto. In May 2017, the University reestablished the payments to the trustee of the DUI's AFICA Bonds (approximately \$475,000 monthly) and paid all the basic lease payments due from July 2016 until May 2017 (approximately \$5.2 million). Presently, DUI has paid as agreed the scheduled principal and interest payments on its outstanding AFICA Bonds.

On August 19, 2016, the U.S. Bank Trust National Association, in its capacity as Trustee for the University of Puerto Rico System Revenue Bonds (Series P and Q Bonds), filed a civil lawsuit under the United States Court, District of Puerto Rico against the Commonwealth and its Governor, the University and its President. The motion seeks relief from the stay of PROMESA, or Executive Orders related thereto, and a preliminary injunction against the Commonwealth's diversion and expropriation of pledged revenues, which constitute the University's Bonds collateral. On June 29, 2017, the Trustee and the University, at the direction of FAFAA, entered into a letter agreement providing that the University will transfer certain amounts in respect of pledged revenue, as defined in the trust agreement, to the Trustee on condition, among others, that through August 31, 2017 (the Compliance Period) the Trustee not institute, commence, or continue certain legal proceedings against the University, the Commonwealth or any other agency, instrumentality, or municipality thereof during the Compliance Period, except in certain enumerated circumstances. As agreed in the letter agreement, the University paid \$20 million on June 30, 2017 and an additional \$20 million on September 1, 2017 and continued to pay monthly to the trustee the \$4 million of pledged revenues. The University commits to transfer to the Trustee, to hold or make payments or distributions as provided under the trust agreement, in lieu of the transfer of an equivalent amount of the pledged revenues received by the University from the date hereof through August 31, 2017 as provided in the trust agreement.

The letter agreement has been extended nine times and the new Compliance Period is June 30, 2019. Pursuant to the letter agreement and the nine standstill extension agreements, during the compliance period, holders of the majority in amount of the bonds and the Trustee at the direction of the University's bondholders will negotiate in good faith towards a restructuring of the bonds. In addition, the trustee agreed not to institute or commence certain legal proceedings and the University agreed to transfer the following monthly payments of pledged revenues to the trustee to be applied in accordance with the trust agreement governing the Series P and Q Bonds during the new Compliance Period:

- in consideration for extending the new Compliance Period until May 31, 2018, the University agreed to transfer to the Trustee \$4 million monthly from July 2017 to May 2018;
- in consideration for extending the new Compliance Period until December 31, 2018, the University agreed to transfer to the Trustee the following monthly payments: \$4.0 million of the June 2018 Payment on or before July 15, 2018; \$2.0 million of the July 2018 Payment on or before August 5, 2018; \$3.0 million of the August 2018 Payment on or before August 25, 2018; \$2.3 million of the September 2018 Payment on or before September 25, 2018; \$2.3 million of the October 2018 Payment on or before October 25, 2018; \$3.0 million of the November 2018 Payment on or before November 25, 2018; and \$3.0 million of the December 2018 Payment, less a credit for any amount as of November 30, 2018 in the Trustee's Bond Service Account and Reserve Account that is, in the aggregate, in excess of \$68,606,318, on or before December 25, 2018; and



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

- in consideration for extending the new Compliance Period until June 30, 2019, the University agreed to transfer to the Trustee the following monthly payments: \$2.9 million of the January 2019 Payment on or before January 25, 2019; \$2.9 million of the February 2019 Payment on or before February 25, 2019; \$2.9 million of the March 2019 Payment on or before March 25, 2019; \$2.9 million of the April 2019 Payment on or before April 25, 2019; \$2.9 million of the May 2019 Payment on or before May 25, 2019; and \$2.9 million of the June 2019 Payment, less a credit for any amount as of May 30, 2019 in the Trustee's Bond Service Account and Reserve Account that is, in the aggregate, in excess of \$75,395,125, on or before June 30, 2019.

Discussions with respect to a consensual restructuring of the University's bonds are continuing. Presently, the University has paid as agreed the scheduled principal and interest payments on its outstanding Series P and Q Bonds and has complied with the letter agreement, as extended, with the Trustee.

The University had two credit facilities with the GDB, a ten-year term loan which amounted to approximately \$48.3 million at June 30, 2016 and a \$75 million non-revolving line of credit with the GDB to complete certain construction projects of the University's Program for Permanent Improvements which amounted to approximately \$28.1 million at June 30, 2016. The University had not made the monthly payments of this term loan since May 2016. The \$75 million line of credit expired on January 31, 2016 and the University had not made the monthly interest payments of this line of credit since September 2016. In May 2016, the Governing Board of the University authorized its president to cancel the term loan and the expired line of credit with the GDB using the University's funds deposited in the GDB. The University had not paid its debt service on these credit facilities with GDB because it and the GDB had not reached an agreement to cancel these credit facilities or to determine how these credit facilities will be managed. Refer to the Subsequent Events Section for the offset of the credit facilities with the GDB, on a dollar-for-dollar basis, by the amount of the University's deposits held at the GDB on November 29, 2018.

On October 30, 2016, the Oversight Board created by PROMESA designated the University as a covered entity subject to oversight under PROMESA. As a covered entity, the University is required to submit to the Oversight Board of PROMESA an individual fiscal plan. The University submitted its ten-year fiscal plan to the Oversight Board of PROMESA for certification on August 1, 2017.

On June 2, 2017, the Oversight Board of PROMESA approved the aggregate spending level in the Governor's fiscal year 2017-2018 proposed budget, but not its specific allocations. On June 27, 2017, the Oversight Board of PROMESA issued a notice of violation on the submitted Commonwealth budget that included a description of necessary corrective action. The Oversight Board of PROMESA gave the Legislature of Puerto Rico an opportunity to correct the violations by June 29, 2017. Because the Legislature failed to take corrective actions, the Oversight Board of PROMESA approved and certified a revised, compliant budget for fiscal year 2018 for the Commonwealth in compliance with PROMESA. The Commonwealth's fiscal year 2018 budget was deemed approved by the Governor and Legislature and in full force and effect beginning on July 1, 2017. The Commonwealth's formula appropriations to the University included in the approved Commonwealth's budget for fiscal year 2018 will amount to \$631 million, a decrease of \$203 when compared with the Commonwealth's formula appropriations of \$834 million received in fiscal year 2017. In addition, the approved Commonwealth's budget for fiscal year 2018 includes nonrecurrent contributions to the University of approximately \$30 million, for a net decrease in the Commonwealth's appropriations of approximately \$173 million in the fiscal year 2018.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

On April 6, 2017, a student stoppage at the University interrupted the operations of all campuses for up to 93 days, but less in other cases. This student stoppage was prompted as a result of student opposition to the annual reductions in the Commonwealth's formula appropriations to the University as ordered by the Oversight Board of PROMESA. As a result of the student stoppage at the University, eight of the eleven units that comprise the University of Puerto system are on probation by the Middle States Commission on Higher Education, the regional accreditation entity.

In the fourth quarter of fiscal year 2017, the U.S. Department of Education notified each campus of the University that they failed the financial responsibility requirements under the U.S. Department of Education regulations due to its failure to submit on March 31, 2017 acceptable compliance and financial statement audits. As a result, the eleven campuses of the University are under provisional certifications with the U.S. Department of Education for initial or continued participation in any of the student financial assistance programs authorized by Title IV of the Higher Education Act of 1965, as amended (Title IV HEA Programs). These provisional certifications place the eleven campuses of the University on a heightened cash monitoring payment method and expire between June 30, 2018 and December 31, 2018.

Each campus of the University agreed to participate in the Title IV, HEA Programs under the U.S. Department of Education's cash monitoring method and comply with the provisions under the Zone alternative. Starting with academic year 2017-2018, the eleven campuses of the University will be operating on limited Title IV eligibility and will be placed on the Heightened Cash Monitoring I (HCM-1) method of payment requiring enhanced reporting and documentation until further written notice from the U.S. Department of Education. Under the HCM-1 method payment, each campus of the University must first make disbursements to eligible students and parents and pay any credit balances due before it requests or receives funds for those disbursements from the U.S. Department of Education in accordance with 34 CFR 668.162 (d). The funding request may not exceed the amount of the actual disbursements that were made to the students and parents including in the funding request. Expenditures of Federal Awards under Title IV HEA programs amounted to approximately \$250.9 million for the year ended June 30, 2017.

On September 6, 2017, Hurricane Irma did some damages to the island of Puerto Rico and then on September 20, 2017, the island of Puerto Rico suffered the complete devastation caused by Hurricane Maria, causing catastrophic wind and water damage to Puerto Rico's infrastructure, home and businesses.

As a result of the Hurricane Maria, most of the island's population was left without electrical power and there was significant disruption to the water distribution system. Other basic utility and infrastructure services such as communications, ports and transportation were also materially affected, causing a significant disruption to the island's economic activity. The entire island of Puerto Rico will need a massive infrastructure rebuilding program.

Immediately after the landfall of the Hurricane Maria on Puerto Rico, the President of the United States of America issued a state of emergency declaration for Puerto Rico, as a U.S territory. The order mandates federal assistance through the Department of Homeland Security and the Federal Emergency Management Agency (FEMA) be made available to assist in local and territorial recovery efforts.

Some of the University's eleven campuses were more affected than others, but all were impacted in some way. A few days after Hurricane Maria, many of the University employees, as well as students and other volunteers, returned to the campuses and to the University's central Administration to begin the rebuilding



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

process. At the end of October and the beginning of November 2017, administrative and academic functions had resumed at basically all areas and units that comprise the University System.

The University's costs associated with repairing the damages sustained by the hurricanes could range from \$130 million to \$140 million. Part of these costs are expected to be covered by insurance funds and by disaster-relief funds granted by FEMA. The University's commercial property and fine arts insurance coverages have an aggregate lost limit of \$100 million each. On September 28, 2018, the insurance company was intervened by the Puerto Rico Insurance Commissioner for insolvency under a "rehabilitation order" for the insurance company before the Court of First Instance, Superior Court of San Juan. The order designates the Puerto Rico Insurance Commissioner, as "rehabilitator" and orders him to take possession of the insurer's assets, in protection of the interests of the policyholders with claims, creditors of the insurer and the public in general. On November 8, 2018, the University settled this claim with the insurance company for a total consideration of \$50.0 million (\$57.0 million less \$7.0 million of deductible amounts). Presently, the University has received advanced funds from the insurance company of approximately \$38.8 million and from FEMA of approximately \$1.0 million for these natural disasters.

Given the high dependency of the University on the Commonwealth appropriations and lack of available financing sources at reasonable interest rates, the University's financial condition and liquidity is being adversely affected. As a consequence, the University may not be able to avoid future defaults on its obligations. Management has plans to address the University's liquidity situation and continue providing services. However, there can be no assurance that the Commonwealth will be able to continue to provide adequate appropriations or funding alternatives or that the affiliated or unaffiliated creditors will be able and willing to refinance or modify the terms of the University's obligations, that management's current plans to repay or refinance the obligations or extend their terms will be achieved or that certain services will not have to be terminated, curtailed or modified. These conditions raise substantial doubt about the University's ability to continue as a going concern.

The University Management Fiscal Plan

On August 1, 2017, the University presented to the Oversight Board of PROMESA its fiscal plan for the ensuing ten years. The fiscal plan included a series of expense reduction measures complemented with revenue enhancing initiatives, including tuitions hikes, which in the aggregate will add up to \$512 million in the Central Government appropriations reductions by fiscal year 2026. The Central Government appropriations are the Commonwealth appropriations, excluding unremitted distributions of income received by the University from the Puerto Rico Tourism Company under the Gambling Law, slot machines and others, by virtue of Act No. 36 of 2005.

On August 26, 2017, the Oversight Board of PROMESA announced, through a letter from its Executive Director, that the University fiscal plan will not be certified as submitted above. The letter requested to the University Governing Board develop a new version of the fiscal plan correcting several deficiencies that the Oversight Board of PROMESA identified.

After the passages of Hurricane Irma and Maria in September 2017, the Oversight Board of PROMESA requested the University to submit a revised fiscal plan for the ensuing five years. On April 5, 2018 (as revised on September 7, 2018), the University submitted its revised fiscal plan for the fiscal years 2018 to



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

2023. On April 20, 2018 (as amended on June 29, 2018 and October 23, 2018), the Oversight Board of PROMESA certified its own University fiscal plan.

The University's Fiscal Plan Certified by the Oversight Board of PROMESA

The University fiscal plan for the fiscal years 2018 to 2023 certified by the Oversight Board of PROMESA maintained the August 2017 Fiscal Plan measures, less reductions to the Central Government appropriations, as well as reductions in addressable spend. This fiscal plan includes the approved projected reductions in the Commonwealth's formula appropriations that which would rise annually from approximately \$203 million in fiscal year 2018 to approximately \$478 million in fiscal year 2023. The Commonwealth approved formula appropriations will range from \$631 million in fiscal year 2018 to \$383 million in fiscal year 2023. Other Central Government appropriations for general current obligations, for capital improvement programs, and for loans and financial assistance to students are keeping fixed in \$58.8 million from fiscal year 2019 to 2023.

Targeted measures to increase revenues and reduce expenditures will allow the University to operate sustainably under a reduced Commonwealth subsidy. On the revenue side, these include modestly raising tuition using a means-based approach (e.g., creating a means-based scholarship fund in parallel), applying more aggressively for federal grants (seeking to achieve funding equal to the level of 25th percentile of U.S. public universities), charging more dues and fees to students, applying for patents and other intellectual property, and continuing to provide trainings to the Puerto Rico Department of Education and the Government more broadly.

The University certified fiscal plan includes the following revenue generating measures, among others:

- gradual increase in the undergraduate student cost from \$57 per credit in fiscal year 2018 to \$157 per credit in fiscal year 2023;
- gradual increase in the graduate student average annual tuition from \$3,699 per student in fiscal year 2018 to \$7,209 per student in fiscal year 2023;
- gradual increase in tuition fees (dues and charges); and reduction in tuition exemptions;
- gradual decrease in the student population;
- and annual increase in federal awards - The University's federal awards level is below the similar public universities in the continental United States of America. It can increase by tailored research and processes for public research grants.

Expenditure reduction measures include consolidating campuses, optimizing human resources through reducing temporary and trust positions, improving procurement, reducing the cost of medical insurance, and reducing tuition exemptions and special scholarships. These include identifying campuses and programs for consolidations based on performance metrics, tying personnel savings to roles implicated by campus consolidations and service reductions, reducing the University employee pensions in a manner similar to the Commonwealth and increasing tuition in future years to be roughly equivalent to federal Pell Grant less a reasonable contribution to cost of living and other related expenditures.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

The University certified fiscal plan includes the following expense reduction measures, among others:

- Transformational Enhancements- Leaner administrative structure into four conglomerates (keeping open the actual eleven campuses) to reduce duplicated functions and services; evaluation of the academic offer to reduce redundant expenses; and implementation of full academic optimization. Projected headcount reduction from 12,779 employees in fiscal year 2018 to 10,650 employees in fiscal year 2023.
- Reductions in variety of benefits as follows: elimination of Christmas bonus for all employees starting in fiscal year 2019; based on 15-day liquidations of sick days starting in fiscal year 2020; and reduction in the employer monthly contribution to medical insurance plans from \$640 per employee (average employer contribution) in fiscal year 2019 to \$390 per month to each faculty members and to \$125 per month to each non-faculty members, excluding those employees with pre-existing conditions, starting in fiscal year 2020, among others.
- Freeze pension plan benefits in fiscal year 2019; reduction in accrued pension benefits, using the same mechanism as for other Commonwealth plans in fiscal year 2019; and establishment of a defined contribution plan similar to those of other Commonwealth plans, but with a 50% employer match on member contributions of up to 2% in fiscal year 2020. Savings from reduction in accrued pension benefits offset the projected 50% employer match of the defined contribution plan and an increased contribution to improve the solvency of the pension plan.

These efforts to improve the operations of the University will in turn allow the University to renew its operating model to provide the best outcomes for its students. These outcomes will include reduced time to degree, improved job placement, and higher standardized test scores, among others. A re-envisioned University, which focuses on areas of strengths and on improving outcomes for students, will ultimately prove to be a critical source of renewal for the Island, as it is a cornerstone of human capital development to propel growth in the economy.

This certified fiscal plan establishes an independent scholarship fund for low-income University students. A means-based scholarship fund for the University will be supported by reductions to the budgets of the Oversight Board, Legislative Assembly, and FAFAA. These reductions should generate from \$35 to \$37 million annually in reinvestment funds from fiscal year 2019 through fiscal year 2023, and they will be used to help build up an endowment to pay for need-based scholarships for the University students. Specifically, the savings will fund an independent endowment for needs-based scholarships for students at the University, which will be managed by the Office of the Chief Financial Officer of the Commonwealth.

With these fiscal plan measures, including the reduction in the Commonwealth's appropriations, the University would have operational deficits starting in fiscal year 2021 and increasing through fiscal year 2023.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

The University's Fiscal Plan Submitted to the Oversight Board of PROMESA

The following are the most significant differences between the University submitted fiscal plan and the fiscal plan certified by the Oversight Board of PROMESA:

Revenue Generating Measures

- gradual increase in the undergraduate student cost from \$57 per credit in fiscal year 2018 to \$140 per credit in fiscal year 2023;
- and gradual increase in the graduate student average annual tuition from \$3,699 per student in fiscal year 2018 to \$6,617 per student in fiscal year 2023.

The University will incorporate a new internal Scholarship Fund that will further mitigate the increase of tuition for the most vulnerable student population.

The University does not agree with the Oversight Board reductions in tuition exemptions which include the elimination of tuition exemptions unrelated to financial aid, with the exception for honor and veteran students. For fiscal year 2019, the University modified its tuition exemption program as follows: full scholarship exclusively for honor, veteran and graduate research students; 50% exemption to employees, athletes and others; and reduced and capped the amount of exemptions granted to student athletes to 2,000 participants.

Expense Reduction Measures

- Transformational Enhancements- Leaning administrative structure into five conglomerates (keeping open the actual eleven campuses) to reduce duplicated functions and services; evaluation of the academic offer to reduce redundant expenses; and implementation of full academic optimization. Projected headcount reduction from 12,779 employees in fiscal year 2018 to 10,919 employees in fiscal year 2023.
- Reductions in variety of benefits as follows:
 - Christmas bonus- The University's forecasts does not deliver the immediate cessation of the Christmas bonus.
 - Medical insurance plan- The University's forecasts contemplates the actual medical expenditure per beneficiary rate. However, that does not preclude the University from taking additional steps to lower the medical contribution costs by either renegotiating existing terms of the agreement; restructuring the beneficiary's medical contribution structure; or voluntary joining central government's medical plan group.
 - Pension costs- The University's forecasts contemplates the actual pension benefit structure. The University is committed to undertake the necessary reforms to its pension system and intends to do so in a collaborative effort with the Governing Board and other University work group. A work plan has been developed, leading towards the most responsible reform of the pension system. The University expects to have a defined action plan by the end of 2018.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

With these fiscal plan measures, including the reduction in the Commonwealth's appropriations, the University would have operational deficits starting in fiscal year 2020 and increasing through fiscal year 2023.

There is no certainty that the Certified University Fiscal Plan (as revised and amended) will be fully implemented or if implemented will ultimately provide the intended results. All these plans and measures, and the University's ability to reduce its deficit and to achieve a balanced budget in the future fiscal years depends on a number of factors and risks, some of which are not wholly within its control.

Overview of the Basic Financial Statements

This discussion and analysis is required supplementary information to the basic financial statements of the University and is intended to serve as introduction to the basic financial statements of the University. The basic financial statements present information about the University, which includes the University's Blended Component Unit. This information is presented separately from the University's Discretely Presented Component Units.

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 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, deferred outflows of resources, liabilities, deferred inflows of resources, net position, revenues, expenses, changes in net position and cash flows.

For financial reporting purposes, the University is considered a special purpose governmental agency engaged only in business type activities, as defined by GASB Statement No. 35, *Basic Financial Statements-and Management's Discussion and Analysis-for Public Colleges and Universities*. Accordingly, the University's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. 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, as well as, interfund receivable and payable balances and transactions, have been eliminated where appropriate.

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

The statement of net position presents information on all the University's assets, liabilities and deferred outflows and inflows of resources. Net position is the difference between (a) assets and deferred outflows of resources and (b) liabilities and deferred inflows of resources. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the University is improving or deteriorating. The net position is displayed in three parts, net investment in capital assets, restricted and unrestricted. Restricted net position 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 position, while it is generally designated for specific purposes, is available for use by the University to meet current expenses



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

for any purpose. The statements of net position, 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 position are classified as current or noncurrent.

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

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

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

The required supplementary information consists of three schedules concerning the following: (1) the supplementary information (two schedules) of the University's Employees Retirement Plan as required by the GASB Statement No. 68, and (2) the supplementary information (one schedule) 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 University's schedules of changes in sinking fund reserves.

New Accounting Standards Adopted

In fiscal year 2017, the University adopted the following new statements of financial accounting standards issued by the GASB:

- GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68* (GASB Statement No. 73).
- GASB Statement No. 77, *Tax Abatement Disclosures* (GASB Statement No. 77).
- GASB Statement No. 80, *Blending Requirements for Certain Component Units- an Amendment of GASB Statement No. 14* (GASB Statement No. 80).
- GASB Statement No. 82, *Pension Issues- an Amendment of GASB Statements No 67, No. 68, and No. 73* (GASB Statement No. 82).



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

GASB Statement No. 73 establishes requirements for defined benefit pension plans and defined contribution plans that are not within the scope of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* (GASB Statement No. 68). This Statement extends the approach to accounting and financial reporting established in GASB Statement No. 68 to all pensions to reflect that for accounting and financial reporting purposes, any assets accumulated for pensions that are provided through pension plans that are not administered through trusts that meet the criteria specified in GASB Statement No. 68, should not be considered pension plan assets. It also requires that information similar to that required by GASB Statement No. 68 be included in notes to financial statements and required supplementary information by all similarly situated employers and nonemployer contributing entities. The adoption of this statement had no impact on the University's financial statements.

GASB Statement No. 77 establishes financial reporting standards for tax abatement agreements entered into by state and local governments. The disclosures required by this Statement encompass tax abatements resulting from both (a) agreements that are entered into by the reporting government and (b) agreements that are entered into by other governments and that reduce the reporting government's tax revenues. The provisions of this Statement should be applied to all state and local governments subject to such tax abatement agreements. For financial reporting purposes, a tax abatement is defined as a reduction in tax revenues that results from an agreement between one or more governments and an individual or entity in which (a) one or more governments promise to forgo tax revenues to which they are otherwise entitled and (b) the individual or entity promises to take a specific action after the agreement has been entered into that contributes to economic development or otherwise benefits the governments or the citizens of those governments. A transaction's substance, not its form or title, is a key factor in determining whether the transaction meets the definition of a tax abatement for the purpose of this Statement. The adoption of this statement had no impact on the University's financial statements.

GASB Statement No. 80 amends the blending requirements for the financial statement presentation of component units of all state and local governments by providing an additional criterion. A component unit should be included in the reporting entity financial statements using the blending method if the component unit is organized as a not-for-profit corporation in which the primary government is the sole corporate member as identified in the component unit's articles of incorporation or bylaws. The adoption of this statement had no impact on the University's financial statements.

GASB Statement No. 82 addresses certain issues raised with respect to GASB Statement No. 67, *Financial Reporting for Pension Plans— an amendment of GASB Statement No. 25*; GASB No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27 and GASB Statement No. 73 Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. This Statement specifically addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The adoption of this statement had no material impact on the University's financial statements.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

In fiscal year 2016, the University adopted the following new statements of financial accounting standards issued by the GASB:

- GASB Statement No. 72, *Fair Value Measurement and Application* (GASB Statement No. 72).
- GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* (GASB Statement No. 76)
- GASB Statement No. 79, *Certain External Investment Pools and Pool Participants* (GASB Statement No. 79).

GASB Statement No. 72 requires the University to use valuation techniques which are appropriate under the circumstances and are either a market approach, a cost approach or an income approach. GASB Statement No. 72 establishes a hierarchy of inputs used to measure fair value consisting of three levels. Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs, such as management's assumption of the default rate among underlying mortgages of a mortgage-backed security. GASB Statement No. 72 also contains note disclosure requirements regarding the hierarchy of valuation inputs and valuation techniques that was used for the fair value measurements. There was no material impact on the University's financial statement as a result of the implementation of GASB Statement No. 72.

GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* (GASB Statement No. 76), which is effective for reporting periods beginning after June 15, 2015. GASB Statement No. 76 reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature if the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. This statement supersedes GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. It also amends GASB Statement No. 62, *Codification of accounting and financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, paragraph 64, 74, and 82. The adoption of this statement had no impact on the University's financial statements.

GASB Statement No. 79 establishes specific criteria used to determine whether a qualifying external investment pool may elect to use an amortized cost exception to fair value measurement. Those criteria will provide qualifying external investment pools and participants in those pools with consistent application of an amortized cost-based measurement for financial reporting purposes. The statement also establishes additional note disclosures for qualifying external investment pools. There was no material impact on the University's financial statement as a result of the implementation of Statement No. 79.

In fiscal year 2015, the University adopted the following new statements of financial accounting standards issued by the GASB which had effects on the University's financial statements:

- GASB Statement No. 68, *Accounting and Financial Reporting for Pension - an Amendment of GASB Statement No. 27* (GASB Statement No. 68).
- GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an Amendment of GASB Statement No. 68* (GASB Statement No. 71).



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

GASB Statement No. 68 establishes standards of accounting and financial reporting, but not funding or budgetary standards, for defined benefit pensions and defined contribution pensions provided to the employees of state and local governmental employers through pension plans that are administered through trusts or equivalent arrangements (pension trusts).

This Statement replaces the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of GASB Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans within the scope of the Statement. The requirements of GASB Statement No. 68 apply to the financial statements of all state and local governmental employers whose employees (or volunteers that provide services to state and local governments) are provided with pensions through pension plans that are administered through trusts or equivalent arrangements as described above, and to the financial statements of state and local governmental nonemployer contributing entities that have a legal obligation to make contributions directly to such pension plans. This Statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, and deferred inflows of resources, and expense/expenditures related to pensions. Note disclosure and Required Supplementary Information requirements about pensions also are addressed. For defined benefit pensions, this Statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service.

The major fundamental change is switching from the existing “funding-based” accounting model, where the Annual Required Contribution (ARC) was compared to the actual payments made and that difference determined the Net Pension Obligation (or Asset); to an “accrual basis” model similar to current Financial Accounting Standards Board (“FASB”) standards, where the Total Pension Obligation (Actuarially determined) is compared to the Net Plan Position (or assets) and the difference represents the Net Pension Liability. The information to adopt this Statement was based on actuarial reports prepared under the new GASB Statement No. 67, *Financial Reporting for Pension Plans - an Amendment of GASB Statement No. 25*.

GASB Statement No. 71 amends GASB Statement No. 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date for determining net pension liability.

At transition, the noncash impact of GASB Statement No. 68 and GASB Statement No. 71 decreased the net position as of July 1, 2014 by \$2.24 billion, as a result of the net impact of the following effects: derecognized the prepaid pension asset previously recorded under GASB Statement No. 27 by \$92.5 million, recognized a deferred outflows of resources for the pension plan employer’s contributions made after the June 30, 2014 measurement date of \$91.7 million (as required by GASB Statement No. 71) and recognized a net pension liability of \$2.24 billion (as required by GASB Statement No. 68). At transition, the effect of deferred outflows and inflows of resources from other pension activities as required by GASB Statement No. 68 was not included because it was impracticable to determine them.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

Analysis of Net Position and Changes in Net Position

Statements of Net Position (Deficit)

Assets

Total assets amounted to \$1.50 billion, \$1.42 billion and \$1.47 billion as of June 30, 2017, 2016 and 2015, respectively. Total assets increased by \$76.9 million or 5% in 2017 and decreased by \$51.2 million or 3% in 2016, 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, 2017, cash and cash equivalents, investments and accounts receivable, including due from related parties, comprise approximately 73%, 11% and 15%, respectively, of the current assets; meanwhile 80% and 18% of the noncurrent assets are capital assets and investments, respectively. As of June 30, 2016, cash and cash equivalents, investments and accounts receivable, including due from related parties, comprise approximately 58%, 22% and 19%, respectively, of the current assets; meanwhile 82% and 17% of the noncurrent assets are capital assets and investments, respectively.

Total cash and cash equivalents (current and noncurrent assets) (mainly deposit accounts in a commercial bank in Puerto Rico and money market funds in U.S. commercial banks at June 30, 2017 and 2016) amounted to \$313.4 million, \$191.9 million and \$106.4 million at June 30, 2017, 2016 and 2015, respectively. The increase in the University's cash position of \$121.5 million or 63% in 2017 mainly resulted from the excess of the net cash provided by the noncapital financing activities which amounted to approximately \$1.13 billion over the net cash used in the operating activities which amounted to approximately \$965.4 million and over the net cash used in the capital and related financing activities which amounted to approximately \$45.7 million. The net cash provided by the noncapital financing activities in 2017 remained almost equal to the prior year balance and includes the collected Commonwealth appropriations which amounted to approximately \$934.4 million and collected revenues from Federal Pell Grant program which amounted to approximately \$189.4 million. The net cash used in the operating activities decreased by \$1.1 million from \$966.5 million in 2016 mainly as a result of the decrease in the payments for benefits and to suppliers. Benefits paid to and on behalf of employees amounted to \$221.9 million in fiscal year 2017 and \$255.6 million in fiscal year 2016, a decrease of \$33.6 million or 13%. Contributions paid to the University Retirement System in fiscal year 2017 were lower than in prior year. The Governing Board approved an additional contribution to the University Retirement System of approximately \$6.3 million for the year 2017 that was paid in November 2018. Payments to suppliers amounted to \$153.6 million in fiscal year 2017 and \$157.3 million in fiscal year 2016, a decrease of \$3.7 million or 2%. The net cash used in the capital and related financing activities decreased by \$33.3 million from \$79.0 million in 2016 mainly as a result of suspension of about \$20 million in payments to the trustee of the University System Revenue Bonds in fiscal 2017 and approximately \$7.5 million in lower purchases of capital assets. As agreed in the letter agreement with the trustee, as previously disclosed in the Going Concern Section and further discussed in the Capital Assets and Debt Administration Section, on September 1, 2017, the University paid the trustee \$20.0 million corresponding to unremitted deposits to trustee for the fiscal year 2017 and continued to pay monthly to the trustee \$4.0 million of the pledged revenues starting in July 2017.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

The increase in the University's cash position of \$85.5 million or 80% in 2016 mainly resulted from the collection of \$20.0 million from the Commonwealth in July 2015 corresponding to a portion of the formula appropriations for June 2015, the collection of \$38.6 million in December 2015 of advances given to the University Retirement System mainly in fiscal year 2014, the increase in collections of grants and contracts mainly from Federal Pell program of \$11.5 million and the net decrease in operating expenses paid in fiscal year 2016 mainly as a result of lower payments to suppliers and for utilities, which effects were partially offset by the increase in benefits paid to and on behalf of employees. Payments to suppliers and for utilities amounted to \$194.2 million in fiscal year 2016 and \$219.8 million in fiscal year 2015, a decrease of \$25.6 million or 12%. Benefits paid to and on behalf of employees amounted to \$255.6 million in fiscal year 2016 and \$239.3 million in fiscal year 2015, an increase of \$16.3 million or 7% mainly due to the decrease in accrued benefit liabilities of \$34.4 million in 2016. For a more detailed information of the changes in cash and cash equivalents, refer to the University's statements of cash flows for the years ended June 30, 2017 and 2016.

Total investments (current and noncurrent assets) amounted to \$245.0 million, \$259.3 million and \$282.0 million at June 30, 2017, 2016 and 2015, respectively. The decrease of \$14.3 million or 6% in 2017 mainly resulted from a decrease of \$23.7 million in the restricted investments of the sinking funds used to pay the debt service payment of the University's bonds payable, which effect was partially offset by the increase of \$3.6 million in the restricted investments of the permanent endowment funds and the increase of \$5.3 million in the restricted investments of the University's Healthcare Deferred Compensation Plan as a result of the increase in the fair value such investments. In fiscal year 2017, the University suspended the monthly payments to the trustee for the University of Puerto Rico System Revenue Bonds from July 2016 to May 2017 in compliance with EO 31. On June 29, 2017, the University entered into a letter agreement with the trustee and paid \$20 million of the deposits corresponding to fiscal year 2017 on June 30, 2017 and \$20 million on September 1, 2017. The decrease of \$22.7 million or 8% in 2016 mainly resulted from a decrease of \$15.3 million in the investments designated to fund the University's Healthcare Deferred Compensation Plan and the transfer to cash equivalents of \$6.8 million in other restricted investments in certificates of deposit at GDB of the University's Internship Program for the First Labor Experience Fund.

Deposits held with GDB amounted to approximately \$92.1 million, \$92.0 million and \$88.4 million as of June 30, 2017, 2016 and 2015, respectively. Management concluded that the information available indicates that it is probable that an impairment loss on the University's certificates of deposit held with the GDB exists as of June 30, 2017, 2016 and 2015. GDB faces significant risks and uncertainties and it currently does not have (and is not expected to have) sufficient liquid financial resources to meet its obligations in full. Pursuant to enacted legislation and executive orders by two separate government administrations, GDB has been ordered to suspend loan disbursements, to impose restrictions on the withdrawal and transfer of deposits from GDB and has been imposed a moratorium on its debt obligations, among other measures. On March 23, 2018, GDB ceased its operations and it is currently winding down in an orderly fashion under Title VI of PROMESA. Based on an evaluation of the availability and recoverability of such funds, an impairment loss on deposits held with the GDB was recorded in the University's basic financial statements for the years ended June 30, 2016 and 2015 of approximately \$69.8 million and \$21.7 million, respectively. The carrying value of the cash equivalents and investments in certificates of deposit held with GDB after the impairment charge amounted to \$500,000 and \$66.8 million as of June 30, 2016 and 2015, respectively. The realizable balance of the deposits held with the GDB was determined based on the corresponding actual collections received from the GDB on such deposits after year end. At June 30, 2017, the entire balance of the deposits held with GDB was considered not realizable. Deposits held with GDB increased by



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

approximately \$672,000 in fiscal year 2017 for capitalized interest which collection was considered improbable. Thus, related interest income was not recorded in fiscal year 2017. Refer to the Subsequent Events Section for the offset of the credit facilities with the GDB, on a dollar-for-dollar basis, by the amount of the University's deposits held at the GDB on November 29, 2018.

Accounts receivable, net, amounted to \$17.0 million, \$15.7 million and \$21.0 million at June 30, 2017, 2016 and 2015, respectively. Most of the University's accounts receivable are amounts due from medical plans and other entities located in Puerto Rico, student tuitions and fees receivable and other accounts. The increase of \$1.3 million or 8% in 2017 mainly resulted from an increase in student tuition and fees and other accounts receivable of \$1.4 million or 20%. The decrease of \$5.3 million or 25% in 2016 mainly resulted from a decrease in other accounts receivable of \$3.0 million or 39%. Gross accounts receivable amounted to \$142.0 million, \$131.9 million and \$138.2 million at June 30, 2017, 2016 and 2015, respectively. The allowance for doubtful accounts amounted to \$125.0 million, \$116.2 million and \$117.2 million at June 30, 2017, 2016 and 2015, respectively. The increase in the allowance for doubtful accounts in 2017 mainly resulted from the deterioration in the aging of these receivable because of the recessionary economic conditions in Puerto Rico.

Due from Federal Government, net, amounted to \$33.6 million, \$32.4 million and \$38.3 million at June 30, 2017, 2016 and 2015, respectively. These accounts are related to grants and contracts from Federal Government for research activity in the Sciences, Health Sciences, Engineering, Technology and the Arts. These accounts increased by \$1.2 million or 3% in 2017 and decreased by \$5.9 million or 15% in 2016. Gross amount of these accounts amounted to \$54.2 million, \$52.8 million and \$54.0 million at June 30, 2017, 2016 and 2015, respectively. The allowance for doubtful accounts amounted to \$20.6 million, \$20.4 million and \$15.7 million at June 30, 2017, 2016 and 2015, respectively.

Due from related parties, net amounted to \$13.0 million, \$12.5 million and \$91.3 million at June 30, 2017, 2016 and 2015, respectively. Most of the University's related party accounts receivable are with Commonwealth's agencies, component units and municipalities and with Servicios Médicos Universitarios, Inc., a discretely presented component unit of the University. In fiscal year 2017, these accounts increased by \$436,000 or 3%. The decrease of \$78.8 million or 86% in 2016 mainly resulted from the collection of \$20.0 million from the Commonwealth in July 2015 corresponding to a portion of the formula appropriations for June 2015, the collection of \$38.6 million in December 2015 of advances given to the University Retirement System mainly in fiscal year 2014, and an increase in the corresponding allowance for doubtful accounts of \$20.6 million or 26%. Gross related party accounts receivable amounted to \$108.8 million, \$111.3 million and \$169.4 million at June 30, 2017, 2016 and 2015, respectively. The allowance for these doubtful accounts amounted to \$96.3 million, \$98.8 million and \$78.1 million at June 30, 2017, 2016 and 2015, respectively. The increases in the allowance for doubtful accounts in 2016 mainly resulted from the deterioration of the financial condition of the Commonwealth and several of its component units as previously discussed.

Due from Commonwealth's agencies mainly includes the accounts receivable from the Department of Health which amounted to \$15.8 million, \$15.2 million and \$15.1 million at June 30, 2017, 2016 and 2015, respectively, for unpaid medical services provided by the faculty members of the Medical Sciences Campus of the University to the Commonwealth's health reform program patients and other services, and from the Department of Education which amounted to \$2.3 million, \$2.9 million and \$4.5 million at June 30, 2017, 2016 and 2015, respectively, for contracts for professional development of public school teachers and



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

others.

Due from Commonwealth's component units include an account receivable from the Puerto Rico Medical Service Administration ("PRMSA"), a component unit of the Commonwealth, which amounted to \$44.7 million, \$40.9 million and \$38.3 million at June 30, 2017, 2016 and 2015, respectively, for contracted medical services provided by the faculty members of the Medical Sciences Campus of the University to the PRMSA. In addition, due from Commonwealth's component units include the accounts receivable from the Puerto Rico Tourism Company ("PRTC"), a component unit of the Commonwealth, which amounted to \$5.0 million, \$5.5 million and \$5.5 million at June 30, 2017, 2016 and 2015, respectively, for unremitted distributions of income to be received by the University under the Gambling Law that in each year were collected at the beginning of the next fiscal year. Due from Commonwealth's component units also includes accounts receivable from the Comprehensive Cancer Center of the University of Puerto Rico ("CCCUPR"), a component unit of the Commonwealth, which amounted to \$3.6 million \$2.4 million and \$1.3 million at June 30, 2017, 2016 and 2015, respectively, for unpaid charges of salaries, fringe benefits and other expenses incurred by certain professors of the Medical Science Campus of the University for cancer research and investigations provided to the CCCUPR.

Due from Servicios Médicos Universitarios, Inc. (the "Hospital"), a discretely presented component unit of the University, which amounted to \$21.8 million, \$24.3 million, and \$24.9 million at June 30, 2017, 2016, and 2015, respectively, mainly comes from contracted medical services provided by the faculty members of the Medical Science Campus of the University to the Hospital.

The University had a due from the University of Puerto Rico Retirement System (the "Retirement System") of approximately \$53,000, \$14,000 and \$38.6 million at June 30, 2017, 2016 and 2015, respectively, which resulted from unpaid advances given by the University to the Retirement System. The amount due by the Retirement System was unsecured, non-interest bearing and payable upon demand. In December 2015, the University collected the whole amount due from the Retirement System at June 30, 2015.

The University maintains an allowance for doubtful accounts for estimated losses inherent in its accounts receivable based on type of receivables and expectations of repayment. In establishing the required allowance, management considers one or more of the following: type of receivables, Commonwealth guidelines, historical losses adjusted to consider current market conditions, the amounts of receivable in dispute, the current receivables aging, and current payment patterns. The University has significant amounts receivable from the Commonwealth's and its instrumentalities. There is significant uncertainty regarding the collection of such receivables due to the financial challenges these entities are facing. The University has considered this in its estimate of the specific governmental allowance for uncollectible accounts and fully reserved for all receivables from the Commonwealth affiliated entities that have not been collected in the twelve months period post the balance sheet date. The University reviews its allowance for doubtful accounts annually. Past due balances over a specified amount are reviewed individually for collectibility. Because of uncertainties inherent in the estimation process, management's estimate of credit losses inherent in the existing accounts receivable and related allowance may change in the future.

Capital assets, net of depreciation and amortization, amounted to \$866.5 million, \$896.8 million, and \$923.8 million at June 30, 2017, 2016 and 2015, respectively. Capital assets decreased by \$30.3 million or 3% in 2017 and by \$27.0 million or 3% in 2016. The decreases in both years mainly resulted from the depreciation and amortization expense of \$49.1 million in 2017 and \$47.9 million in 2016 and the capital asset



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

retirements of \$1.8 million in 2017 and \$7.1 million in 2016, which effects were partially offset by the University's investment in construction projects and other capital assets for educational facilities that amounted to \$20.6 million in 2017 and \$28.0 million in 2016.

Noncurrent other assets amounted to \$15.0 million, \$13.3 million, and \$9.2 million at June 30, 2017, 2016 and 2015, respectively, and mainly consisted of restricted cash and cash equivalents and notes receivable, net.

Deferred Outflows of Resources

Deferred outflows of resources, which represents resources applicable to a future reporting period, amounted to \$222.1 million, \$104.6 million, and \$90.8 million at June 30, 2017, 2016 and 2015, respectively. The increases of \$117.5 million in 2017 and \$13.8 million in 2016 mainly resulted from changes in the deferred outflows of resources for the pension plan employer's contributions made subsequent to the measure date, from pension activities related to changes in assumptions and other input and from net difference between projected and actual earnings on plan investments. Deferred outflows of resources also include the deferred refunding loss on the University's revenue bonds of \$1.9 million, \$2.2 million and \$2.5 million at June 30, 2017, 2016 and 2015, respectively, which decreased by the amortization expense of approximately \$300,000 each year.

Liabilities

Total liabilities amounted to \$2.92 billion, \$2.73 billion and \$3.10 billion at June 30, 2017, 2016 and 2015, respectively, an increase of \$194.6 million in 2017 and a decrease of \$369.2 million in 2016, when compared with the prior year balances. The changes in both years mainly resulted from the change in the net pension liability which balance amounted to \$2.01 billion, \$1.80 billion, and \$2.10 billion at June 30, 2017, 2016 and 2015, respectively, an increase of \$210.0 million in 2017 and a decrease of \$307.3 million in 2016. As further explained below, the changes in the net pension liability mainly resulted from changes in the discount rates used to measure the total pension liability.

Current liabilities consist primarily of accounts payable and accrued liabilities, the current portions of long-term debt and other liabilities. Noncurrent liabilities primarily consist of long-term debt obligations, net pension liability, deferred compensation payable and compensated absences.

Accounts payable and accrued liabilities amounted to \$82.0 million, \$64.8 million, and \$73.3 million at June 30, 2017, 2016 and 2015, respectively. Accounts payable and accrued liabilities increased by \$17.2 million or 27% in 2017 mainly as a result of an unpaid additional contribution to the University's Retirement System of approximately \$6.3 million for the fiscal year 2017 approved by the Governing Board that was paid in November 2018, the increase of approximately \$5.1 million in the accounts payable to suppliers, and the increase of approximately \$4.3 million in the accrued interest payable on GDB credit facilities because the University stopped the interest payment almost entirely in fiscal year 2017, as further explained below. No additional contribution to the University's Retirement System was approved for fiscal year 2016. Accounts payable and accrued liabilities decreased by \$8.5 million or 12% in 2016 mainly as a result of the payment in fiscal year 2016 of \$8.8 million to the University's Retirement System for an unpaid additional contribution at June 30, 2015 approved by the Governing Board of the University for the year ended June 30, 2015.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

Total long-term debt obligations (current and noncurrent liabilities) amounted to \$567.6 million, \$593.0 million, and \$623.4 million at June 30, 2017, 2016 and 2015, respectively. The decreases of \$25.4 million or 4% in 2017 and of \$30.4 million or 5% in 2016 mainly resulted from principal paid on long-term debt of \$23.7 million in 2017 and \$28.9 million in 2016 and the amortization of bond premium of \$1.8 million in 2017 and 2016, net of advances of \$220,000 in 2016 taken from the lines of credit with the GDB for the University's capital improvement program.

Long-term debt obligations include the University's revenue bonds and the Desarrollos Universitarios, Inc's AFICA bonds (the AFICA bonds) which amounted to \$427.1 million and \$64.0 million as of June 30, 2017, \$449.8 million and \$66.3 million as of June 30, 2016, respectively, and to \$471.6 million and \$68.5 million as of June 30, 2015, respectively. The decreases in 2017 and 2016 mainly resulted from the principal repayments of \$21.0 million and \$20.0 million in the University's revenue bonds, respectively, and of \$2.3 million and \$2.2 million in the AFICA bonds, respectively. These bonds are currently rated "C" by Moody's Investors Service (Moody's) and "CC" by Standard & Poor's Ratings Services (S&P).

In October 2011, the University converted a line of credit with the GDB used for working capital purposes into a ten-year term loan payable in monthly equal principal payments plus interest starting on October 1, 2013. The term loan is collateralized by the University's accounts receivable from the Commonwealth of Puerto Rico and its agencies as well as by the Commonwealth of Puerto Rico income guaranteed appropriations under Act No. 2 of January 20, 1966, as amended. The University had not made the monthly payments of this term loan since May 2016. In addition, the University had a \$75 million non-revolving line of credit with the GDB used complete certain construction projects of the University's Program for Permanent Improvements. Advances taken from the line of credit with the GDB for the University's capital improvement program amounted to approximately \$220,000 in 2016, meanwhile the principal repayments in the term loan with the GDB used for working capital purposes amounted to approximately \$6.8 million in 2016. The \$75.0 million line of credit expired on January 31, 2016 and the University had not made the monthly interest payments of this line of credit since September 2016. The balances outstanding under the term loan and the \$75 million line of credit with the GDB amounted to \$48.3 million and \$28.1 million, respectively, at June 30, 2017. Accrued interest payable of the term loan and the \$75 million line of credit with the GDB amounted to approximately \$3.5 million and \$1.5 million, respectively, at June 30, 2017.

GDB also served as depository of some of the University's funds. Total amount deposited in the GDB amounted to approximately \$92.1 million as of June 30, 2017 and are deemed fully impaired as mentioned before. In May 2016, the Governing Board of the University authorized its president to cancel the term loan and the expired line of credit with the GDB using the University's funds deposited in the GDB. On March 23, 2018, GDB ceased its operations and it is currently winding down in an orderly fashion under Title VI of PROMESA. The University had not paid its debt service on these credit facilities with GDB because it and the GDB had not reached an agreement to cancel these credit facilities or to determine how these credit facilities will be managed. Refer to the Subsequent Events Section for the offset of the credit facilities with the GDB, on a dollar-for-dollar basis, by the amount of the University's deposits held at the GDB on November 29, 2018.

In January 2012, the University entered into two term loan agreements with a commercial bank for a total amount of \$2.4 million for the acquisition of medical equipment to be used in the Medical Sciences Campus.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

The balance outstanding of the two-term loans, which amounted to \$375,000 at June 30, 2016, was paid in fiscal year 2017.

Net pension liability amounted to \$2.01 billion, \$1.80 billion and \$2.10 billion at June 30, 2017, 2016 and 2015, respectively, an increase of approximately \$210.0 million in fiscal year 2017 and a decrease of approximately \$307.3 million in fiscal year 2016. In fiscal year 2015, the University recognized a net pension liability which amounted to \$2.10 billion at June 30, 2015 as a result of the University's adoption of GASB Statement No. 68. As permitted by GASB, the University's net pension liability as of June 30, 2017 and 2016 were measured as of June 30, 2016 and 2015, respectively, and the total pension liability used to calculate the net pension liability was determined by actuarial valuations with beginning-of-year census data that were rolled forward to June 30, 2016 and 2015, respectively, and assuming no liability gains and losses. The changes in the net pension liability mainly resulted from changes in the discount rates used to measure the total pension liability, which amounted to 5.89%, 6.37% and 5.31% in fiscal years 2017, 2016 and 2015, respectively. The projection of cash flows used to determine the discount rate for fiscal years 2017 and 2016 assumed that plan member contributions will be made at the current contribution rate and that the Plan contributions will be made at rates equal to the difference between actuarially determined contribution rates and the member rate.

Effective June 30, 2015, the contribution rates reflect amortization of the Retirement System's unfunded actuarial accrued liability over a closed 40 – year period from that date as established by Certification No. 146 (2014-2015) of the Governing Board issued on June 4, 2015.

Based on those assumptions, in fiscal year 2017, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members until the plan year ending June 30, 2045. Therefore, the long-term expected rate of return on pension plan investments of 7.75% was applied to all periods of projected benefit payments through June 30, 2045 and the applicable municipal bond index rate of 3.01%, based on the Bond Buyer General Obligation 20-year Municipal Bond Index published monthly by the Board of Governors of the Federal Reserve System as of June 30, 2016, was applied to all periods of projected benefit payments after June 30, 2045. The single equivalent interest rate (SEIR) of 5.89% that discounts the entire projected benefit stream to the same amount as the sum of the present values of the two separate benefit payments streams was used to determine the total pension liability at June 30, 2016.

In fiscal year 2016, the SEIR at June 30, 2015 was 6.37% based on the long-term expected rate of return on pension plan investments of 7.75% applied to all periods of projected benefit payments through June 30, 2044 and the applicable municipal bond index rate of 3.825% as of June 30, 2015 applied to all periods of projected benefit payments after June 30, 2044.

Total other long-term debt liabilities (current and noncurrent liabilities) amounted to \$266.2 million, \$273.3 million, and \$296.3 million at June 30, 2017, 2016 and 2015, respectively, a decrease of \$7.1 million or 3% in 2017 and a decrease of \$23.0 million or 8% in 2016, when compared with the prior year balances. Other long-term debt liabilities include the accrual of compensated absences, the liability for the deferred compensation plan, claims liability and other postemployment benefit obligation.

The accrual for compensated absences amounted to \$145.7 million, \$154.8 million and \$166.6 million at June 30, 2017, 2016 and 2015, respectively, a decrease of \$9.1 million or 6% in 2017 and a of \$11.8 million



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

or 7% in 2016, when compared with prior year balances. Changes in compensated absences are mainly related to variations on the use of vacations and sick leaves by employees, salary changes and the total number of employees at the end of periods.

The liability for the deferred compensation plan amounted to \$93.0 million, \$87.7 million and \$103.0 million at June 30, 2017, 2016 and 2015, respectively, an increase of \$5.3 million or 6% in 2017 and a decrease of \$15.3 million or 15% in 2016, when compared with prior year balances. The University offered to certain employees of the Medical Sciences Campus 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, which is managed by independent plan administrators, permits employees to defer a portion of their salary until future years. At the employee's election, such amounts may be invested in mutual funds and other securities, 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, subject only to the claims of the University's general creditors in the event of the University's insolvency, as defined in the Trust Agreements. 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.

On May 11, 2016, the plan participants of the University's Healthcare Deferred Compensation Plan of the Medical Sciences Campus recommended, by majority of more than fifty percent (96.9%) to terminate the University's Healthcare Deferred Compensation Plan. Its Board of Directors ratified such recommendation. On June 30, 2016, the Governing Board of the University ratified the termination of Voya Institutional Trust Company as Trustees of the Trust of the University's Healthcare Deferred Compensation Plan. The members of the Governing Board of the University were designated as the Successor Trustees of the Trust of the University's Healthcare Deferred Compensation Plan. In addition, the Governing Board of the University approved the dissolution of the University's Healthcare Deferred Compensation Plan and the distribution of the deferred funds to its participants. On August 22, 2016, Voya filed a complaint in the U.S. District Court for the District of Puerto Rico against the Governor of the Commonwealth, the University and its President. The complaint seeks relief from the Court relating to its administration of the Trust in light of the financial crisis in Puerto Rico and its effect on the University. Specifically, this complaint for declaratory relief seeks federal judicial review as expressly provided for by PROMESA of the issues arising under PROMESA, the Trust Agreements, and other relevant law, in light of the University's financial condition and its efforts to distribute all Plan assets. The University, Voya, the Oversight Board of PROMESA and FAFAA are participating in a mediation to attempt to resolve the case consensually. Voya has not yet transferred the plan assets to the University waiting for the resolution of this complaint by the U.S. District Court for the Puerto Rico District.

Claims liability amounted to \$13.3 million, \$22.3 million and \$19.1 million at June 30, 2017, 2016 and 2015, respectively, a decrease of \$9.0 million or 40% in 2017 and an increase of \$3.2 million or 17% in 2016, when compared with prior year balances. As further explained in the Subsequent Events Section, claims liability as of June 30, 2017 and 2016 includes the claim of the Plaza Universitaria Project's general contractor of approximately \$2.3 million and \$6.3 million, respectively, and a claim with the federal



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

agencies of approximately \$1.8 million and \$5.6 million, respectively. The decrease in 2017 mainly resulted for the settlements of both claims for a lower amount in September 2018. The increase in 2016 mainly resulted for the accrual of approximately \$5.6 million of a claim with the federal agencies as of June 30, 2016.

Other postemployment obligation amounted to \$14.2 million, \$8.6 million and \$7.6 million at June 30, 2017, 2016 and 2015, respectively, an increase of \$5.6 million or 65% in 2017 and an increase of \$945,000 or 12% in 2016, when compared with prior year balances. The changes in the other postemployment obligation mainly resulted from changes in the discount rates used to measure the other postemployment obligation, which amounted to 2.7%, 3.1% and 3.5% in fiscal years 2017, 2016 and 2015, respectively.

Deferred Inflows of Resources

Deferred inflows of resources, which is an acquisition of resources by the University that is applicable to a future reporting period, amounted to \$172.9 million, \$301.4 million and \$107.1 million at June 30, 2017, 2016 and 2015, respectively. The decrease of \$128.5 million in 2017 and the increase of \$194.3 million in 2016 mainly resulted from changes in the deferred inflows of resources from pension activities related to differences between expected and actual experience, net differences between projected and actual earnings on plan investments and changes in assumptions and other input.

Net Position (Deficit)

Net position represents the residual interest in the University's assets and deferred outflows of resources after liabilities and deferred inflows of resources are deducted. Net position amounted to a deficit of \$1.37 billion, \$1.50 billion and \$1.64 billion at June 30, 2017, 2016 and 2015, respectively.

The change in the net position amounted to an increase of \$128.4 million and of \$137.6 million for the years ended June 30, 2017 and 2016, respectively.

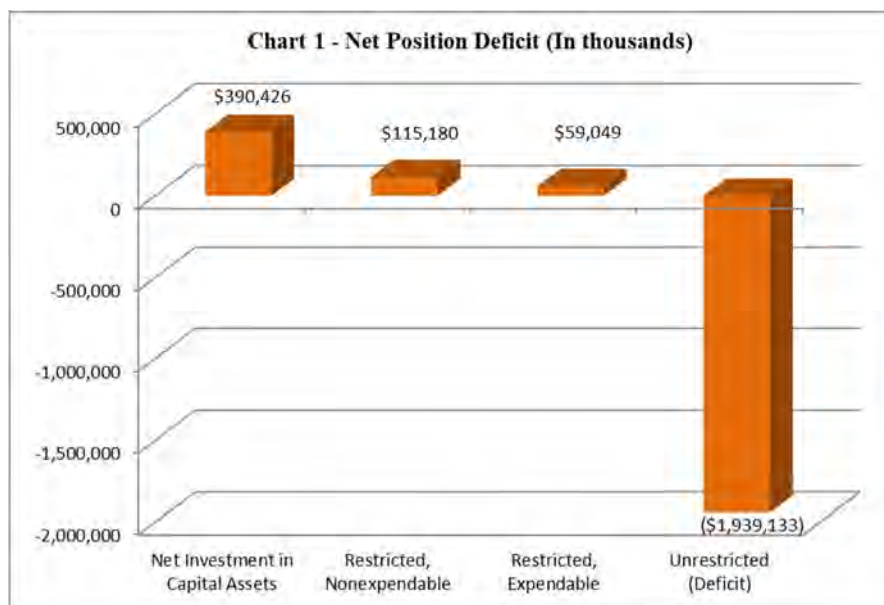
In 2015, the net position reached a deficit position of \$1.64 billion as of June 30, 2015, when compared with the net position of \$531.1 million at June 30, 2014. Effective July 1, 2014, the University recognized a decrease of \$2.24 billion in its net position at July 1, 2014 as a cumulative effect of change in accounting for pension costs as required by GASB Statement No. 68 and GASB Statement No. 71.

The changes in the net deficit position are explained in the section entitled "*Statements of Revenues, Expenses and Changes in Net Position*".



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

The major classifications of the net position (deficit) at June 30, 2017 are shown in the following illustration:



Net investment in capital assets consists of the University's capital assets less accumulated depreciation, reduced by outstanding debt obligations that are attributable to the acquisition, construction or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt are required to be included in this component of net position. To the extent proceeds from issuance of debt have been received but not yet expended for capital assets or deferred inflow of resources attributable to the unspent amount, such amounts are not included as a component of net investment in capital assets.

Restricted, nonexpendable net position consists of restricted, nonexpendable assets reduced by liabilities and deferred inflows of resources related to those assets. Restricted, nonexpendable assets include endowment and similar type funds which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity and invested for the purpose of producing present and future income, which may either be expended or added to principal.

Restricted, expendable net position consists of restricted, expendable assets reduced by liabilities and deferred inflows of resources related to those assets. Restricted, expendable assets include resources that the University is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

Unrestricted net position is the net position (deficit) amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of the net investment in capital assets or restricted components of net position. It represents 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 position may be designated for specific purposes by action



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

of management or the Governing Board, they are available for use, at the discretion of the Governing Board, to meet current expenses for any purpose.

Statements of Revenues, Expenses and Changes in Net Position (Deficit)

Approximately 90% of the operating revenues and nonoperating revenues, net of the University are Commonwealth and Federal appropriations, grants and contracts. The remainder consists primarily of tuition and fees and patient services.

Operating Revenues

Total operating revenues amounted to \$253.5 million, \$246.4 million and \$260.2 million for the years ended June 30, 2017, 2016 and 2015, respectively, an increase of \$7.2 million or 3% in 2017 and of \$13.8 million or 5% in 2016. The changes in operating revenues mainly resulted from the changes in tuitions and fees, in governmental grants and contracts and in-patient services revenues.

Tuitions and fees decreased by \$810,000 or 2%, from \$48.5 million in 2016 to \$47.7 million in 2017, mainly as a result of the increase in the scholarship allowances because of more student enrollments at the University, eligible to Federal Pell Grant program. Scholarship allowances increased by \$3.1 million or 6%, from \$54.8 million in 2016 to \$57.9 million in 2017, as a result of the increase in eligible participants. For fiscal year 2017, the student body of the University consisted of 61,748 students, an increase of 1,824 students when compared with 59,924 students for fiscal year 2016. Gross tuitions and fees increased by \$1.7 million or 2%, from \$106.7 million in 2016 to \$108.4 million in 2017. The provision for doubtful accounts decreased by \$553,000 in 2017, from \$3.4 million in 2016 to \$2.9 million in 2017. In fiscal year 2016, tuitions and fees increased by \$1.3 million or 3%, from \$47.2 million in 2015, mainly as a result of more student enrollments at the University, which effect was partially offset by the increase in the scholarship allowances and in the provision for doubtful accounts. For fiscal year 2016, the student body of the University increased by 2,353 students when compared with 57,571 students for fiscal year 2015. Scholarship allowances increased by \$3.7 million or 7%, from \$51.1 million in 2015, as a result of the increase in eligible participants. The provision for doubtful accounts increased by \$2.7 million in 2016, from \$735,000 in 2015, as a result of the aging deterioration of these accounts.

The University tuition is among the lowest in Puerto Rico and in the United States of America. In accordance with a Board of Trustees Resolution, tuition cost per credit was increased 4% annually per incoming class from academic year 2007-2008 to academic year 2012-2013. On July 30, 2013, the Governing Board of the University declared a moratorium period of one year to the 4% annual increase per incoming class in the tuition cost per credit. This moratorium period was extended for academic years 2014-2015 and 2015-2016. On June 30, 2016, the Governing Board of the University reestablished the annual increase per incoming class (approximately 2% increase) in the tuition cost per credit for academic year 2016-2017. Refer to the Going Concern Section for future increases in tuitions and related fees included in the University fiscal plan for the fiscal years 2018 to 2023.

In fiscal year 2017, revenues from governmental grants and contracts decreased by \$10.3 million or 10%, from \$106.9 million in 2016, to \$96.5 million in 2017. The decrease in 2017 mainly resulted from an increase of \$3.0 million in the provision for doubtful accounts and a decrease of \$7.3 million in revenues from these grants and contracts, principally from Federal grants and contracts. In fiscal year 2016, revenues



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

from governmental grants and contracts decreased by \$8.5 million or 7%, from \$115.4 million in 2015. The decrease in 2016 mainly resulted from an increase of \$10.0 million in the provision for doubtful accounts, which effect was partially offset by an increase of \$1.4 million in revenues from these grants and contracts, principally from Federal grants and contracts.

Net patient services revenue and other amounted to \$75.8 million, \$61.8 million and \$57.8 million for the years ended June 30, 2017, 2016 and 2015, respectively, an increase of \$14.0 million or 23% in 2017 and an increase of \$4.0 million or 7% in 2016. Patient service revenue depends on medical services, including laboratories, rendered by the University's Medical Sciences Campus faculty members. The provision for doubtful accounts for these accounts decreased by \$10.3 million in 2017 and decreased by \$6.5 million in 2016.

Non-operating Revenues, Net

Total non-operating revenues, net amounted to \$1.11 billion, \$1.03 billion and \$1.07 billion for the years ended June 30, 2017, 2016 and 2015, respectively, an increase of \$85.7 million or 8% in 2017 and a decrease of \$42.1 million or 4% in 2016.

The Commonwealth and other appropriations amounted to \$934.4 million, \$932.5 million and \$937.4 million for the years ended June 30, 2017, 2016 and 2015, respectively, an increase of \$1.9 million in 2017 and a decrease of \$4.9 million in 2016.

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 fund revenues collected under the laws of the Commonwealth in the two fiscal years immediately preceding the current fiscal year (the Commonwealth formula appropriations). The Commonwealth formula appropriations amounted to \$833.9 million for the years ended June 30, 2017, 2016 and 2015. On June 17, 2014, the Legislature of the Commonwealth enacted Act No. 66-2014 (the "Fiscal Sustainability Act"). The Fiscal Sustainability Act was a temporary fiscal emergency law designed to address the fiscal condition of the Commonwealth. Among other things, the Fiscal Sustainability Act froze the benefit under the formula-based appropriation of the University to the amount appropriated for fiscal year ended June 30, 2014. The Fiscal Sustainability Act remained in effect for three fiscal years ended on June 30, 2017. Refer to Going Concern Section for significant reductions in the Commonwealth's formula appropriations to the University from fiscal year 2018 to 2023 included in the Commonwealth's fiscal plan approved by the Oversight Board of PROMESA. The projected reductions in the Commonwealth's formula appropriations to the University rise annually from approximately \$203 million in fiscal year 2018 to approximately \$478 million in fiscal year 2023.

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 \$39.0 million, \$36.0 million and \$39.9 million for the years ended June 30, 2017, 2016 and 2015, respectively, an increase of \$3.0 million in 2017 and a decrease of \$3.9 million in 2016.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

Appropriations from the Commonwealth also include unremitted distributions of income received by the University from the PRTC under the Gambling Law (slot machines and others) by virtue of Act No. 36 of 2005 which are payable upon demand. PRTC appropriations for the years ended June 30, 2017, 2016 and 2015 amounted to \$61.5 million, \$62.6 million and \$63.6 million, respectively, a decrease of \$1.1 million in 2017 and of \$918,000 in 2016.

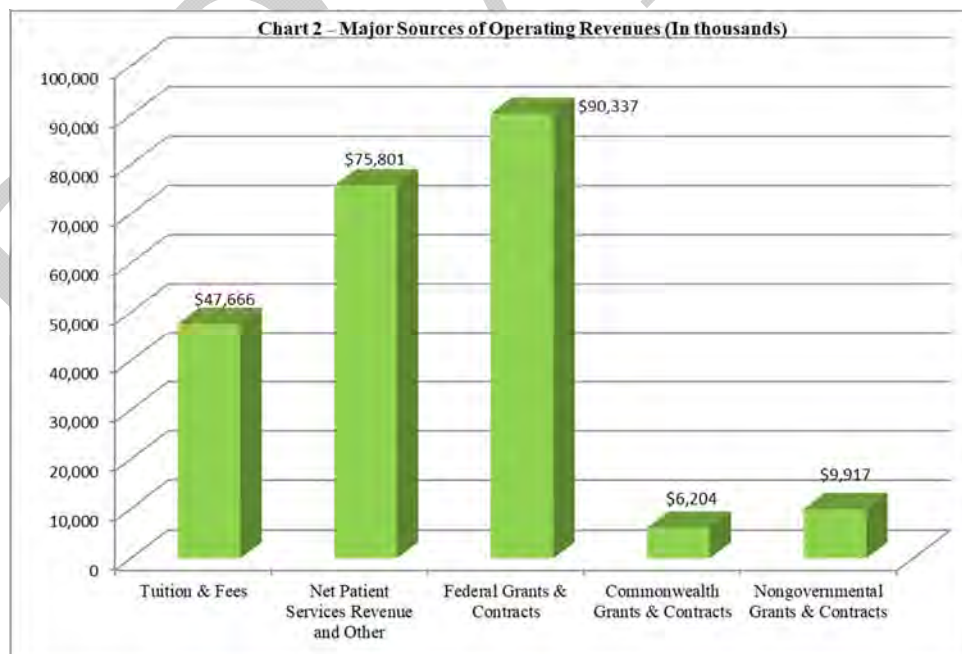
Federal Pell Grant program revenues amounted to \$189.4 million, \$178.7 million and \$167.2 million in 2017, 2016 and 2015, respectively, an increase of \$10.7 million or 6% in 2017 and of \$11.5 million or 7% in 2016. The increases in 2017 and 2016 were mainly due to the increase in the number of eligible participants.

As previously explained, the University recognized an impairment loss on deposits with GDB of approximately \$69.8 million for the year ended June 30, 2016. No impairment loss on deposits with GDB was incurred in 2017.

Other nonoperating revenues (expenses), net mainly includes the interest expense on capital assets-related debt and others which amounted to \$28.0 million, \$28.4 million, and \$28.8 million for the years ended June 30, 2017, 2016 and 2015, respectively. The decreases of interest expense in fiscal years 2017 and 2016 are related to the reduced principal balance on these debts.

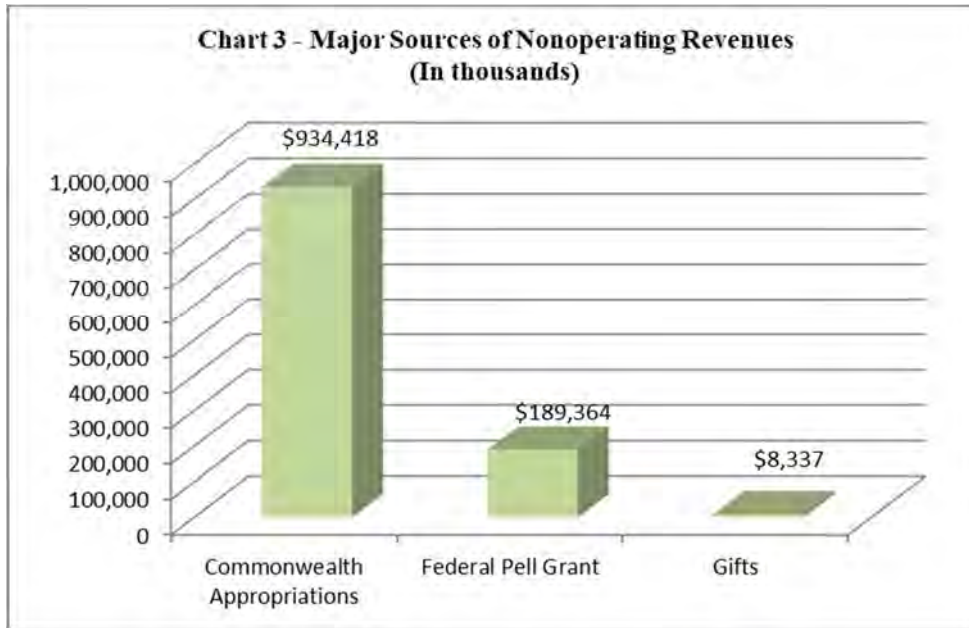
No capital appropriations were received in fiscal years 2017 and 2016.

The following illustrations present the major sources of the University revenues (both operating and nonoperating) for the year ended June 30, 2017:

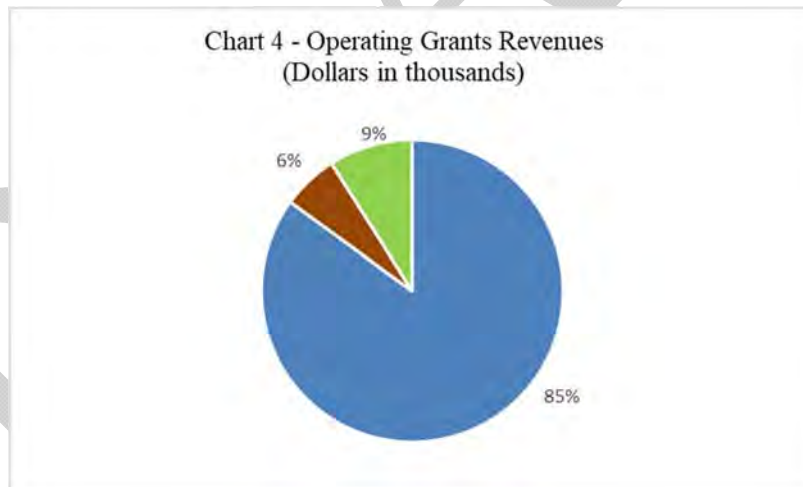




University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis



Federal grants represent approximately 85% 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, 2017:



■	Federal	\$ 90,337	85%
■	Commonwealth	6,204	6%
■	Nongovernmental	9,917	9%
	Total	\$ 106,458	100%



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

Operating Expenses

The University's expenses are presented using natural expense classifications. Total operating expenses amounted to \$1.24 billion, \$1.14 billion and \$1.27 billion for the years ended June 30, 2017, 2016 and 2015, respectively, an increase of \$102.0 million or 9% in 2017 and a decrease of \$129.9 million or 10% in 2016. Operating expenses increased in 2017 mainly as the result of the increase in the pension cost and decreased in 2016 mainly as a result of lower salaries and benefit expenses.

Salaries and benefits, the most significant component of operating expenses, amounted to \$805.0 million, \$701.4 million and \$822.5 million for the years ended June 30, 2017, 2016 and 2015, respectively, an increase of \$103.6 million or 15% in 2017 and a decrease of \$121.1 million or 15% in 2016.

Salaries amounted to \$609.8 million, \$607.5 million and \$611.0 million for the years ended June 30, 2017, 2016 and 2015, respectively, an increase of \$2.3 million or less than 1% in 2017 and a decrease of \$3.5 million or less than 1% in 2016. In fiscal year 2017, salaries of faculty personnel increased by \$9.2 million or 3%; meanwhile, salaries of exempt staff decreased by \$6.5 million or 3%. In fiscal year 2016, salaries of exempt staff decreased by \$8.1 million; however, it increased in faculty personnel by \$4.5 million, mainly in personnel of the medical practice plans of the Medical Sciences Campus of the University, for a reduction of about 170 positions of retired employees.

Benefits amounted to \$195.2 million, \$94.0 million, and \$211.5 million for the years ended June 30, 2017, 2016 and 2015, respectively. In fiscal year 2017, benefits increased by \$101.2 million or 108%, when compared with the prior year balance, mainly as a result of the change in the pension cost (credit). In fiscal year 2017, the University recognized a pension cost of approximately \$42.7 million in accordance with GASB Statement No. 68 mainly as result of the \$210.0 million increase in the net pension liability, as previously explained in the Liabilities Section; meanwhile, in fiscal year 2016, it recognized a pension credit of approximately \$49.4 million which caused an increase in benefits of \$92.1 million, when compared to fiscal year 2016. In fiscal year 2016, benefits decreased by \$117.5 million or 56%, when compared with the prior year balance, mainly as a result of the change in the pension cost. In fiscal year 2016, the University recognized a pension credit of approximately \$49.4 million in accordance with GASB Statement No. 68 mainly as result of the \$307.3 million decrease in the net pension liability, as previously explained in the Liabilities Section; meanwhile, in fiscal year 2015, it recognized a pension cost of \$66.3 million which caused a reduction in benefits of \$115.7 million.

Scholarships and fellowships amounted to \$193.4 million, \$185.5 million and \$185.4 million for the years ended June 30, 2017, 2016 and 2015, respectively, an increase of \$7.9 in 2017 and of \$80,000 in 2016. The increases in 2017 and 2016 resulted from an increase in the number of eligible participants in the Federal Pell Grant program.

Supplies and other services and utilities amounted to \$181.6 million, \$178.0 million and \$196.9 million for the years ended June 30, 2017, 2016 and 2015, respectively, an increase of \$3.6 million or 2% in 2017 and of \$18.9 million or 10% in 2016. The increase in 2017 mainly resulted from the increase in the utilities (electricity and water) and legal fees and others; meanwhile; the decrease in 2016 mainly resulted from the decrease in the utilities (electricity and water). Utilities amounted to \$38.9 million, \$37.2 million and \$48.2 million for the years ended June 30, 2017, 2016 and 2015, respectively, an increase of \$1.7 million or 5% in 2017 and a decrease of \$11.0 million or 23% in 2016. The decreases in utilities 2016 mainly resulted



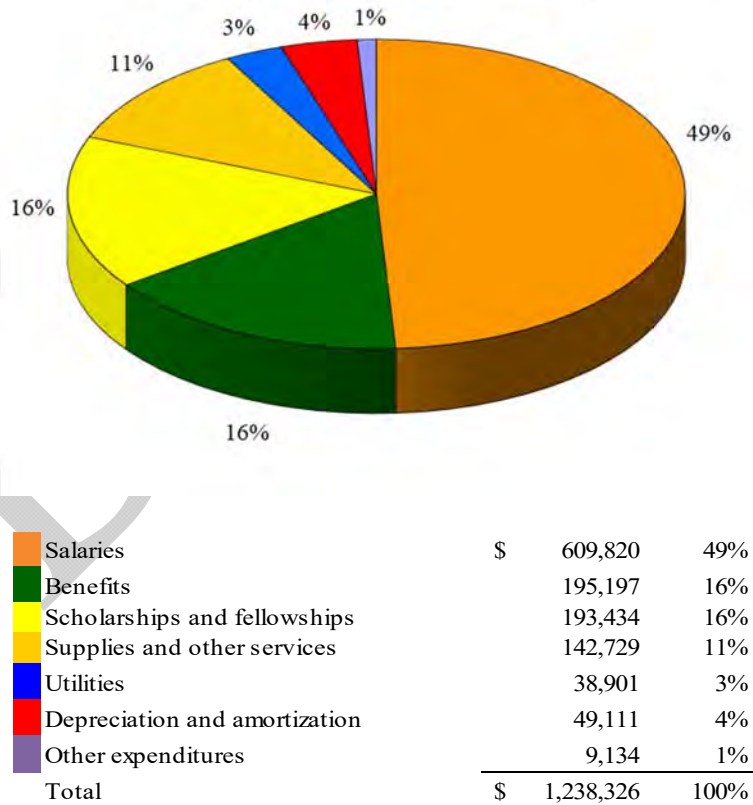
University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

from lower electricity cost. In addition, maintenance expense and professional services decreased in 2017 and 2016 as a result of the cost control measures taken by the University.

Other expenses amounted to \$58.2 million, \$71.3 million and \$61.3 million for the years ended June 30, 2017, 2016 and 2015, respectively, a decrease of \$13.1 million or 18% in 2017 and an increase of \$10.0 million or 16% in 2016. The decrease in 2017 mainly resulted from a reduction in expenses of \$13.6 million related to legal claims and a claim payable to federal agencies. As further explained in the Subsequent Events Section, claims liability as of June 30, 2017 and 2016 includes the claim of the Plaza Universitaria Project's general contractor of approximately \$2.3 million and \$6.3 million, respectively, and a claim with the federal agencies of approximately \$1.8 million and \$5.6 million, respectively. The decrease in 2017 mainly resulted for the settlements of both claims for a lower amount in September 2018. The increase in 2016 mainly resulted from an increase in losses incurred in other accounts receivable of \$1.5 million, the accrual of a claim payable to federal agencies of \$5.6 million and the increase in the depreciation and amortization expense. Depreciation and amortization expense amounted to \$49.1 million, \$47.9 million and \$44.7 million for the years ended June 30, 2017, 2016 and 2015, respectively, an increase of \$1.2 million or 3% in 2017 and an increase of \$3.2 million or 7% in 2016.

The following illustration presents the major University operating expenses, using natural classification for the year ended June 30, 2017:

Chart 5 - Operating Expenses (Dollars in thousands)

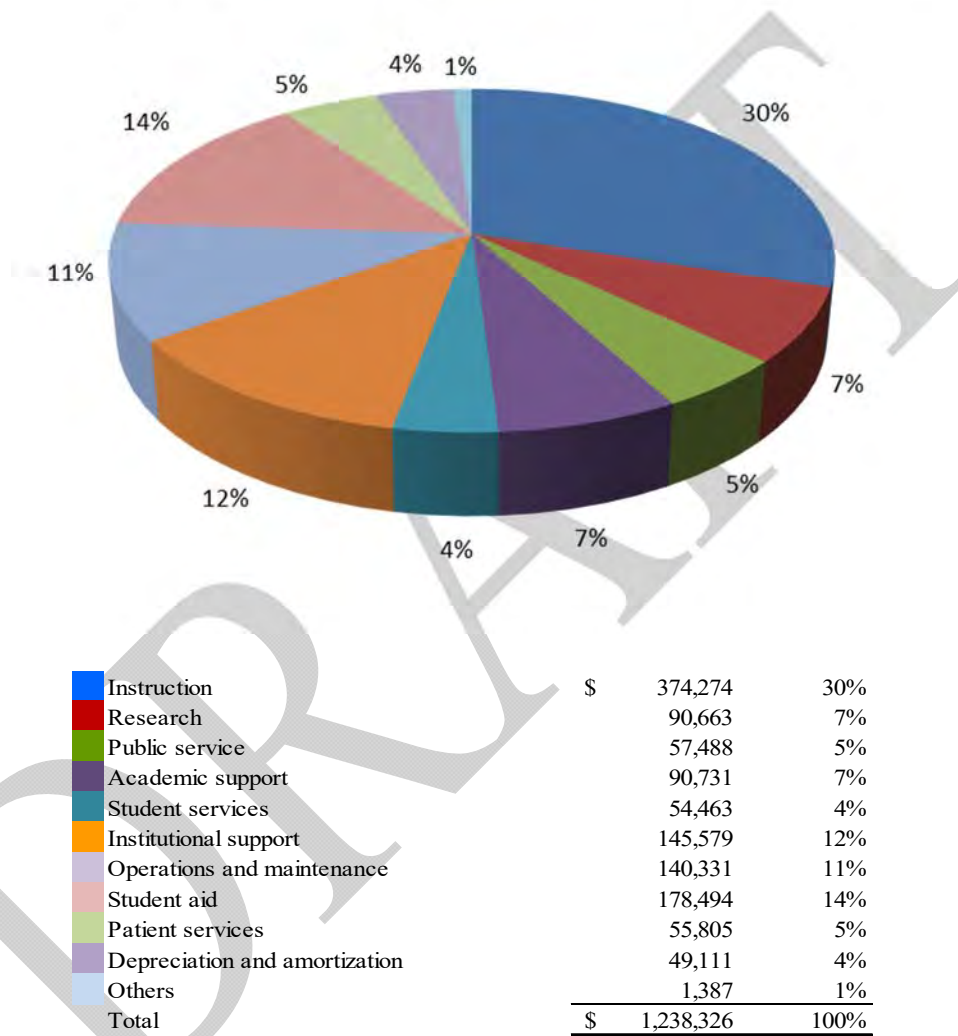




University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

Functional expense classification presents University expenses in the operational categories they benefit. The following illustration presents the major uses of University revenues (both operating and nonoperating) on a functional basis for the year ended June 30, 2017:

Chart 6 - Expenses by Function (Dollars in thousands)



Operating Loss and Net Change in Net Position (Deficit)

For the year ended June 30, 2017, the University reported an operating loss of \$984.8 million. After adding nonoperating revenues, net of \$1.11 billion, primarily from the Commonwealth's appropriations and Federal Pell Grant program, the net deficit position decreased by \$128.4 million for the year ended June 30, 2017 or 9 % from the prior year net deficit position.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

For the year ended June 30, 2016, the University reported an operating loss of \$890.0 million. After adding nonoperating revenues, net of \$1.03 billion, primarily from the Commonwealth's appropriations and Federal Pell Grant program, the net deficit position decreased by \$137.6 million for the year ended June 30, 2016 or 8% from the prior year net deficit position.

In fiscal year 2017, nonoperating revenues, net increased by approximately \$85.7 million or 8%, when compared to prior year balance mainly because in fiscal year 2016, the University recorded the impairment losses on deposits with governmental bank and on capital assets which reduced the nonoperating revenues, net by approximately \$71.1 million; meanwhile, in fiscal year 2017, those losses were not incurred. Also, in fiscal year 2017, the Commonwealth appropriations and Federal Pell Grant program revenues which amounted to approximately \$934.4 million and \$189.4 million, respectively, increased by approximately \$1.9 million and \$10.7 million, respectively, when compared to prior year balances. In fiscal year 2016, the Commonwealth appropriations and Federal Pell Grant program revenues which amounted to approximately \$932.5 million and \$178.7 million, respectively, decreased by approximately \$4.9 million and increased by approximately \$11.5 million, respectively, when compared to prior year balances.

The change in the net operating loss in fiscal years 2017 and 2016 was mainly caused by the change in the pension cost. In fiscal year 2017, the University recognized a pension cost of approximately \$42.7 million which caused an increase in benefits of \$92.1 million; meanwhile, in fiscal years 2016 and 2015, it recognized a pension credit of approximately \$49.4 million and a pension cost of approximately \$66.3 million, respectively, in accordance with Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions- an Amendment of GASB Statement No. 27* (GASB Statement No. 68), which caused a reduction in benefits expense of \$115.7 million in fiscal year 2016.

Cumulative Effect of Change in Accounting for Pension Costs

The overall change to net position as of July 1, 2014 due to adoption of GASB Statement No. 68 and 71 was a decrease of \$2.24 billion.

Statements of Cash Flows

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

Subsequent Events

On August 19, 2016, the U.S. Bank Trust National Association, in its capacity as Trustee for the University of Puerto Rico System Revenue Bonds (Series P and Q Bonds), filed a civil lawsuit under the United States Court, District of Puerto Rico against the Commonwealth and its Governor, the University and its President. The motion seeks relief from the stay of PROMESA, or Executive Orders related thereto, and a preliminary



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

injunction against the Commonwealth's diversion and expropriation of pledged revenues, which constitute the University's Bonds collateral. On June 29, 2017, the Trustee and the University, at the direction of FAFAA, entered into a letter agreement providing that the University will transfer certain amounts in respect of pledged revenue, as defined in the trust agreement, to the Trustee on condition, among others, that through August 31, 2017 (the Compliance Period) the Trustee not institute, commence, or continue certain legal proceedings against the University, the Commonwealth or any other agency, instrumentality, or municipality thereof during the Compliance Period, except in certain enumerated circumstances. As agreed in the letter agreement, the University paid \$20 million on June 30, 2017 and an additional \$20 million on September 1, 2017 and continued to pay monthly to the trustee the \$4 million of pledged revenues. The University commits to transfer to the Trustee, to hold or make payments or distributions as provided under the trust agreement, in lieu of the transfer of an equivalent amount of the pledged revenues received by the University from the date hereof through August 31, 2017 as provided in the trust agreement.

The letter agreement has been extended nine times and the new Compliance Period is June 30, 2019. Pursuant to the letter agreement and the nine standstill extension agreements, during the compliance period, holders of the majority in amount of the bonds and the Trustee at the direction of the University's bondholders will negotiate in good faith towards a restructuring of the bonds. In addition, the trustee agreed not to institute or commence certain legal proceedings and the University agreed to transfer the following monthly payments of pledged revenues to the trustee to be applied in accordance with the trust agreement governing the Series P and Q Bonds during the new Compliance Period:

- in consideration for extending the new Compliance Period until May 31, 2018, the University agreed to transfer to the Trustee \$4 million monthly from July 2017 to May 2018;
- in consideration for extending the new Compliance Period until December 31, 2018, the University agreed to transfer to the Trustee the following monthly payments: \$4.0 million of the June 2018 Payment on or before July 15, 2018; \$2.0 million of the July 2018 Payment on or before August 5, 2018; \$3.0 million of the August 2018 Payment on or before August 25, 2018; \$2.3 million of the September 2018 Payment on or before September 25, 2018; \$2.3 million of the October 2018 Payment on or before October 25, 2018; \$3.0 million of the November 2018 Payment on or before November 25, 2018; and \$3.0 million of the December 2018 Payment, less a credit for any amount as of November 30, 2018 in the Trustee's Bond Service Account and Reserve Account that is, in the aggregate, in excess of \$68,606,318, on or before December 25, 2018; and
- in consideration for extending the new Compliance Period until June 30, 2019, the University agreed to transfer to the Trustee the following monthly payments: \$2.9 million of the January 2019 Payment on or before January 25, 2019; \$2.9 million of the February 2019 Payment on or before February 25, 2019; \$2.9 million of the March 2019 Payment on or before March 25, 2019; \$2.9 million of the April 2019 Payment on or before April 25, 2019; \$2.9 million of the May 2019 Payment on or before May 25, 2019; and \$2.9 million of the June 2019 Payment, less a credit for any amount as of May 30, 2019 in the Trustee's Bond Service Account and Reserve Account that is, in the aggregate, in excess of \$75,395,125, on or before June 30, 2019.

In addition, the University and FAFAA shall provide the trustee with detailed plans and specifications for repairing, replacing or reconstructing the University's property that was damaged or destroyed by Hurricane Maria as these plans are approved by the University. The University shall deposit all proceeds of casualty insurance policies or direct federal aid (the "Repair Funds") in segregated accounts of the University at a



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

commercial bank. The University shall deposit proceeds of casualty insurance in a separate account and shall deposit proceeds of direct federal aid in one or more separate accounts to facilitate the audit of the expenditure of such funds. All Repair Funds in excess of \$1,000,000 shall be used pursuant to a written requisition. On or before the fifteenth (15th) calendar day of each month, the University will submit the preceding month's Requisitions to the trustee, as set forth below. Pursuant to extended letter agreement, the majority bondholders expand their direction to instruct the trustee not to call a default during the pendency of the new Compliance Period if by the fifteenth (15th) calendar day of each month the University sends to the trustee copies of the preceding month's Requisitions. On the fifteenth (15th) calendar day of each month the University or FAFAA will provide, or cause relevant agencies to provide, the trustee with all project requests, progress or other reports provided to the Federal Emergency Management Agency (FEMA) or to any casualty insurance company with respect to the expenditure of Repair Funds during the preceding month.

Discussions with respect to a consensual restructuring of the University's bonds are continuing. Presently, the University has paid as agreed the scheduled principal and interest payments on its outstanding Series P and Q Bonds and has complied with the letter agreement, as extended, with the Trustee.

In September 2017, the University received from the U.S. Department of Justice a Claim Letter/Notice of Intent to File Suit on behalf of the National Science Foundation ("NSF"), the National Aeronautics and Space Administration and the United States Department of Energy to take action in the Federal Court against the University for violations of the False Claims Act as a result of an examination of federal grants received by two units of the University. The claim sought treble damages amounted to approximately \$5.6 million, including \$300,000 for penalties. On September 27, 2018, the University settled this claim with the federal agencies for approximately \$1,773,000. On November 20, 2018, the University paid this claim.

On September 6, 2017, Hurricane Irma did some damages to the island of Puerto Rico and then on September 20, 2017, the island of Puerto Rico suffered the complete devastation caused by Hurricane Maria, causing catastrophic wind and water damage to Puerto Rico's infrastructure, home and businesses.

As a result of the Hurricane Maria, most of the island's population was left without electrical power and there was significant disruption to the water distribution system. Other basic utility and infrastructure services such as communications, ports and transportation were also materially affected, causing a significant disruption to the island's economic activity. The entire island of Puerto Rico will need a massive infrastructure rebuilding program.

Immediately after the landfall of the Hurricane Maria on Puerto Rico, the President of the United States of America issued a state of emergency declaration for Puerto Rico, as a U.S territory. The order mandates federal assistance through the Department of Homeland Security and the Federal Emergency Management Agency (FEMA) be made available to assist in local and territorial recovery efforts.

Some of the University's eleven campuses were more affected than others, but all were impacted in some way. A few days after Hurricane Maria, many of the University employees, as well as students and other volunteers, returned to the campuses and to the University's central Administration to begin the rebuilding process. At the end of October and the beginning of November 2017, administrative and academic functions had resumed at basically all areas and units that comprise the University System.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

The University's costs associated with repairing the damages sustained by the hurricanes could range from \$130 million to \$140 million. Part of these costs are expected to be covered by insurance funds and by disaster-relief funds granted by FEMA. The University's commercial property and fine arts insurance coverages have an aggregate lost limit of \$100 million each. On September 28, 2018, the insurance company was intervened by the Puerto Rico Insurance Commissioner for insolvency under a "rehabilitation order" for the insurance company before the Court of First Instance, Superior Court of San Juan. The order designates the Puerto Rico Insurance Commissioner, as "rehabilitator" and orders him to take possession of the insurer's assets, in protection of the interests of the policyholders with claims, creditors of the insurer and the public in general. On November 8, 2018, the University settled this claim with the insurance company for a total consideration of \$50.0 million (\$57.0 million less \$7.0 million of deductible amounts). Presently, the University has received advanced funds from the insurance company of approximately \$38.8 million and from FEMA of approximately \$1.0 million for these natural disasters.

On July 1, 2018, the commercial property and fine arts insurance policies expired. On October 1, 2018, the University contracted policies with another insurance carrier with effective date from October 1, 2018 to June 30, 2019.

On August 1, 2017, the University presented to the Oversight Board of PROMESA its fiscal plan for the ensuing ten years. The fiscal plan included a series of expense reduction measures complemented with revenue enhancing initiatives, including tuitions hikes, which in the aggregate will add up to \$512 million in Commonwealth appropriations reductions by fiscal year 2026.

On August 26, 2017, the Oversight Board of PROMESA announced, through a letter from its Executive Director, that the University fiscal plan will not be certified as submitted above. The letter requested to the University Governing Board develop a new version of the fiscal plan correcting several deficiencies that the Oversight Board of PROMESA identified.

After the passages of Hurricane Irma and Maria in September 2017, the Oversight Board of PROMESA requested the University to submit a revised fiscal plan for the ensuing five years. On April 5, 2018 (as revised on September 7, 2018), the University submitted its revised fiscal plan for the fiscal years 2018 to 2023. On April 20, 2018 (as amended on June 29, 2018 and October 23, 2018), the Oversight Board of PROMESA certified its own University fiscal plan. For a more detail of the University fiscal plans, refer to the Going Concern Section.

On October 24, 2017, the Puerto Rico First Court of Instance issued a partial declaratory judgement ordering DUI to pay the retainage amount under the construction contract of about \$1.6 million, plus interest, to the Plaza Universitaria Project's general contractor. DUI appealed this partial declaratory judgement. On September 10, 2018, the Plaza Universitaria Project's general contractor, the University and DUI signed a settlement agreement in which the University and DUI committed to paid \$2,300,000 and \$1,550,000, respectively, for a total consideration of \$3,850,000. On September 11, 2018, the Puerto Rico First Court of Instance approved the settlement agreement. In November 2018, the University and DUI made the corresponding payments to the Plaza Universitaria Project's general contractor.

On May 15, 2017, the Puerto Rico Fiscal Agency and Financial Advisory Authority (FAFAA) and the Government Development Bank for Puerto Rico (GDB) entered into a Restructuring Support Agreement (the "RSA") with a significant portion of the GDB's creditors. The parties to the RSA agreed to undertake



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

a financial restructuring of the GDB pursuant to a Qualifying Modification under Title VI of PROMESA (the "Qualifying Modification"). On August 9, 2018, the GDB commenced the solicitation of votes on the Qualifying Modification and on August 10, 2018 commenced an action to obtain court approval of the Qualifying Modification. Following the conclusion of voting on September 12, 2018, the GDB announced that it received the necessary votes from holders of claims subject to the Qualifying Modification (the "Participating Bond Claims") to approve the Qualifying Modification, as required under PROMESA. On November 6, 2018, the Qualifying Modification was approved by the Federal Court. On November 29, 2019, the FAFAA and the GDB announced the consummation of the Qualifying Modification.

Under the Qualifying Modification, holders of Participating Bond Claims exchanged their Participating Bonds claims for bonds issued by a newly created public instrumentality, the GDB Debt Recovery Authority, and the GDB transferred to such entity its municipal loan portfolio, a portion of its public entity loan portfolio, its real estate owned assets and its unencumbered cash.

Pursuant to Act No. 109-2017, also known as the Government Development Bank for Puerto Rico Debt Restructuring Act (the "GDB Restructuring Act"), claims on account of deposits held by the Commonwealth and other public entities, including the University, will be exchanged for interest in the Public Entity Deed of Trust created pursuant to the GDB Restructuring Act. Specifically, pursuant to the GDB Restructuring Act, on the closing date of the Qualifying Modification (the "Closing Date"), the balance of liabilities owed between the Commonwealth and its agents, instrumentalities and affiliates, including the University (each a "Non-Municipal Government Entity") and the GDB will be determined by applying the outstanding balance of any deposits held at GDB in a Non-Municipal Government Entity's name against the outstanding balance of any loan of such Non-Municipal Government Entity owed to the GDB or of any bond or note of such Non-Municipal Government Entity held by the GDB as of such date. Those Non-Municipal Government Entities having net claims against the GDB, after giving effect to the foregoing adjustment, including the University, will receive their pro rata share of interests in the Public Entity Trust (PET), which will be deemed to be full satisfaction of any and all claims such Non-Municipal Government Entity may have against GDB. The assets of the PET (the "PET Assets") will consist of, among other items, a \$890 million claim against the Commonwealth, which is the subject of a proof of claim filed in the Commonwealth Title III case under PROMESA. A portion of the PET Assets will be transferred to the PET on the Closing Date and the remainder of the PET Assets, or any portion thereof, will be transferred to the PET in one or more transactions, as set forth in the Public Entity Deed of Trust (as defined in the GDB Restructuring Act). Under the GDB Restructuring Act, the transfer of the PET Assets by the GDB to the PET will be an irrevocable, non-voidable, and absolute transfer of all the GDB's legal and equitable right, title, and interest in the PET Assets.

As a result of the Qualifying Modification, on November 29, 2018, the credit facilities the University owed to the GDB (approximately \$88.1 million, including accrued interest, as of November 29, 2018) were fully offset on a dollar-for-dollar basis by the amount of the University's deposits held at the GDB (approximately \$94.6 million, including accrued interest, as of November 29, 2018) and such facilities were extinguished. The remainder of the University's recovery on account of its deposits at the GDB (approximately \$6.5 million) will depend upon the recovery received by the Public Entity Trust on account of the PET Assets.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

Capital Assets and Debt Administration

- **Capital assets, net, decreased by \$30.3 million or 3% in 2017**

Capital assets are comprised of buildings used to provide high quality education and create new knowledge in the Arts, Sciences and Technology and equipment and assets under capital lease. Significant capital assets additions for the year ended June 30, 2017, consisted mainly of renovation and rehabilitation of existing facilities, restoration of historic buildings, and modifications of existing facilities in light of new technology, educational standards and the requirements of modern building codes. Capital assets decreased by \$30.3 million or 3%, from \$896.8 million at June 30, 2016 to \$866.5 million at June 30, 2017. The decrease in 2017 mainly resulted from the depreciation and amortization expense of \$49.1 million and the capital asset dispositions of \$1.8 million, which effects were partially offset by the University's investment in construction projects and other capital assets for educational facilities that amounted to \$20.6 million. Construction commitments at June 30, 2017, entered into by the University, amounted to approximately \$62.6 million. Refer to Note 10 to the financial statements for further information regarding the University's net capital assets.

- **Long-term debt obligations decreased by \$25.4 million or 4% in 2017**

The decrease in 2017 mainly resulted from principal paid on long-term debt obligations of \$23.7 million and the amortization of bond premium of \$1.8 million.

Long-term debt obligations include the University's revenue bonds which amounted to \$427.1 million as of June 30, 2017. The University issued revenue bonds designated as "University System Revenue Bonds", the proceeds of which were used mainly to finance new activities in connection with its educational facilities construction program and to cancel and refinance previous debts incurred. These bonds are rated "C" by Moody's Investors Service (Moody's) and "CC" by Standard & Poor's Ratings Services (S&P). In addition, long-term debt obligations include the Desarrollos Universitarios, Inc's AFICA bonds (the "AFICA bonds") which amounted to \$64.0 million as of June 30, 2017. The AFICA bonds are rated "C" by Moody's and "CC" by S&P. The AFICA bonds were principally issued to finance the development, construction and equipment of the Plaza Universitaria Project (the Project), a residential and commercial facility for the use of students and other persons or entities conducting business with the University. In October 2007, the University entered into a capital lease agreement with Desarrollos Universitarios, Inc. for the use of Project. The lease payments from the University shall have a fixed component and a variable component. The fixed component shall be in an amount sufficient to guarantee to bondholders the payment of principal and interest on the AFICA Bonds as is established in the financing documents and is pledged to guarantee such payments. The variable component of the lease payments is used to cover operating, maintenance, administrative, management, and other fees and costs, which is 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 2010, the University obtained a \$100 million revolving line of credit facility with GDB for working capital purposes, which was increased to \$125 million in October 2011. This line of credit was converted into a ten-year term loan in October 2011 payable in monthly equal principal payments plus interest starting on October 1, 2013. The term loan is collateralized by the University's accounts receivable from the Commonwealth of Puerto Rico and its agencies as well as by the Commonwealth of Puerto Rico



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

income guaranteed appropriations under Act No. 2 of January 20, 1966, as amended. The University had not made the monthly payments of this term loan since May 2016. The University obtained a non-revolving line of credit with GDB, which was increased to \$75 million in August 2011, to complete certain construction projects of the University's Program for Permanent Improvements. The \$75.0 million line of credit expired on January 31, 2016 and the University had not made the monthly interest payments of this line of credit since September 2016. The balances outstanding under the term loan and the \$75 million line of credit with GDB amounted to \$48.3 million and \$28.1 million, respectively, at June 30, 2017. Accrued interest payable of the term loan and the \$75 million line of credit with the GDB amounted to approximately \$3.5 million and \$1.5 million, respectively, at June 30, 2017.

GDB faces significant risks and uncertainties and it currently does not have (and is not expected to have) sufficient liquid financial resources to meet its obligations in full. Pursuant to enacted legislation and executive orders by two separate government administrations, GDB has been ordered to suspend loan disbursements, to impose restrictions on the withdrawal and transfer of deposits from GDB and has been imposed a moratorium on its debt obligations, among other measures. On March 23, 2018, GDB ceased its operations and it is currently winding down in an orderly fashion under Title VI of PROMESA. Total amount deposited in the GDB amounted to approximately \$92.1 million as of June 30, 2017 and are deemed fully impaired. In May 2016, the Governing Board of the University authorized its president to cancel the term loan and the expired line of credit with the GDB using the University's funds deposited in the GDB. The University has not paid these credit facilities with GDB because it and the GDB have not reached an agreement to cancel these credit facilities or to determine how these credit facilities will be managed. Refer to the Subsequent Events Section for the offset of the credit facilities with the GDB, on a dollar-for-dollar basis, by the amount of the University's deposits held at the GDB on November 29, 2018.

The Trust Agreement required the University to comply with other covenants. At June 30, 2017, the University was not in compliance with the following covenants: maintain a required level of the reserve account balance equal to the maximum aggregate principal and interest requirements; provide its audited financial statements not later than six months after the end of each fiscal year; and provide an Officer's Certificate of No Defaults not later than 210 days after the end of each fiscal year. Also, the University and the Commonwealth did not file within 305 days after the end of each fiscal year, core financial information and operating data (including audited financial statements) for the prior year to each Nationally Recognized Municipal Securities Information Repository ("NRMSIR") and with any Commonwealth state information depository ("SID") in compliance with the requirements of Rule 15c2-12 ("Continuing Disclosures"), as amended, promulgated by the Securities and Exchange Commission (the SEC). The noncompliance of the required level of the reserve account noncompliance was cured with a payment of \$20 million made by the University to the Trustee on September 1, 2017, as explained below.

On June 30, 2016, the Governor of Puerto Rico signed EO 31 which established the following: (i) designated any of the University's obligations, pursuant to the Trust Agreement, dated June 1, 1971, as amended, to transfer Pledged Revenues (as such term is defined in the Trust Agreement) to the Trustee as an enumerated obligation (as such term is defined in Section 103 of the Act No. 21); and suspended such obligations of the University to transfer Pledged Revenues to the Trustee, and (ii) designated any obligation of the University pursuant to the Lease Agreement with DUI, dated December 21, 2010, as a covered obligation (as such term is defined in Section 103 of the Act No. 21); and suspended the payment of such obligation of the University. EO 31 did not suspend the payment obligations of the University with respect to any other obligation. In compliance with EO 31, the University suspended the monthly payments to the



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

trustee of the Trust Agreement that govern the University System Revenue Bonds and the monthly payments of the Lease Agreement with DUI from July 2016 to May 2017.

On August 5, 2016 and monthly thereafter until April 2017, the trustee of the DUI's AFICA Bonds notified to the University that it failed to make the basic lease payment to the trustee since July 25, 2016 and that a default under the lease agreement with DUI constitutes an event of default under the DUI's AFICA Bonds Trust Agreement. As such, the University was in default of this obligation until April 2017. The trustee was not seeking any indebtedness from, enforce any judgment, or obtain possession of, or exercise control over, any property of or from, the Commonwealth or any of its instrumentalities, including DUI and the University, or exercise any act that is stayed by PROMESA, the Act No. 21, the Moratorium Act, or the Executive Orders related thereto. In May 2017, the University reestablished the payments to the trustee of the DUI's AFICA Bonds (approximately \$475,000 monthly) and paid all the basic lease payments due from July 2016 until May 2017 (approximately \$5.2 million). Presently, DUI has paid as agreed the scheduled principal and interest payments on its outstanding AFICA Bonds.

On August 19, 2016, the U.S. Bank Trust National Association, in its capacity as Trustee for the University of Puerto Rico System Revenue Bonds (Series P and Q Bonds), filed a civil lawsuit under the United States Court, District of Puerto Rico against the Commonwealth and its Governor, the University and its President. The motion seeks relief from the stay of PROMESA, or Executive Orders related thereto, and a preliminary injunction against the Commonwealth's diversion and expropriation of pledged revenues, which constitute the University's Bonds collateral. On June 29, 2017, the Trustee and the University, at the direction of FAFAA, entered into a letter agreement providing that the University will transfer certain amounts in respect of pledged revenue, as defined in the trust agreement, to the Trustee on condition, among others, that through August 31, 2017 (the Compliance Period) the Trustee not institute, commence, or continue certain legal proceedings against the University, the Commonwealth or any other agency, instrumentality, or municipality thereof during the Compliance Period, except in certain enumerated circumstances. As agreed in the letter agreement, the University paid \$20 million on June 30, 2017 and an additional \$20 million on September 1, 2017 and continued to pay monthly to the trustee the \$4 million of pledged revenues until May 2018. The University commits to transfer to the Trustee, to hold or make payments or distributions as provided under the trust agreement, in lieu of the transfer of an equivalent amount of the pledged revenues received by the University from the date hereof through August 31, 2017 as provided in the trust agreement.

The letter agreement has been extended eight times and the new Compliance Period is December 31, 2018. Pursuant to the letter agreement and the eight standstill extension agreements, during the compliance period, holders of the majority in amount of the bonds and the Trustee at the direction of the University's bondholders will negotiate in good faith towards a restructuring of the bonds. In addition, the trustee agreed not to institute or commence certain legal proceedings and the University agreed to transfer \$4 million monthly until May 2018 to the trustee to be applied in accordance with the trust agreement governing the Series P and Q Bonds during the new Compliance Period.

In consideration for extending the new Compliance Period until December 31, 2018, the University agreed to transfer to the Trustee to hold or make payments or distributions as required under the Trust Agreement as follows: \$4.0 million of the June 2018 Payment on or before July 15, 2018; \$2.0 million of the July 2018 Payment on or before August 5, 2018; \$3.0 million of the August 2018 Payment on or before August 25, 2018; \$2.3 million of the September 2018 Payment on or before September 25, 2018; \$2.3 million of the



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

October 2018 Payment on or before October 25, 2018; \$3.0 million of the November 2018 Payment on or before November 25, 2018; and \$3.0 million of the December 2018 Payment, less a credit for any amount as of November 30, 2018 in the Trustee's Bond Service Account and Reserve Account that is, in the aggregate, in excess of \$68,606,318, on or before December 25, 2018. Discussions with respect to a consensual restructuring of the University's bonds are continuing. Presently, the University has paid as agreed the scheduled principal and interest payments on its outstanding Series P and Q Bonds and has complied with the letter agreement, as extended, with the Trustee.

Refer to Notes 2, 9, 11, 12, 13, and 20 to the basic financial statements for further information regarding the University's long-term debt obligations.

Economic Outlook

The University's operational and academic activities are conducted in Puerto Rico, which in recent years has been experiencing a deep economic recession and a government fiscal and liquidity crisis. The University's operating results are mainly funded by nonoperating revenues mainly from the Commonwealth of Puerto Rico appropriations and from the United States of America Government grants and contracts (Federal Pell Grant Program). Therefore, the University's operations and financial condition may be adversely affected by an extended economic slowdown, adverse political, fiscal or economic developments in Puerto Rico or the effects of a natural disaster.

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.

The dominant sectors of the Commonwealth's economy are manufacturing and services. The manufacturing sector has undergone fundamental changes in recent years as a result of the elimination of certain tax incentives under the U.S. Tax Code and an increased concentration in higher-wage, high-technology industries, such as pharmaceuticals, computer products, biotechnology, professional and scientific instruments, and certain high technology machinery and equipment. The service sector, which includes finance, insurance, real estate, wholesale and retail trade, transportation, communications and public utilities and other services, leads all sectors in providing employment.

The Puerto Rico economy has been in a recession since 2006, and the Commonwealth's gross national product has contracted (in real terms) almost every fiscal year between 2007 and 2017. The Commonwealth has been unable to spur economic growth and eliminate the recurrent excess of expenditures over revenues.

The Commonwealth government currently faces a severe fiscal and liquidity crisis as a result of many years of significant budget deficits, among other factors. There has been an overall contraction in sectors of Puerto Rico's economy, principally within the manufacturing and construction sectors, coupled with declines in retail sales, budget shortfalls and diminished consumer buying power resulting in higher costs of living.

Economic activity is expected to be constrained as a result of anticipated severe austerity measures and continued increasing migration trends. A further deterioration in local economic conditions or in the



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

financial condition of an industry on which the local market depends could adversely affect factors such as unemployment rates and real estate vacancy and values.

The Commonwealth is in the midst of a profound fiscal, economic and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations and inability to access the credit markets at reasonable interest rates. Further stressing the Commonwealth's liquidity is the vulnerability of revenue streams during times of major economic downturns and large health care, pension and debt service costs. As the Commonwealth's tax base has shrunk and its revenues affected by prevailing economic conditions, health care, pension and debt service costs have become an increasing portion of the Commonwealth's General Fund budget, which has resulted in reduced funding available for other essential services, including appropriations to the University. The Commonwealth's high level of debt and unfunded pension liabilities and the resulting required allocation of revenues to service debt and pension obligations have contributed to significant budget deficits during the past several years, which deficits the Commonwealth has financed, further increasing the amount of its debt. Additionally, the Commonwealth is currently restructuring its obligations in an orderly fashion under Title III of PROMESA. This voluntary petition under Title III of PROMESA operates as an automatic stay of actions against the Commonwealth.

The University is highly dependent on the Commonwealth's appropriations to finance its operations. The financial difficulties being experienced by the Commonwealth have significant adverse impacts on the University, given its reliance on Commonwealth's appropriations and lack of available funding alternatives at reasonable interest rates. The Approximately 67% of the University's total revenues are derived from the Commonwealth's appropriations which amounted to approximately \$934.4 million for the year ended June 30, 2017. Moreover, the University has limited ability to raise operating revenues due to the economic and political related challenges of maintaining enrollment and increasing tuition.

The University fiscal plan for the fiscal years 2018 to 2023 certified by the Oversight Board of PROMESA on October 23, 2018 includes the approved projected reductions in the Commonwealth's formula appropriations that which would rise annually from approximately \$203 million in fiscal year 2018 to approximately \$478 million in fiscal year 2023. Commonwealth approved formula appropriations will range from \$631 million in fiscal year 2018 to \$383 million in fiscal year 2023.

Given the high dependency of the University on the Commonwealth appropriations and lack of available financing sources at reasonable interest rates, the University's financial condition and liquidity is being adversely affected. There can be no assurance that the Commonwealth will be able to continue to provide adequate appropriations or funding alternatives or that the affiliated or unaffiliated creditors will be able and willing to refinance or modify the terms of the University's obligations, that management's current plans to repay or refinance the obligations or extend their terms will be achieved or that certain services will not have to be terminated, curtailed or modified.

On September 6, 2017, Hurricane Irma did some damages to the island of Puerto Rico and then on September 20, 2017, the island of Puerto Rico suffered the complete devastation caused by Hurricane Maria, causing catastrophic wind and water damage to Puerto Rico's infrastructure, home and businesses.

As a result of the Hurricane Maria, most of the island's population was left without electrical power and there was significant disruption to the water distribution system. Other basic utility and infrastructure



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

services such as communications, ports and transportation were also materially affected, causing a significant disruption to the island's economic activity. The entire island of Puerto Rico will need a massive infrastructure rebuilding program.

Immediately after the landfall of the Hurricane Maria on Puerto Rico, the President of the United States of America issued a state of emergency declaration for Puerto Rico, as a U.S territory. The order mandates federal assistance through the Department of Homeland Security and the Federal Emergency Management Agency (FEMA) be made available to assist in local and territorial recovery efforts.

Some of the University's eleven campuses were more affected than others, but all were impacted in some way. A few days after Hurricane Maria, many of the University employees, as well as students and other volunteers, returned to the campuses and to the University's central Administration to begin the rebuilding process. At the end of October and the beginning of November 2017, administrative and academic functions had resumed at basically all areas and units that comprise the University System.

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 and the University's liquidity, which could have an adverse effect on the University's financial position or changes in its net position.

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



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Statements of Net Position (Deficit)
As of June 30, 2017 and 2016 (In thousands)

	2017		2016	
	Primary Government	Component Units	Primary Government	Component Units
Assets				
Current assets:				
Cash and cash equivalents	\$ 290,644	\$ 16,678	\$ 182,539	\$ 14,936
Restricted cash and cash equivalents	13,494	-	2,731	-
Restricted investments at fair value deposited with trustees and others	45,436	-	69,148	-
Accounts receivable, net	17,001	10,990	15,690	9,965
Due from Federal Government, net	33,584	1,014	32,449	1,475
Due from related parties, net:				
Commonwealth of Puerto Rico (Commonwealth)	3,594	-	4,719	-
Commonwealth's component units	7,516	-	6,705	-
University of Puerto Rico Retirement System	53	-	14	-
University of Puerto Rico	-	8,963	-	10,327
Others	1,809	-	1,098	-
Inventories	2,882	661	2,832	440
Other assets	1,781	372	3,521	408
Total current assets	417,794	38,678	321,446	37,551
Noncurrent assets:				
Restricted cash and cash equivalents	9,220	-	6,630	-
Restricted investments at fair value:				
Endowment funds	103,482	-	99,860	-
Healthcare Deferred Compensation Plan	93,011	-	87,678	-
Other long-term investments at fair value	3,030	-	2,632	-
Due from Commonwealth	-	243	-	236
Notes receivable, net	5,125	-	6,232	-
Capital assets (net of accumulated depreciation and amortization):				
Land and other nondepreciable assets	59,743	1,071	56,190	1,810
Depreciable assets	806,714	8,735	840,653	7,938
Other assets	640	-	496	-
Total noncurrent assets	1,080,965	10,049	1,100,371	9,984
Total assets	1,498,759	48,727	1,421,817	47,535
Deferred outflows of resources:				
Deferred refunding loss	1,943	-	2,225	-
Deferred outflows from pension activities	220,168	-	102,379	-
Total deferred outflows of resources	222,111	-	104,604	-
Total assets and deferred outflows of resources	1,720,870	48,727	1,526,421	47,535
Liabilities				
Current liabilities:				
Accounts payable and accrued liabilities	82,007	5,394	64,830	6,542
Current portion of long-term debt:				
Notes payable	76,406	2,557	76,781	2,586
Bonds payable	24,455	-	23,280	-
Due to University of Puerto Rico	-	21,304	-	21,983
Other current liabilities:				
Claims liability	1,170	-	2,494	-
Compensated absences	26,272	731	27,049	767
Total current liabilities	210,310	29,986	194,434	31,878
Noncurrent liabilities:				
Long-term debt, net of current portion:				
Notes payable	-	17,627	-	19,307
Bonds payable	466,700	-	492,892	-
Other long-term liabilities, net of current portion:				
Deferred compensation plan	93,011	-	87,678	-
Claims liability	12,127	1,544	19,783	1,426
Compensated absences	119,431	-	127,755	-
Net pension liability	2,006,703	-	1,796,727	-
Other postemployment benefit obligation	14,153	-	8,578	-
Total noncurrent liabilities	2,712,125	19,171	2,533,413	20,733
Total liabilities	2,922,435	49,157	2,727,847	52,611
Deferred inflows of resources from pension activities	172,913	-	301,418	-
Total liabilities and deferred inflows of resources	3,095,348	49,157	3,029,265	52,611
Net position (deficit):				
Net investment in capital assets	390,426	281	393,465	297
Restricted, nonexpendable:				
Scholarships and fellowships	48,830	-	42,758	-
Research	48,708	-	51,046	-
Other	17,642	-	13,793	-
Restricted, expendable:				
Loans	8,058	-	7,649	-
Capital projects	18,360	-	10,960	-
Debt service	32,631	-	56,210	-
Unrestricted (deficit)	(1,939,133)	(711)	(2,078,725)	(5,373)
Total net position (deficit)	\$ (1,374,478)	\$ (430)	\$ (1,502,844)	\$ (5,076)

See accompanying notes to financial statements.



University of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Statements of Revenues, Expenses and Changes in Net Position (Deficit)
For the Years Ended June 30, 2017 and 2016 (In thousands)

	2017		2016	
	Primary Government	Component Units	Primary Government	Component Units
Revenues				
Operating revenues:				
Tuitions and fees (net of scholarship allowances and others of \$60,780 in 2017 and \$58,246 in 2016)	\$ 47,666	\$ —	\$ 48,476	\$ —
Net patient services revenue and other (net of provision for allowances of \$4,949 in 2017 and \$14,724 in 2016)	75,801	46,881	61,830	44,985
Federal grants and contracts (net of provision for allowances of \$188 in 2017 and \$3,234 in 2016)	90,337	—	95,476	—
Commonwealth grants and contracts (net of provision for allowances of \$13,045 in 2017 and \$6,974 in 2016)	6,204	—	11,399	—
Nongovernmental grants and contracts (net of provision for allowances of \$2,094 in 2017 and \$10,415 in 2016)	9,917	—	2,565	—
Sales and services of educational departments	11,565	—	11,968	—
Auxiliary enterprises (net of provision for (credit to) allowances of (\$332) in 2017 and \$290 in 2016)	2,128	—	1,925	—
Other operating revenues	9,914	3,455	12,714	3,215
Total operating revenues	253,532	50,336	246,353	48,200
Operating expenses:				
Salaries:				
Faculty	370,553	—	361,322	—
Exempt staff	238,668	4,641	245,134	4,725
Nonexempt wages	599	9,601	1,006	9,692
Benefits:				
Pension cost (credit) (see Note 15)	42,650	—	(49,350)	—
Other benefits	152,547	2,830	143,324	2,278
Scholarships and fellowships	193,434	—	185,522	—
Supplies and other services	142,729	22,782	140,879	22,638
Utilities	38,901	2,386	37,162	2,296
Depreciation and amortization	49,111	1,861	47,906	1,770
Other expenses	9,134	953	23,378	663
Total operating expenses	1,238,326	45,054	1,136,283	44,062
Operating income (loss)	(984,794)	5,282	(889,930)	4,138
Nonoperating revenues (expenses):				
Commonwealth and other appropriations	934,418	—	932,503	—
Federal Pell Grant program	189,364	—	178,729	—
Gifts	8,337	—	9,265	—
Net investment income	6,488	3	5,869	4
Impairment loss on deposits with governmental bank (note 5)	—	—	(69,807)	—
Impairment loss on capital assets	—	—	(1,245)	—
Interest on capital assets - related debt	(25,068)	(639)	(25,318)	(670)
Interest on notes payable	(2,897)	—	(3,047)	—
Other nonoperating revenues (expenses), net	2,509	—	538	133
Net nonoperating revenues (expenses)	1,113,151	(636)	1,027,487	(533)
Income before other revenues	128,357	4,646	137,557	3,605
Capital appropriations				
Additions to term and permanent endowments	9	—	30	—
Change in net position	128,366	4,646	137,587	3,605
Net position (deficit):				
Beginning net position (deficit)	(1,502,844)	(5,076)	(1,640,431)	(8,681)
End of year	\$ (1,374,478)	\$ (430)	\$ (1,502,844)	\$ (5,076)

See accompanying notes to financial statements.



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

	Primary Government	
	For the Years Ended June 30:	
	2017	2016
Cash flows from operating activities		
Tuition and fees	\$ 48,548	\$ 49,276
Grants and contracts	104,490	127,154
Patient services	75,574	71,107
Payments to employees	(610,084)	(606,687)
Payments for benefits	(221,931)	(255,564)
Payments for scholarships and fellowships	(193,434)	(185,522)
Payments to suppliers	(153,559)	(157,297)
Payments for utilities	(38,664)	(36,854)
Loans issued to students, net of collections	27	(235)
Auxiliary enterprises	1,818	2,249
Sales and services educational departments and others	21,723	25,933
Other receipts (payments)	75	(64)
Net cash used in operating activities	(965,417)	(966,504)
Cash flows from noncapital financing activities		
Commonwealth and other appropriations	934,418	952,503
Federal Pell Grant program	189,364	178,729
Endowment gifts	9	30
Principal paid on noncapital debt	-	(6,241)
Interest paid on notes payable	-	(2,649)
Federal direct student loan program receipts	52,758	51,084
Federal direct student loan program disbursements	(52,773)	(51,084)
Gifts and grants for other than capital purposes	8,336	9,265
Other non-operating receipts	3,156	538
Net cash provided by noncapital financing activities	1,135,268	1,132,175
Cash flows from capital and related financing activities		
Purchases of capital assets	(20,552)	(28,006)
Proceeds from capital debt	-	220
Principal paid on capital debt	(23,655)	(22,694)
Interest paid on capital debt	(25,199)	(27,888)
Decrease (increase) in deposits with trustees and others	23,711	(611)
Net cash used in capital and related financing activities	(45,695)	(78,979)
Cash flows from investing activities		
Proceeds from sales and maturities of investments	35,369	62,157
Purchases of investments	(41,891)	(107,277)
Collections of interest and dividend income on investments	3,743	4,659
Advances to the University of Puerto Rico Retirement System	(53)	-
Repayments of advances to the University of Puerto Rico Retirement System	14	38,607
Contribution from component unit	1	640
Other receipts	119	29
Net cash used in investing activities	(2,698)	(1,185)
Net change in cash and cash equivalents	121,458	85,507
Cash and cash equivalents:		
Beginning of year	191,900	106,393
End of year	\$ 313,358	\$ 191,900

(Continued)



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

Primary Government
For the Years Ended June 30:
2017 2016

**Reconciliation of operating loss to net cash used
in operating activities:**

Operating loss	\$ (984,794)	\$ (889,930)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	49,111	47,906
Provision for doubtful accounts	17,872	36,080
Changes in operating assets and liabilities and deferred outflows and inflows of resources:		
Decrease (increase) in:		
Grants and contracts receivables	(19,531)	(5,365)
Prepaid expenses, inventories and other	2,704	3,280
Deferred outflows of resources from pension activities	(117,789)	(14,128)
Increase (decrease) in:		
Accounts payable and accrued liabilities	(4,181)	3,114
Accrued salaries, wages, benefits and other liabilities	9,720	(34,428)
Net pension liability	209,976	(307,313)
Deferred inflows of resources from pension activities	(128,505)	194,280
Net cash used in operating activities	<u>\$ (965,417)</u>	<u>\$ (966,504)</u>

**Supplemental schedule of noncash investing, capital and
financing activities:**

Changes in fair value of investments	<u>\$ 2,831</u>	<u>\$ 1,362</u>
Amortization of:		
Bonds premiums, net of discounts	<u>\$ 1,781</u>	<u>\$ 1,780</u>
Deferred refunding loss	<u>\$ 292</u>	<u>\$ 292</u>
Impairment loss on deposits with governmental bank (note 5)	<u>\$ -</u>	<u>\$ 69,807</u>

See accompanying notes to basic financial statements.



University of Puerto Rico
Notes to Financial Statements
June 30, 2017

1. Reporting Entity and Summary of Significant Accounting Policies

Reporting Entity

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

The University is a public corporation of the Commonwealth of Puerto Rico (the Commonwealth) governed by a fourteen-member Governing Board, of which eight members are appointed by the Governor of Puerto Rico and confirmed by the Senate of Puerto Rico. The remaining members of the Governing Board consist of two tenured professors and two full-time students. The Secretary of the Department of Education of the Commonwealth and a member of the Puerto Rico Fiscal Agency and Financial Advisory Authority become ex-officio members of the Governing Board. The Governor appointed the original members for a term of six years. The terms for the students 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 University system includes all the campuses at Río Piedras, Mayagüez, Medical Sciences, Cayey, Humacao, Ponce, Bayamón, Aguadilla, Arecibo, Carolina and Utuado, and the Central Administration.

The financial reporting entity consists of the University and its Component Units which are legally separate organizations for which the University is financially accountable. The University of Puerto Rico consists of the University and its blended component unit (hereafter referred as the University). The definition of the reporting entity is based primarily on the notion of financial accountability. The University is financially accountable for the organizations that make up its legal entity. It is also financially accountable for legally separate organizations if its officials appoint a voting majority of an organization’s governing body and either it is able to impose its will on that organization or there is a potential for the organization to provide specific financial benefits to, or to impose specific financial burdens on the University. The University may also be financially accountable for organizations that are fiscally dependent on it if there is a potential for the organizations to provide specific financial benefits to the University or impose specific financial burdens on the University regardless of whether the organizations have separate elected governing boards, governing boards appointed by higher levels of government or jointly appointed boards. The University is financially accountable for all of its Component Units.

Most Component Units are included in the financial reporting entity by discrete presentation. One of the component units, despite being legally separate from the University, is so integrated with the University that it is in substance part of the University. This component unit is blended with the University.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

Reporting Entity (continued)

Blended Component Unit: The following component unit, although legally separate, is reported as if it was part of the University because its debt is expected to be repaid entirely or almost entirely with resources of the University:

Desarrollos Universitarios, Inc.

Desarrollos Universitarios, Inc. (“DUI”) is a legally separate entity from the University and a nonstock corporation that is governed by a separate board. DUI was organized on January 22, 1997, under the laws of the Commonwealth of Puerto Rico, as a not-for-profit organization. DUI 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. DUI developed the Plaza Universitaria Project, which consists of a student housing facility, a multi-story parking building and an institution 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 DUI for the Plaza Universitaria project which was assigned to the AFICA bonds. DUI is fiscally dependent on the University and its debt is expected to be repaid entirely or almost entirely with resources of the University. Complete financial statements of DUI can be obtained directly by contacting DUI’s administrative offices.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

Reporting Entity (continued)

Desarrollos Universitarios, Inc. (continued)

Condensed financial information as of June 30, 2017 and 2016 and for the fiscal years then ended for DUI is as follows (expressed in thousands):

	<u>2017</u>	<u>2016</u>
Statements of net position as of June 30		
Current assets:		
Cash and cash equivalents	\$ 1,324	\$ 813
Restricted investments at fair value deposited with trustee	14,657	14,281
Internal balance- net investment in direct financing lease, current portion	2,321	2,185
Due from the University of Puerto Rico	1,532	1,889
Other assets	14	100
Total current assets	<u>19,848</u>	<u>19,268</u>
Noncurrent assets:		
Restricted cash and cash equivalents	2,279	2,347
Internal balance- net investment in direct financing lease, net of current portion	53,273	55,594
Other assets	238	239
Total noncurrent assets	<u>55,790</u>	<u>58,180</u>
Total assets	<u>\$ 75,638</u>	<u>\$ 77,448</u>
Current liabilities:		
Accounts payable and accrued liabilities	\$ 4,681	\$ 4,635
Current portion of long-term debt bonds payable	2,445	2,315
Total current liabilities	<u>7,126</u>	<u>6,950</u>
Noncurrent liabilities- long-term debt, net of current portion of bonds payable	61,578	64,010
Total liabilities	<u>\$ 68,704</u>	<u>\$ 70,960</u>
Net position:		
Restricted expendable:		
Capital project	\$ 2,394	\$ 2,299
Debt service	7,512	7,071
Unrestricted (deficit)	<u>(2,972)</u>	<u>(2,882)</u>
Total net position	<u>\$ 6,934</u>	<u>\$ 6,488</u>



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

Reporting Entity (continued)

Desarrollos Universitarios, Inc. (continued)

	2017	2016
Statements of revenues, expenses and changes in net position for the years ended June 30		
Operating revenues	\$ 3,546	\$ 3,789
Operating expenses	(3,580)	(3,616)
Operating income	(34)	173
Non operating revenues (expenses):		
Interest on capital assets - related debt	(3,402)	(3,413)
Interest income from internal balance investment in direct financing lease	3,517	3,648
Net investing income	365	436
Total nonoperating revenues (expenses)	480	671
Change in net position	446	844
Net position:		
Beginning of year	6,488	5,644
End of year	\$ 6,934	\$ 6,488

	2017	2016
Statements of cash flows for the years ended June 30		
Net cash used in operating activities	\$ 255	\$ (157)
Net cash provided by noncapital financing activities	-	-
Net cash used in capital and related financing activities	(6,013)	(6,098)
Net cash provided by investing activities	6,201	6,180
Net decrease in cash and cash equivalents	443	(75)
Cash and cash equivalents:		
Beginning of year	3,160	3,235
End of year	\$ 3,603	\$ 3,160



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

Reporting Entity (continued)

Discretely Presented Component Units: All discretely presented component units are legally separate from the University. These entities are reported as discretely presented component units because the University appoints a majority of these organization's boards, is able to impose its will on them, or a financial benefit/burden situation exists. They include the following:

Servicios Médicos Universitarios, Inc.

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

University of Puerto Rico Parking System, Inc.

University of Puerto Rico Parking System, Inc. ("UPRPS") is a legally separate entity from the University and a nonstock corporation that is governed by a separate board. UPRPS was organized on May 5, 2000, under the laws of the Commonwealth of Puerto Rico, as a not-for-profit organization. UPRPS was organized to operate the parking facilities of the University system. UPRPS operates the parking facilities of the Medical Sciences and Rio Piedras campuses. The University appoints a voting majority of UPRPS board and is also financially accountable for UPRPS. UPRPS's assets, liabilities, revenues, expenses and changes in its net position were not significant as of and for the year ended June 30, 2017. Complete financial statements of UPRPS can be obtained directly by contacting the UPRPS's administrative offices.

Materials Characterization Center, Inc.

Materials Characterization Center, Inc. ("MCC") is a legally separate entity from the University and a nonstock corporation that is governed by a separate board. MCC was organized on April 15, 1999, under the laws of the Commonwealth of Puerto Rico, as a not-for-profit organization. MCC was organized to provide a much-needed accessible and reliable center to chemically and physically characterize materials from the pharmaceutical as well as other manufacturing endeavors. MCC is administrated in conjunction with the College of Natural Sciences of the Río Piedras Campus of the University. The University appoints a voting majority of MCC board and is also financially accountable for MCC. MCC's assets, liabilities, revenues, expenses and changes in its net position were not significant as of and for the year ended June 30, 2017. Complete financial statements of MCC can be obtained directly by contacting the MCC's administrative offices.

The financial statements of the discretely presented component units have a June 30 year-end, except for MCC, which has a December 31 year-end.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

Reporting Entity (continued)

Refer to Note 3 for the combining financial information of the discretely presented component units as of June 30, 2017 and 2016 and for the fiscal years then ended.

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

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*, an Amendment of GASB Statement No. 34. Accordingly, the University's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. All significant transactions related to internal service activities such as publications, telecommunications and institutional computing have been eliminated, where appropriate.

Estimates and Assumptions

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, deferred outflows of resources, liabilities and deferred inflows of resources, 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.

Cash Equivalents

Cash equivalents include all highly liquid debt instruments with original maturities of three months or less from the date of acquisition.

Investments

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

Donated investments are recorded at their fair value at the date of donation. Investments of the Deferred Compensation Plan are valued at fair value, except for nonparticipating guaranteed investment contracts and money investments which are carried at cost.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

Restricted Cash, Cash Equivalents and Investments

Restricted cash, cash equivalents and investments includes funds restricted for capital expenditures or set aside for payments to bondholders because their use is limited by applicable bond covenants; 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; funds that the University is legally or contractually obligated to spend in accordance with restrictions imposed by external source or entity such as: creditors, laws or regulations of other governments, or by constitutional provisions or enabling legislation; and funds held in escrow based on terms and conditions of various agreements, among others.

Receivables

Accounts receivable consists of tuition and fee charges to students and auxiliary enterprise services provided to students, faculty and staff. This also includes amounts due from the federal government, state and local governments or private sources in connection with reimbursement of allowable expenditures made pursuant to the University's sponsored agreements. In addition, accounts receivable includes unpaid medical services provided by the faculty members of the Medical Sciences Campus (MSC) of the University to the Commonwealth's health reform program patients; contracted services provided by the faculty members of the MSC to a component unit of the Commonwealth and to SMU; and unremitted distributions of income to be received by the University from a component unit of the Commonwealth under the Gambling Law by virtue of Act No. 36 of 2005.

Other receivables mainly consist of due from Commonwealth which includes unremitted Commonwealth formula appropriations by virtue of Act No. 2 of January 20, 1966, as amended; due from the University Retirement System which includes unpaid advances given to the Retirement System; and notes receivable which includes Federal program and institutional loans.

Receivables are stated net of estimated allowances for uncollectible accounts. The University maintains an allowance for doubtful accounts for estimated losses inherent in its accounts receivable based on type of receivables and expectations of repayment. In establishing the required allowance, management considers one or more of the following: type of receivables, Commonwealth guidelines, historical losses adjusted to consider current market conditions, the amounts of receivable in dispute, the current receivables aging, and current payment patterns. The University has significant amounts receivable from the Commonwealth's and its instrumentalities. There is significant uncertainty regarding the collection of such receivables due to the financial challenges these entities are facing. The University has considered this in its estimate of the specific governmental allowance for uncollectible accounts and fully reserved for all receivables from the Commonwealth and its affiliated entities that have not been collected in the twelve months period post the balance sheet date. The University reviews its allowance for doubtful accounts annually. Past due balances over a specified amount are reviewed individually for collectability. Because of uncertainties inherent in the estimation process, management's estimate of credit losses inherent in the existing accounts receivable and related allowance may change in the future.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

Interfund Balances and Transactions

Interfund receivable and payable balances and transactions have been eliminated from the basic financial statements.

Inventories

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

Capital Assets

All capital expenditures of \$5,000 (\$1,000 before July 1, 2014) 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.

Impairment of Capital Assets

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 University are reported at the lower of carrying value or fair value. Impairment charges amounted to approximately \$1,245,000 for the year ended June 30, 2016. In fiscal year 2017, no impairment loss was incurred.

Debt Issuance Costs, Debt Premiums/Discounts and Deferred Loss on Debt Refunding

Debt issuance costs are presented as expense during the year they are incurred. Premium and discounts incurred in the issuance of bonds are deferred and amortized using the effective interest method. DUI amortizes bond premium and/or discount using a method which approximates the effective interest method.

For debt refunding, the excess of reacquisition cost over the carrying value of long-term debt is recorded as a deferred outflow of resources and amortized to operating expenses using the effective interest method over the remaining life of the original debt or the life of the new debt, whichever is shorter.

Bonds payable are reported net of applicable bond premium or discount.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

Deferred Compensation Plan

The University offered to certain employees of the Medical Sciences Campus 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, which is managed by independent plan administrators, permits certain employees to defer a portion of their salary until future years. At the participant's election, such amounts may be invested in mutual funds and other securities, which represent varying levels of risk and return. The deferred compensation is not available to participants 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 participant or other beneficiary) solely the property and rights of the University, subject only to the claims of the University's general creditors in the event of the University's insolvency, as defined in the Trust Agreements. 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.

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 up to a maximum of 60 days. Employees accumulate sick leave generally at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, termination or death, an employee receives compensation for all accumulated unpaid vacation leave at the current rate regardless of years of service; and for all accumulated unpaid sick if the employee has at least 10 years of service with the University. Accrued compensated absences liabilities include an additional amount for salary-related payments directly and incrementally associated with the payment of compensated absences.

Deferred Outflows and Inflows of Resources

In addition to assets, the Statement of Net Position reports a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents an increase in net position (a consumption of assets) applicable to a future period(s) and so will *not* be recognized as an outflow of resources (expense) until then. Similarly, the University reports deferred inflows of resources in the Statement of Net Position in a separate section following Liabilities. This separate financial statement element, *deferred inflows of resources*, represents a reduction of net position and resources (an acquisition of assets) applicable to a future period(s) and so will *not* be recognized as an inflow of resources (revenue) until that time.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

Classification of Net Position

The University's net position is classified as follows:

- *Net investment in capital assets component of net position* consists of capital assets, net of accumulated depreciation, reduced by outstanding debt obligations that are attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt are required to be included in this component of net position. To the extent proceeds from issuance of debt have been received but not yet expended for capital assets or deferred inflow of resources attributable to the unspent amount, such amounts are not included as a component of net investment in capital assets.
- *Restricted, nonexpendable component of net position* consists of restricted, nonexpendable assets reduced by liabilities and deferred inflows of resources related to those assets. Restricted, nonexpendable assets include endowment and similar type funds which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity and invested for the purpose of producing present and future income, which may either be expended or added to principal.
- *Restricted, expendable component of net position* consists of restricted, expendable assets reduced by liabilities and deferred inflows of resources related to those assets. Restricted, expendable assets include resources that the University is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.
- *Unrestricted component of net position* is the net position amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of the net investment in capital assets or restricted components of net position. It represents 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 position may be designated for specific purposes by action of management or the Governing Board, they are available for use, at the discretion of the Governing Board, to meet current expenses for any purpose.

Classification of Revenues

The University and its component units have classified their 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. Nonoperating 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, such as Commonwealth appropriations, investment income and gifts. Gifts to the endowment fund are classified as other nonoperating revenues.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

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 position. 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.

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.

Grants and Contracts

The University has been awarded grants and contracts for which the funds have not yet 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 is 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.

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, and are not recorded as assets until the related gift has been received. Unconditional promises that are expected to be collected in future years are recorded at the present value of the estimated future cash flows.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

Pension

Pension cost is recognized and disclosed using the accrual basis of accounting. The University recognizes a net pension liability for its qualified pension plan, which represents the excess of the total pension liability over the fiduciary net position of the qualified pension plan, measured as of the University's prior year-end. Changes in the net pension liability during the period are recorded as pension expense, or as deferred inflows of resources or deferred outflows of resources depending on the nature of the change, in the period incurred. Those changes in net pension liability that are recorded as deferred inflows of resources or deferred outflows of resources that arise from changes in actuarial assumptions or other inputs and differences between expected or actual experience are amortized over the average of the remaining service life of all participants including retirees, in the qualified pension plan and recorded as a component of pension expense beginning with the period in which they arose. Projected earnings on qualified pension plan investments are recognized as a component of pension expense. Differences between projected and actual investment earnings are reported as deferred inflows of resources or deferred outflows of resources and amortized as a component of pension expense on a closed basis over a five-year period beginning with the period in which the difference occurred. Employer's contributions made after the measurement date of the net pension liability are recorded as a deferred outflow of resources.

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information of the fiduciary net position of the University of Puerto Rico Retirement System and additions to/deductions from the employees pension plan's fiduciary net position have been determined on the same basis as they are reported by the University of Puerto Rico Retirement System. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms.

Postemployment Benefits Other Than Pensions

Other postemployment benefits ("OPEB") are measured and disclosed using the accrual basis of accounting. Annual OPEB cost should be equal to the annual required contributions to the OPEB plan, calculated in accordance with certain parameters.

New Accounting Standards Adopted

In fiscal year 2017, the University adopted the following new statements of financial accounting standards issued by the GASB:

- GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68* (GASB Statement No. 73).
- GASB Statement No. 77, *Tax Abatement Disclosures* (GASB Statement No. 77).
- GASB Statement No. 80, *Blending Requirements for Certain Component Units- an Amendment of GASB Statement No. 14* (GASB Statement No. 80).
- GASB Statement No. 82, *Pension Issues- an Amendment of GASB Statements No 67, No. 68, and No. 73* (GASB Statement No. 82).



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

New Accounting Standards Adopted (continued)

GASB Statement No. 73 establishes requirements for defined benefit pension plans and defined contribution plans that are not within the scope of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* (GASB Statement No. 68). This Statement extends the approach to accounting and financial reporting established in GASB Statement No. 68 to all pensions to reflect that for accounting and financial reporting purposes, any assets accumulated for pensions that are provided through pension plans that are not administered through trusts that meet the criteria specified in GASB Statement No. 68, should not be considered pension plan assets. It also requires that information similar to that required by GASB Statement No. 68 be included in notes to financial statements and required supplementary information by all similarly situated employers and nonemployer contributing entities. The adoption of this statement had no impact on the University's financial statements.

GASB Statement No. 77 establishes financial reporting standards for tax abatement agreements entered into by state and local governments. The disclosures required by this Statement encompass tax abatements resulting from both (a) agreements that are entered into by the reporting government and (b) agreements that are entered into by other governments and that reduce the reporting government's tax revenues. The provisions of this Statement should be applied to all state and local governments subject to such tax abatement agreements. For financial reporting purposes, a tax abatement is defined as a reduction in tax revenues that results from an agreement between one or more governments and an individual or entity in which (a) one or more governments promise to forgo tax revenues to which they are otherwise entitled and (b) the individual or entity promises to take a specific action after the agreement has been entered into that contributes to economic development or otherwise benefits the governments or the citizens of those governments. A transaction's substance, not its form or title, is a key factor in determining whether the transaction meets the definition of a tax abatement for the purpose of this Statement. The adoption of this statement had no impact on the University's financial statements.

GASB Statement No. 80 amends the blending requirements for the financial statement presentation of component units of all state and local governments by providing an additional criterion. A component unit should be included in the reporting entity financial statements using the blending method if the component unit is organized as a not-for-profit corporations in which the primary government is the sole corporate member as identified in the component unit's articles of incorporation or bylaws. The adoption of this statement had no impact on the University's financial statements.

GASB Statement No. 82 addresses certain issues raised with respect to GASB Statement No. 67, *Financial Reporting for Pension Plans— an amendment of GASB Statement No. 25*; GASB No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27 and GASB Statement No. 73 Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. This Statement specifically addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The adoption of this statement had no material impact on the University's financial statements.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

New Accounting Standards Adopted (continued)

In fiscal year 2016, the University adopted the following new statements of financial accounting standards issued by the GASB:

- GASB Statement No. 72, *Fair Value Measurement and Application* (GASB Statement No. 72).
- GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* (GASB Statement No. 76).
- GASB Statement No. 79, *Certain External Investment Pools and Pool Participants* (GASB Statement No. 79).

GASB Statement No. 72 requires the University to use valuation techniques which are appropriate under the circumstances and are either a market approach, a cost approach or an income approach. GASB Statement No. 72 establishes a hierarchy of inputs used to measure fair value consisting of three levels. Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs, such as management's assumption of the default rate among underlying mortgages of a mortgage-backed security. GASB Statement No. 72 also contains note disclosure requirements regarding the hierarchy of valuation inputs and valuation techniques that was used for the fair value measurements. There was no material impact on the University's financial statement as a result of the implementation of GASB Statement No. 72.

GASB Statement No. 76 reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. This statement supersedes GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. It also amends GASB Statement No. 62, *Codification of accounting and financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, paragraph 64, 74, and 82. The adoption of this statement had no impact on the University's financial statements.

GASB Statement No. 79 establishes specific criteria used to determine whether a qualifying external investment pool may elect to use an amortized cost exception to fair value measurement. Those criteria will provide qualifying external investment pools and participants in those pools with consistent application of an amortized cost-based measurement for financial reporting purposes. The statement also establishes additional note disclosures for qualifying external investment pools. There was no material impact on the University's financial statement as a result of the implementation of Statement No. 79.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

Future Adoption of Accounting Pronouncements

The GASB has issued the following Statements:

- GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (OPEB) (GASB Statement No. 75), which is effective for fiscal years beginning after June 15, 2017. GASB Statement No. 75 addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employees. This Statement also establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB plans this statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosures and required supplementary information are also addressed by the statement. This statement replaces the requirements of GASB Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB.
- GASB Statement No. 81, *Irrevocable Split-Interest Agreements*. (GASB Statement No. 81), which is effective for periods beginning after December 15, 2016. GASB Statement No. 81 improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. Split-interest agreements are a type of giving agreement used by donors to provide resources to two or more beneficiaries, including governments. Split-interest agreements can be created through trusts, or other legally enforceable agreements with characteristics that are equivalent to split-interest agreements, in which a donor transfers resources to an intermediary to hold and administer for the benefit of a government and at least one other beneficiary. Examples of these types of agreements include charitable lead trusts, charitable remainder trusts, and life-interests in real estate. This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This Statement requires that a government recognize revenue when the resources become applicable to the reporting period.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

Future Adoption of Accounting Pronouncements (continued)

- GASB Statement No. 83, *Certain Asset Retirement Obligations* (GASB Statement No. 83), which is effective for periods beginning after June 15, 2018, establishes uniform guidance for governments in recognizing and measuring certain Asset Retirement Obligations (ARO) and to require disclosures related to those AROs. An ARO is defined as a legally enforceable liability associated with the retirement of a capital asset. This Statement requires that ARO recognition occur when the liability is both incurred and reasonably estimable. ARO measurement is to be based on the best estimate of the current value of the outlays expected to be incurred. Governments should recognize a deferred outflow of resources when an ARO is recognized at the initial measurement value. Deferred outflows of resources should then be reduced and recognized as an outflow of resources (i.e. expense) in a rational manner over a period of time. After initial measurement, governments are required to adjust the current value of their AROs for the effects of inflation or deflation annually. Also, annually, governments are required to evaluate all relevant factors related to an ARO and to determine if any of those factors are expected to increase or decrease the estimated asset retirement outlays associated with an ARO. Governments should only remeasure an ARO when the results of this evaluation indicate a significant change in the estimated outlay. GASB Statement No. 83 also discusses how AROs should be reported in instances in which a government may have a minority share of ownership in a tangible asset and the remaining owners are nongovernmental entities.
- GASB Statement No. 84, *Fiduciary Activities* (GASB Statement No. 84), which is effective for periods beginning after December 15, 2018, establishes specific criteria for identifying activities that should be reported as fiduciary activities and clarifying whether and how business-type activities should report their fiduciary activities. This Statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities. An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. An exception to that requirement is provided for a business-type activity that normally expects to hold custodial assets for three months or less.
- GASB Statement No. 85, *Omnibus 2017* (GASB Statement No. 85), which is effective for periods beginning after June 15, 2017, addresses practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits (OPEB)).



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

Future Adoption of Accounting Pronouncements (continued)

- GASB Statement No. 86, *Certain Debt Extinguishment Issues* (GASB Statement No. 86), which is effective for periods beginning after June 15, 2017, improves consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance.

GASB Statement No. 87, *Leases* (GASB Statement No. 87), which is effective for periods beginning after December 15, 2019, establishes a single approach to accounting for and reporting leases by state and local governments. GASB Statement No. 87 is based on the principle that leases are financing of the right to use an underlying asset. Statement 87 provides guidance for lease contracts for nonfinancial assets—including vehicles, heavy equipment and buildings—but excludes nonexchange transactions, including donated assets, and leases of intangible assets (such as patents and software licenses). GASB Statement No. 87 provides exceptions from the single-approach for short-term leases, financial purchases, leases of assets that are investments and certain regulated leases. GASB Statement No. 87 also addresses accounting for lease terminations and modifications, sale-leaseback transactions, nonlease components embedded in lease contracts (such as service agreements) and leases with related parties.

Lessee accounting under the New Standard: a lessee government is required to recognize a lease liability and an intangible asset representing the lessee's right to use the leased asset. The liability should be the present value of the payments covered by the contract, and its value should be reduced as payments are made over the lease's term. The asset should equal the initial measurement of the liability. A lessee also will report the following in its financial statements:

(1) amortization expense for using the lease asset (similar to depreciation) over the shorter of the term of the lease or the useful life of the underlying asset; (2) interest expense on the lease liability; and (3) note disclosures about the lease, including a general description of the leasing arrangement, the amount of lease assets recognized, and a schedule of future lease payments to be made.

Lessor accounting under the New Standard: A lessor government is required to recognize a lease receivable and a deferred inflow of resources. A lessor will continue to report the leased asset in its financial statements. A lessor also will report the following in its financial statements: (1) lease revenue, systematically recognized over the term of the lease, corresponding with the reduction of the deferred inflow; (2) interest revenue on the receivable; and (3) note disclosures about the lease, including a general description of the leasing arrangement and the total amount of inflows of resources recognized from leases.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

Future Adoption of Accounting Pronouncements (continued)

- GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements* (GASB Statement No. 88), which is effective for periods beginning after June 15, 2018, improves the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. This Statement defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established. This Statement requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses. For notes to financial statements related to debt, this Statement also requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debt.
- GASB Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period* (GASB Statement No. 89), which is effective for periods beginning after December 15, 2019, enhances the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and simplifies accounting for interest cost incurred before the end of a construction period.

This Statement establishes accounting requirements for interest cost incurred before the end of a construction period. Such interest cost includes all interest that previously was accounted for in accordance with the requirements of paragraphs 5–22 of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which are superseded by this Statement. This Statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund.

This Statement also reiterates that in financial statements prepared using the current financial resources measurement focus, interest cost incurred before the end of a construction period should be recognized as an expenditure on a basis consistent with governmental fund accounting principles.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

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

Future Adoption of Accounting Pronouncements (continued)

- GASB Statement No. 90, *Majority Equity Interests—an amendment of GASB Statements No. 14 and No. 61* (GASB Statement No. 89), which is effective for periods beginning after December 15, 2018, improves the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and improves the relevance of financial statement information for certain component units. It defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. A majority equity interest that meets the definition of an investment should be measured using the equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund. Those governments and funds should measure the majority equity interest at fair value.

For all other holdings of a majority equity interest in a legally separate organization, a government should report the legally separate organization as a component unit, and the government or fund that holds the equity interest should report an asset related to the majority equity interest using the equity method. This Statement establishes that ownership of a majority equity interest in a legally separate organization results in the government being financially accountable for the legally separate organization and, therefore, the government should report that organization as a component unit.

This Statement also requires that a component unit in which a government has a 100 percent equity interest account for its assets, deferred outflows of resources, liabilities, and deferred inflows of resources at acquisition value at the date the government acquired a 100 percent equity interest in the component unit. Transactions presented in flows statements of the component unit in that circumstance should include only transactions that occurred subsequent to the acquisition.

The University is evaluating the impact that these statements will have on its financial statements.

2. Going Concern

The University faces significant risks and uncertainties, including liquidity risk, which is the risk of not having sufficient liquid financial resources to meet obligations when they come due. The risks and uncertainties facing the University together with other factors further described below, have led management to conclude that there is substantial doubt as to the ability of the University to continue as a going concern in accordance with GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards, Going Concern Considerations Section*.

The University is highly dependent on the Commonwealth's appropriations to finance its operations. The financial difficulties being experienced by the Commonwealth have significant adverse impacts on the University, given its reliance on Commonwealth's appropriations and lack of available funding alternatives at reasonable interest rates.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

2. Going Concern (continued)

The Commonwealth Going Concern

The Commonwealth and several of its component units face significant risks and uncertainties, including liquidity risk.

The Commonwealth has incurred recurring deficits, has a negative financial condition, has experienced further deterioration of its economic condition, has not been able to access the credit markets, and has stated that substantial doubt exists about the Commonwealth's ability to continue as a going concern. Additionally, the Commonwealth is currently restructuring its obligations in an orderly fashion under Title III of the U.S. Congress Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) which was signed by the U.S. President on June 30, 2016.

PROMESA grants the Commonwealth and its component units access to an orderly mechanism to restructure their debts in exchange for significant federal oversight over the Commonwealth's finances. In broad terms, PROMESA seeks to provide Puerto Rico with fiscal and economic discipline through the creation of a control board (the Oversight Board), relief from creditor lawsuits through the enactment of a temporary stay on litigation, and two alternative methods to adjust unsustainable debt.

PROMESA contains two methods to adjust Puerto Rico's debts. The first method is a streamlined process to achieve modifications of financial indebtedness with the consent of a supermajority of affected financial creditors (Title VI of PROMESA). This method has benefits such as potential speed relative to a traditional restructuring through a formal in-court process. The second method is a court-supervised debt-adjustment process, which is modeled on Chapter 9 of the U.S. Bankruptcy Code (Title III of PROMESA). This process includes the so-called "cram-down" power, which may provide Puerto Rico with flexibility in debt adjustment, but it also gives the oversight board total control over the adjustment process and includes certain provisions designed to protect creditor interests.

The Commonwealth is in the midst of a profound fiscal, economic and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations. Further stressing the Commonwealth's liquidity is the vulnerability of revenue streams during times of major economic downturns and large health care, pension and debt service costs. As the Commonwealth's tax base has shrunk and its revenues affected by prevailing economic conditions, health care, pension and debt service costs have become an increasing portion of the Commonwealth's General Fund budget, which has resulted in reduced funding available for other essential services, including appropriations to the University. The Commonwealth's high level of debt and unfunded pension liabilities and the resulting required allocation of revenues to service debt and pension obligations have contributed to significant budget deficits during the past several years, which deficits the Commonwealth has financed, further increasing the amount of its debt.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

2. Going Concern (continued)

The Commonwealth Going Concern (continued)

These matters and the Commonwealth's liquidity constraints, among other factors, have adversely affected its credit ratings and its ability to obtain financing at reasonable interest rates, if at all. As a result, the Commonwealth had relied more heavily on short-term financings and interim loans from the GDB, and other component units of the Commonwealth, which reliance has constrained the liquidity of the Commonwealth in general and the GDB and increased near-term refinancing risk. These factors have also resulted in delays in the repayment by the Commonwealth and its component units of outstanding GDB lines of credit, which delays have limited GDB's ability to continue providing liquidity to the Commonwealth and certain other component units, such as the University, and have caused GDB to fail to make a principal payment on its debt obligations. Similarly, and pursuant to a series of legislations and executive orders during fiscal year 2016, and further explained below, the Commonwealth and certain other public corporations, such as the University, also delayed the debt service payments on some of its debts, including the general obligation bonds of the Commonwealth.

The Commonwealth's Primary Government reflects a net position deficit/fund balance deficit of approximately \$67 billion as of June 30, 2015 (the most recent audited financial information). The Commonwealth's General Fund shown a fund balance (deficit) of approximately \$2.1 billion as of June 30, 2015.

On April 6, 2016, the Commonwealth enacted Act No. 21, known as the Puerto Rico Emergency Moratorium and Rehabilitation Act (the Moratorium Act or Act No. 21) under which, the Commonwealth and certain of its component units suspended their respectively debt service payments. In particular, the Commonwealth suspended the payment of \$779 million in debt service on general obligation bonds due in July 1, 2016 (net of \$352 million of capitalized interest fund and escrow accounts).

The Moratorium Act also created a new Fiscal Agency and Financial Advisory Authority (FAFAA), as an independent public corporation to assume GDB's role as fiscal agent, financial advisor and reporting agent for the Commonwealth, its component units, including the University, and municipalities. FAFAA has also been assigned the tasks of overseeing matters related to the restructuring or adjustment of the Commonwealth's financial liabilities, coordinating liability management or other transactions with respect to such obligations, and ensuring compliance with fiscal plans and budgets approved by the Oversight Board pursuant to PROMESA.

On May 1, 2017, PROMESA Stay expired, permitting the substantial litigation brought by bondholders and other creditors against the Commonwealth and its component units to resume. As a result, on May 3, 2017, the Oversight Board of PROMESA filed a petition for relief under Title III of PROMESA. Title II of PROMESA incorporates the automatic stay provision of Bankruptcy Code section 362 and 922, which are made applicable to the Title III cases pursuant to PROMESA section 301 (a).

On April 19, 2018 (recertified on May 30, 2018 and amended on June 29, 2018 and October 23, 2018), the Oversight Board of PROMESA certified its fiscal plan for the Commonwealth. There is no certainty that the Certified Commonwealth Fiscal Plan (as revised and amended) will be fully implemented or if implemented will ultimately provide the intended results. All these plans and measures, and the Commonwealth's ability to reduce its deficit and to achieve a balanced budget in the future fiscal years depends on a number of factors and risks, some of which are not wholly within its control.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

2. Going Concern (continued)

The University Going Concern

The University only had an unrestricted deficit position and a total net deficit position of approximately \$1.94 billion and \$1.38 billion, respectively. The University only has had operating losses (without considering nonoperating revenues and expenses such as: Commonwealth appropriations, Federal Pell Grant program and other revenues and depreciation, interest and other expenses) during fiscal years 2017, 2016 and 2015 of \$984.8 million, \$890.1 million and \$1.0 billion, respectively.

The University is highly dependent on the Commonwealth appropriations to finance its operations and had historically relied on the GDB for liquidity. Approximately 68% of the University's total revenues (operating revenues and nonoperating revenues, net) are derived from the Commonwealth's appropriations which amounted to approximately \$934.4 million, \$932.5 million and \$937.4 million for the years ended June 30, 2017, 2016 and 2015, respectively.

Appropriations received by the University from the Commonwealth are mainly supported by Act No. 2 of January 20, 1966, as amended ("Act 2"). Under Act 2, the Commonwealth appropriates for the University an amount equal to 9.60% of the average total amount of annual general fund revenues collected under the laws of the Commonwealth in the two fiscal years immediately preceding the current fiscal year (the Commonwealth formula appropriations). On June 17, 2014, the Legislature of the Commonwealth enacted Act No. 66-2014 (the "Fiscal Sustainability Act"). The Fiscal Sustainability Act is a temporary fiscal emergency law designed to address the fiscal condition of the Commonwealth. Among other things, the Fiscal Sustainability Act froze the benefit under the formula-based appropriation of the University at \$833.9 million for the three fiscal years ended June 30, 2017, 2016 and 2015. 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 \$39.2 million, \$36.0 million and \$39.9 million for the years ended June 30, 2017, 2016, and 2015, respectively. Also, the Commonwealth appropriations include revenues received under the Gambling Law (slot machines and others) from the Puerto Rico Tourism Company, a component unit of the Commonwealth, which amounted to \$61.5 million, \$62.6 million and \$63.5 million for the years ended June 30, 2017, 2016 and 2015, respectively.

Moreover, the University has limited ability to raise operating revenues due to the economic and political related challenges of maintaining enrollment and increasing tuition. The University's ability to continue receiving similar operational support from the Commonwealth and obtaining external financing is uncertain.

Pursuant to a series of legislations and executive orders during fiscal year 2016, as further explained below, the University delayed the \$4.0 million monthly deposits of pledged revenues to the trustee of the University revenue bonds and the \$475,000 monthly basic lease payments to the trustee of the DUI's AFICA Bonds during almost the entire fiscal year 2017. In addition, the University stopped the debt service payments of the GDB credit facilities.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

2. Going Concern (continued)

The University Going Concern (continued)

On June 30, 2016, the Governor of Puerto Rico signed Executive Order No. OE-2016-030 (EO 30) and Executive Order No. OE-2016-031 (OE 31) which (i) declared the Commonwealth and several of its instrumentalities, including the University, to be in a state of emergency and announced the commencement of an emergency period (as such term is defined in Section 103 of the Act No. 21) for the Commonwealth and such instrumentalities, including the University, (ii) extended the state of emergency that had been previously declared for several of the Commonwealth's instrumentalities, (iii) implemented a suspension on transfer obligations of the Commonwealth and certain of its instrumentalities, including the University, with respect to the transfer of funds to and from such entities (pursuant to Section 201 of Act No. 21), and (iv) implemented a suspension on the payment obligations of debt issued or guaranteed by the Commonwealth, as well as the payment obligations of certain of its instrumentalities, including the University. The measures were in place until January 29, 2017.

Specifically to the University, EO 31 established the following: (i) designated any of the University's obligations, pursuant to the Trust Agreement, dated June 1, 1971, as amended, to transfer Pledged Revenues (as such term is defined in the Trust Agreement) to the Trustee as an enumerated obligation (as such term is defined in Section 103 of the Act No. 21); and suspended such obligations of the University to transfer Pledged Revenues to the Trustee, and (ii) designated any obligation of the University pursuant to the Lease Agreement with DUI, dated December 21, 2010, as a covered obligation (as such term is defined in Section 103 of the Act No. 21); and suspended the payment of such obligation of the University. EO 31 did not suspend the payment obligations of the University with respect to any other obligation. In compliance with EO 31, the University suspended the monthly payments to the trustee of the Trust Agreement that govern the University System Revenue Bonds and the monthly payments of the Lease Agreement with DUI from July 2016 to May 2017.

On August 5, 2016 and monthly thereafter until April 2017, the trustee of the DUI's AFICA Bonds notified to the University that it failed to make the basic lease payment to the trustee since July 25, 2016 and that a default under the lease agreement with DUI constitutes an event of default under the DUI's AFICA Bonds Trust Agreement. As such, the University was in default of this obligation until April 2017. The trustee was not seeking any indebtedness from, enforce any judgment, or obtain possession of, or exercise control over, any property of or from, the Commonwealth or any of its instrumentalities, including DUI and the University, or exercise any act that is stayed by PROMESA, the Act No. 21, or the Executive Orders related thereto. In May 2017, the University reestablished the payments to the trustee of the DUI's AFICA Bonds (approximately \$475,000 monthly) and paid all the basic lease payments due from July 2016 until May 2017 (approximately \$5.2 million). Presently, DUI has paid as agreed the scheduled principal and interest payments on its outstanding AFICA Bonds.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

2. Going Concern (continued)

The University Going Concern (continued)

On August 19, 2016, the U.S. Bank Trust National Association, in its capacity as Trustee for the University of Puerto Rico System Revenue Bonds (Series P and Q Bonds), filed a civil lawsuit under the United States Court, District of Puerto Rico against the Commonwealth and its Governor, the University and its President. The motion seeks relief from the stay of PROMESA, or Executive Orders related thereto, and a preliminary injunction against the Commonwealth's diversion and expropriation of pledged revenues, which constitute the University's Bonds collateral. On June 29, 2017, the Trustee and the University, at the direction of FAFAA, entered into a letter agreement providing that the University will transfer certain amounts in respect of pledged revenue, as defined in the trust agreement, to the Trustee on condition, among others, that through August 31, 2017 (the Compliance Period) the Trustee not institute, commence, or continue certain legal proceedings against the University, the Commonwealth or any other agency, instrumentality, or municipality thereof during the Compliance Period, except in certain enumerated circumstances. As agreed in the letter agreement, the University paid \$20 million on June 30, 2017 and an additional \$20 million on September 1, 2017 and continued to pay monthly to the trustee the \$4 million of pledged revenues. The University commits to transfer to the Trustee, to hold or make payments or distributions as provided under the trust agreement, in lieu of the transfer of an equivalent amount of the pledged revenues received by the University from the date hereof through August 31, 2017 as provided in the trust agreement.

The letter agreement has been extended nine times and the new Compliance Period is June 30, 2019. Pursuant to the letter agreement and the nine standstill extension agreements, during the compliance period, holders of the majority in amount of the bonds and the Trustee at the direction of the University's bondholders will negotiate in good faith towards a restructuring of the bonds. In addition, the trustee agreed not to institute or commence certain legal proceedings and the University agreed to transfer the following monthly payments of pledged revenues to the trustee to be applied in accordance with the trust agreement governing the Series P and Q Bonds during the new Compliance Period:

- in consideration for extending the new Compliance Period until May 31, 2018, the University agreed to transfer to the Trustee \$4 million monthly from July 2017 to May 2018;
- in consideration for extending the new Compliance Period until December 31, 2018, the University agreed to transfer to the Trustee the following monthly payments: \$4.0 million of the June 2018 Payment on or before July 15, 2018; \$2.0 million of the July 2018 Payment on or before August 5, 2018; \$3.0 million of the August 2018 Payment on or before August 25, 2018; \$2.3 million of the September 2018 Payment on or before September 25, 2018; \$2.3 million of the October 2018 Payment on or before October 25, 2018; \$3.0 million of the November 2018 Payment on or before November 25, 2018; and \$3.0 million of the December 2018 Payment, less a credit for any amount as of November 30, 2018 in the Trustee's Bond Service Account and Reserve Account that is, in the aggregate, in excess of \$68,606,318, on or before December 25, 2018; and
- in consideration for extending the new Compliance Period until June 30, 2019, the University agreed to transfer to the Trustee the following monthly payments: \$2.9 million of the January 2019 Payment on or before January 25, 2019; \$2.9 million of the February 2019 Payment on or before February 25, 2019; \$2.9 million of the March 2019 Payment on or before March 25, 2019; \$2.9 million of the April 2019 Payment on or before April 25, 2019; \$2.9 million of the May 2019 Payment on or before May 25, 2019; and \$2.9 million of the June 2019 Payment, less a credit for any amount as of May 30, 2019 in the Trustee's Bond Service Account and Reserve Account that is, in the aggregate, in excess of \$75,395,125, on or before June 30, 2019.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

2. Going Concern (continued)

The University Going Concern (continued)

Discussions with respect to a consensual restructuring of the University's bonds are continuing. Presently, the University has paid as agreed the scheduled principal and interest payments on its outstanding Series P and Q Bonds and has complied with the letter agreement, as extended, with the Trustee.

The University had two credit facilities with the GDB, a ten-year term loan which amounted to approximately \$48.3 million at June 30, 2016 and a \$75 million non-revolving line of credit with the GDB to complete certain construction projects of the University's Program for Permanent Improvements which amounted to approximately \$28.1 million at June 30, 2016. The University had not made the monthly payments of this term loan since May 2016. The \$75 million line of credit expired on January 31, 2016 and the University had not made the monthly interest payments of this line of credit since September 2016. In May 2016, the Governing Board of the University authorized its president to cancel the term loan and the expired line of credit with the GDB using the University's funds deposited in the GDB. The University had not paid its debt service on these credit facilities with GDB because it and the GDB had not reached an agreement to cancel these credit facilities or to determine how these credit facilities will be managed. Refer to Note 20 for the offset of the credit facilities with the GDB, on a dollar-for-dollar basis, by the amount of the University's deposits held at the GDB on November 29, 2018.

On October 30, 2016, the Oversight Board created by PROMESA designated the University as a covered entity subject to oversight under PROMESA. As a covered entity, the University is required to submit to the Oversight Board of PROMESA an individual fiscal plan. The University submitted its ten-year fiscal plan to the Oversight Board of PROMESA for certification on August 1, 2017.

On June 2, 2017, the Oversight Board of PROMESA approved the aggregate spending level in the Governor's fiscal year 2017-2018 proposed budget, but not its specific allocations. On June 27, 2017, the Oversight Board of PROMESA issued a notice of violation on the submitted Commonwealth budget that included a description of necessary corrective action. The Oversight Board of PROMESA gave the Legislature of Puerto Rico an opportunity to correct the violations by June 29, 2017. Because the Legislature failed to take corrective actions, the Oversight Board of PROMESA approved and certified a revised, compliant budget for fiscal year 2018 for the Commonwealth in compliance with PROMESA. The Commonwealth's fiscal year 2018 budget was deemed approved by the Governor and Legislature and in full force and effect beginning on July 1, 2017. The Commonwealth's formula appropriations to the University included in the approved Commonwealth's budget for fiscal year 2018 will amount to \$631 million, a decrease of \$203 when compared with the Commonwealth's formula appropriations of \$834 million received in fiscal year 2017. In addition, the approved Commonwealth's budget for fiscal year 2018 includes nonrecurrent contributions to the University of approximately \$30 million, for a net decrease in the Commonwealth's appropriations of approximately \$173 million in the fiscal year 2018.

On April 6, 2017, a student stoppage at the University interrupted the operations of all campuses for up to 93 days, but less in other cases. This student stoppage was prompted as a result of student opposition to the annual reductions in the Commonwealth's formula appropriations to the University as ordered by the Oversight Board of PROMESA. As a result of the student stoppage at the University, eight of the eleven units that comprise the University of Puerto system are on probation by the Middle States Commission on Higher Education, the regional accreditation entity.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

2. Going Concern (continued)

The University Going Concern (continued)

In the fourth quarter of fiscal year 2017, the U.S. Department of Education notified each campus of the University that they failed the financial responsibility requirements under the U.S. Department of Education regulations due to its failure to submit on March 31, 2017 acceptable compliance and financial statement audits. As a result, the eleven campuses of the University are under provisional certifications with the U.S. Department of Education for initial or continued participation in any of the student financial assistance programs authorized by Title IV of the Higher Education Act of 1965, as amended (Title IV HEA Programs). These provisional certifications place the eleven campuses of the University on a heightened cash monitoring payment method and expire between June 30, 2018 and December 31, 2018.

Each campus of the University agreed to participate in the Title IV, HEA Programs under the U.S. Department of Education's cash monitoring method and comply with the provisions under the Zone alternative. Starting with academic year 2017-2018, the eleven campuses of the University will be operating on limited Title IV eligibility and will be placed on the Heightened Cash Monitoring I (HCM-1) method of payment requiring enhanced reporting and documentation until further written notice from the U.S. Department of Education. Under the HCM-1 method payment, each campus of the University must first make disbursements to eligible students and parents and pay any credit balances due before it requests or receives funds for those disbursements from the U.S. Department of Education in accordance with 34 CFR 668.162 (d). The funding request may not exceed the amount of the actual disbursements that were made to the students and parents including in the funding request. Expenditures of Federal Awards under Title IV HEA programs amounted to approximately \$250.9 million for the year ended June 30, 2017.

On September 6, 2017, Hurricane Irma did some damages to the island of Puerto Rico and then on September 20, 2017, the island of Puerto Rico suffered the complete devastation caused by Hurricane Maria, causing catastrophic wind and water damage to Puerto Rico's infrastructure, home and businesses.

As a result of the Hurricane Maria, most of the island's population was left without electrical power and there was significant disruption to the water distribution system. Other basic utility and infrastructure services such as communications, ports and transportation were also materially affected, causing a significant disruption to the island's economic activity. The entire island of Puerto Rico will need a massive infrastructure rebuilding program.

Immediately after the landfall of the Hurricane Maria on Puerto Rico, the President of the United States of America issued a state of emergency declaration for Puerto Rico, as a U.S territory. The order mandates federal assistance through the Department of Homeland Security and the Federal Emergency Management Agency (FEMA) be made available to assist in local and territorial recovery efforts.

Some of the University's eleven campuses were more affected than others, but all were impacted in some way. A few days after Hurricane Maria, many of the University employees, as well as students and other volunteers, returned to the campuses and to the University's central Administration to begin the rebuilding process. At the end of October and the beginning of November 2017, administrative and academic functions had resumed at basically all areas and units that comprise the University System.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

2. Going Concern (continued)

The University Going Concern (continued)

The University's costs associated with repairing the damages sustained by the hurricanes could range from \$130 million to \$140 million. Part of these costs are expected to be covered by insurance funds and by disaster-relief funds granted by FEMA. The University's commercial property and fine arts insurance coverages have an aggregate lost limit of \$100 million each. On September 28, 2018, the insurance company was intervened by the Puerto Rico Insurance Commissioner for insolvency under a "rehabilitation order" for the insurance company before the Court of First Instance, Superior Court of San Juan. The order designates the Puerto Rico Insurance Commissioner, as "rehabilitator" and orders him to take possession of the insurer's assets, in protection of the interests of the policyholders with claims, creditors of the insurer and the public in general. On November 8, 2018, the University settled this claim with the insurance company for a total consideration of \$50.0 million (\$57.0 million less \$7.0 million of deductible amounts). Presently, the University has received advanced funds from the insurance company of approximately \$38.8 million and from FEMA of approximately \$1.0 million for these natural disasters.

Given the high dependency of the University on the Commonwealth appropriations and lack of available financing sources at reasonable interest rates, the University's financial condition and liquidity is being adversely affected. As a consequence, the University may not be able to avoid future defaults on its obligations. Management has plans to address the University's liquidity situation and continue providing services. However, there can be no assurance that the Commonwealth will be able to continue to provide adequate appropriations or funding alternatives or that the affiliated or unaffiliated creditors will be able and willing to refinance or modify the terms of the University's obligations, that management's current plans to repay or refinance the obligations or extend their terms will be achieved or that certain services will not have to be terminated, curtailed or modified. These conditions raise substantial doubt about the University's ability to continue as a going concern.

The University Management Fiscal Plan

On August 1, 2017, the University presented to the Oversight Board of PROMESA its fiscal plan for the ensuing ten years. The fiscal plan included a series of expense reduction measures complemented with revenue enhancing initiatives, including tuitions hikes, which in the aggregate will add up to \$512 million in the Central Government appropriations reductions by fiscal year 2026. The Central Government appropriations are the Commonwealth appropriations, excluding unremitted distributions of income received by the University from the Puerto Rico Tourism Company under the Gambling Law, slot machines and others, by virtue of Act No. 36 of 2005.

On August 26, 2017, the Oversight Board of PROMESA announced, through a letter from its Executive Director, that the University fiscal plan will not be certified as submitted above. The letter requested to the University Governing Board develop a new version of the fiscal plan correcting several deficiencies that the Oversight Board of PROMESA identified.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

2. Going Concern (continued)

The University Management Fiscal Plan (continued)

After the passages of Hurricane Irma and Maria in September 2017, the Oversight Board of PROMESA requested the University to submit a revised fiscal plan for the ensuing five years. On April 5, 2018 (as revised on September 7, 2018), the University submitted its revised fiscal plan for the fiscal years 2018 to 2023. On April 20, 2018 (as amended on June 29, 2018 and October 23, 2018), the Oversight Board of PROMESA certified its own University fiscal plan.

The University's Fiscal Plan Certified by the Oversight Board of PROMESA

The University fiscal plan for the fiscal years 2018 to 2023 certified by the Oversight Board of PROMESA maintained the August 2017 Fiscal Plan measures, less reductions to the Central Government appropriation, as well as reductions in addressable spend. This fiscal plan includes the approved projected reductions in the Commonwealth's formula appropriations that which would rise annually from approximately \$203 million in fiscal year 2018 to approximately \$478 million in fiscal year 2023. The Commonwealth approved formula appropriations will range from \$631 million in fiscal year 2018 to \$383 million in fiscal year 2023. Other Central Government appropriations for general current obligations, for capital improvement programs, and for loans and financial assistance to students are keeping fixed in \$58.8 million from fiscal year 2019 to 2023.

Targeted measures to increase revenues and reduce expenditures will allow the University to operate sustainably under a reduced Commonwealth subsidy. On the revenue side, these include modestly raising tuition using a means-based approach (e.g., creating a means-based scholarship fund in parallel), applying more aggressively for federal grants (seeking to achieve funding equal to the level of 25th percentile of U.S. public universities), charging more dues and fees to students, applying for patents and other intellectual property, and continuing to provide trainings to the Puerto Rico Department of Education and the Government more broadly.

The University certified fiscal plan includes the following revenue generating measures, among others:

- gradual increase in the undergraduate student cost from \$57 per credit in fiscal year 2018 to \$157 per credit in fiscal year 2023;
- gradual increase in the graduate student average annual tuition from \$3,699 per student in fiscal year 2018 to \$7,209 per student in fiscal year 2023;
- gradual increase in tuition fees (dues and charges); and reduction in tuition exemptions;
- gradual decrease in the student population;
- and annual increase in federal awards - The University's federal awards level is below the similar public universities in the continental United States of America. It can increase by tailored research and processes for public research grants.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

2. Going Concern (continued)

The University Management Fiscal Plan (continued)

Expenditure reduction measures include consolidating campuses, optimizing human resources through reducing temporary and trust positions, improving procurement, reducing the cost of medical insurance, and reducing tuition exemptions and special scholarships. These include identifying campuses and programs for consolidations based on performance metrics, tying personnel savings to roles implicated by campus consolidations and service reductions, reducing the University employee pensions in a manner similar to the Commonwealth and increasing tuition in future years to be roughly equivalent to federal Pell Grant less a reasonable contribution to cost of living and other related expenditures.

The University certified fiscal plan includes the following expense reduction measures, among others:

- Transformational Enhancements- Leaner administrative structure into four conglomerates (keeping open the actual eleven campuses) to reduce duplicated functions and services; evaluation of the academic offer to reduce redundant expenses; and implementation of full academic optimization. Projected headcount reduction from 12,779 employees in fiscal year 2018 to 10,650 employees in fiscal year 2023.
- Reductions in variety of benefits as follows: elimination of Christmas bonus for all employees starting in fiscal year 2019; based on 15-day liquidations of sick days starting in fiscal year 2020; and reduction in the employer monthly contribution to medical insurance plans from \$640 per employee (average employer contribution) in fiscal year 2019 to \$390 per month to each faculty members and to \$125 per month to each non-faculty members, excluding those employees with pre-existing conditions, starting in fiscal year 2020, among others.
- Freeze pension plan benefits in fiscal year 2019; reduction in accrued pension benefits, using the same mechanism as for other Commonwealth plans in fiscal year 2019; and establishment of a defined contribution plan similar to those of other Commonwealth plans in fiscal year 2020, but with a 50% employer match on member contributions of up to 2%. Savings from reduction in accrued pension benefits offset the projected 50% employer match of the defined contribution plan and an increased contribution to improve the solvency of the pension plan.

These efforts to improve the operations of the University will in turn allow the University to renew its operating model to provide the best outcomes for its students. These outcomes will include reduced time to degree, improved job placement, and higher standardized test scores, among others. A re-envisioned University, which focuses on areas of strengths and on improving outcomes for students, will ultimately prove to be a critical source of renewal for the Island, as it is a cornerstone of human capital development to propel growth in the economy.

This certified fiscal plan establishes an independent scholarship fund for low-income University students. A means-based scholarship fund for the University will be supported by reductions to the budgets of the Oversight Board, Legislative Assembly, and FAFAA. These reductions should generate from \$35 to \$37 million annually in reinvestment funds from fiscal year 2019 through fiscal year 2023, and they will be used to help build up an endowment to pay for need-based scholarships for the University students. Specifically, the savings will fund an independent endowment for needs-based scholarships for students at the University, which will be managed by the Office of the Chief Financial Officer of the Commonwealth.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

2. Going Concern (continued)

The University Management Fiscal Plan (continued)

With these fiscal plan measures, including the reduction in the Commonwealth's appropriations, the University would have operational deficits starting in fiscal year 2021 and increasing through fiscal year 2023.

The University's Fiscal Plan Submitted to the Oversight Board of PROMESA

The following are the most significant differences between the University submitted fiscal plan and the fiscal plan certified by the Oversight Board of PROMESA:

Revenue Generating Measures

- gradual increase in the undergraduate student cost from \$57 per credit in fiscal year 2018 to \$140 per credit in fiscal year 2023;

and gradual increase in the graduate student average annual tuition from \$3,699 per student in fiscal year 2018 to \$6,617 per student in fiscal year 2023.

The University will incorporate a new internal Scholarship Fund that will further mitigate the increase of tuition for the most vulnerable student population.

The University does not agree with the Oversight Board reductions in tuition exemptions which include the elimination of tuition exemptions unrelated to financial aid, with the exception for honor and veteran students. For fiscal year 2019, the University modified its tuition exemption program as follows: full scholarship exclusively for honor, veteran and graduate research students; 50% exemption to employees, athletes and others; and reduced and capped the amount of exemptions granted to student athletes to 2,000 participants.

Expense Reduction Measures

- Transformational Enhancements- Leaner administrative structure into five conglomerates (keeping open the actual eleven campuses) to reduce duplicated functions and services; evaluation of the academic offer to reduce redundant expenses; and implementation of full academic optimization. Projected headcount reduction from 12,779 employees in fiscal year 2018 to 10,919 employees in fiscal year 2023.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

2. Going Concern (continued)

The University Management Fiscal Plan (continued)

- Reductions in variety of benefits as follows:
 - Christmas bonus- The University's forecasts does not deliver the immediate cessation of the Christmas bonus.
 - Medical insurance plan- The University's forecasts contemplates the actual medical expenditure per beneficiary rate. However, that does not preclude the University from taking additional steps to lower the medical contribution costs by either renegotiating existing terms of the agreement; restructuring the beneficiary's medical contribution structure; or voluntary joining central government's medical plan group.
 - Pension costs- The University's forecasts contemplates the actual pension benefit structure. The University is committed to undertake the necessary reforms to its pension system and intends to so in a collaborative effort with the Governing Board and other University work group. A work plan has been developed, leading towards the most responsible reform of the pension system. The University expects to have a defined action plan by the end of 2018.

With these fiscal plan measures, including the reduction in the Commonwealth's appropriations, the University would have operational deficits starting in fiscal year 2020 and increasing through fiscal year 2023.

There is no certainty that the Certified University Fiscal Plan (as revised and amended) will be fully implemented or if implemented will ultimately provide the intended results. All these plans and measures, and the University's ability to reduce its deficit and to achieve a balanced budget in the future fiscal years depends on a number of factors and risks, some of which are not wholly within its control.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

3. Combining Financial Information of the Discretely Presented Component Units

The following table presents the combining statements of net position (deficit) of the discretely presented component units as of June 30, 2017 and 2016 (expressed in thousands):

	2017				2016			
	SMU	UPRPS	MCC	Total	SMU	UPRPS	MCC	Total
Assets								
Current assets:								
Cash and cash equivalents	\$ 14,252	\$ 2,113	\$ 313	\$ 16,678	\$ 13,511	\$ 1,172	\$ 253	\$ 14,936
Accounts receivable, net	10,544	128	318	10,990	9,212	347	406	9,965
Due from Federal Government, net	1,014	—	—	1,014	1,475	—	—	1,475
Due from the University of Puerto Rico	8,963	—	—	8,963	10,327	—	—	10,327
Inventories	661	—	—	661	440	—	—	440
Other assets	281	10	81	372	327	6	75	408
Total current assets	35,715	2,251	712	38,678	35,292	1,525	734	37,551
Noncurrent assets:								
Due from Commonwealth of Puerto Rico	243	—	—	243	236	—	—	236
Capital assets (net of accumulated depreciation and amortization):								
Land and other nondepreciable assets	1,071	—	—	1,071	1,810	—	—	1,810
Depreciable assets	8,454	118	163	8,735	7,641	123	174	7,938
Total noncurrent assets	9,768	118	163	10,049	9,687	123	174	9,984
Total assets	45,483	2,369	875	48,727	44,979	1,648	908	47,535
Liabilities								
Current liabilities:								
Accounts payable and accrued liabilities	5,279	64	51	5,394	6,413	56	73	6,542
Current portion of long-term debt - notes payable	2,557	—	—	2,557	2,586	—	—	2,586
Due to University of Puerto Rico	21,304	—	—	21,304	21,983	—	—	21,983
Other current liabilities - compensated absences	731	—	—	731	767	—	—	767
Total current liabilities	29,871	64	51	29,986	31,749	56	73	31,878
Noncurrent liabilities:								
Long-term debt, net of current portion - notes payable	17,627	—	—	17,627	19,307	—	—	19,307
Other long-term liabilities - claims liability	1,544	—	—	1,544	1,426	—	—	1,426
Total noncurrent liabilities	19,171	—	—	19,171	20,733	—	—	20,733
Total liabilities	49,042	64	51	49,157	52,482	56	73	52,611
Net position (deficit)								
Net investment in capital assets	—	118	163	281	—	123	174	297
Unrestricted (deficit)	(3,559)	2,187	661	(711)	(7,503)	1,469	661	(5,373)
Total net position (deficit)	\$ (3,559)	\$ 2,305	\$ 824	\$ (430)	\$ (7,503)	\$ 1,592	\$ 835	\$ (5,076)



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

3. Combining Financial Information of the Discretely Presented Component Units (continued)

The following table presents the combining statements of revenues, expenses and changes in net position (deficit) of the discretely presented component units for the years ended June 30, 2017 and 2016 (expressed in thousands):

	2017				2016			
	SMU	UPRPS	MCC	Total	SMU	UPRPS	MCC	Total
Revenues								
Operating revenues:								
Net patient services revenue and other (net of provision for allowances of \$4,972 in 2017 and \$4,423 in 2016)	\$ 46,881	\$ -	\$ -	\$ 46,881	\$ 44,985	\$ -	\$ -	\$ 44,985
Other operating revenues	1,200	1,584	671	3,455	947	1,614	654	3,215
Total operating revenues	48,081	1,584	671	50,336	45,932	1,614	654	48,200
Operating expenses:								
Salaries:								
Exempt staff	4,641	-	-	4,641	4,725	-	-	4,725
Nonexempt wages	9,093	328	180	9,601	9,202	346	144	9,692
Benefits	2,724	77	29	2,830	2,190	63	25	2,278
Supplies and other services	21,924	413	445	22,782	21,757	494	387	22,638
Utilities	2,376	9	1	2,386	2,283	12	1	2,296
Depreciation and amortization	1,820	19	22	1,861	1,703	22	45	1,770
Other expenses	920	28	5	953	652	6	5	663
Total operating expenses	43,498	874	682	45,054	42,512	943	607	44,062
Operating income	4,583	710	(11)	5,282	3,420	671	47	4,138
Nonoperating revenues (expenses):								
Net investment income	-	3	-	3	-	4	-	4
Interest on capital assets - related debt	(639)	-	-	(639)	(670)	-	-	(670)
Other nonoperating revenues (expenses), net	-	-	-	-	773	(640)	-	133
Net nonoperating revenues (expenses)	(639)	3	-	(636)	103	(636)	-	(533)
Change in net position	3,944	713	(11)	4,646	3,523	35	47	3,605
Net position (deficit):								
Beginning net position (deficit)	(7,503)	1,592	835	(5,076)	(11,026)	1,557	788	(8,681)
End of year	\$ (3,559)	\$ 2,305	\$ 824	\$ (430)	\$ (7,503)	\$ 1,592	\$ 835	\$ (5,076)



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

4. Cash and Cash Equivalents

The University's cash and cash equivalents as of June 30, 2017 and 2016 consisted of the following (expressed in thousands):

	2017			2016		
	Unrestricted	Restricted	Total	Unrestricted	Restricted	Total
The University Only:						
Cash on hand	\$ 128	\$ —	\$ 128	\$ 157	\$ —	\$ 157
Due from commercial banks in Puerto Rico	8,653	2,300	10,953	35,641	2,130	37,771
Total cash on hand and due from commercial banks	<u>8,781</u>	<u>2,300</u>	<u>11,081</u>	<u>35,798</u>	<u>2,130</u>	<u>37,928</u>
Cash equivalents:						
Deposit accounts with:						
GDB	—	—	—	—	500	500
Commercial banks in Puerto Rico	280,420	15,442	295,862	145,401	1,000	146,401
Money market funds	119	2,693	2,812	527	3,384	3,911
Total cash equivalents	<u>280,539</u>	<u>18,135</u>	<u>298,674</u>	<u>145,928</u>	<u>4,884</u>	<u>150,812</u>
Total University's cash and cash equivalents	<u>289,320</u>	<u>20,435</u>	<u>309,755</u>	<u>181,726</u>	<u>7,014</u>	<u>188,740</u>
DUI:						
Cash on hand	10	—	10	10	—	10
Due from commercial banks in Puerto Rico	1,314	2,279	3,593	803	2,347	3,150
Total cash on hand and due from commercial banks	<u>1,324</u>	<u>2,279</u>	<u>3,603</u>	<u>813</u>	<u>2,347</u>	<u>3,160</u>
Total DUI cash and cash equivalents	<u>\$ 290,644</u>	<u>\$ 22,714</u>	<u>\$ 313,358</u>	<u>\$ 182,539</u>	<u>\$ 9,361</u>	<u>\$ 191,900</u>
Current portion	\$ 290,644	\$ 13,494	\$ 304,138	\$ 182,539	\$ 2,731	\$ 185,270
Noncurrent portion	—	9,220	9,220	—	6,630	6,630
Total	<u>\$ 290,644</u>	<u>\$ 22,714</u>	<u>\$ 313,358</u>	<u>\$ 182,539</u>	<u>\$ 9,361</u>	<u>\$ 191,900</u>

The University Only

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 and its discretely presented component units are 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 and its discretely presented component units. Such authorized depositories, except for the Government Development Bank for Puerto Rico ("GDB"), a public corporation of the Commonwealth, collateralize the amount deposited in excess of the federal depository insurance of \$250,000 with securities that are pledged with the Department of the Treasury. There is no formal policy for custodial credit risk for cash accounts opened with commercial banks outside of Puerto Rico.

At June 30, 2017 and 2016, the University and its component units do not have balances in cash accounts with commercial banks outside of Puerto Rico. The deposits at the GDB and in money market funds are uninsured and uncollateralized. These deposits are exposed to custodial credit risk. Refer to Note 5.

Restricted cash equivalents of the University's permanent endowment funds amounted to approximately \$8,943,000 and \$4,884,000 as of June 30, 2017 and 2016, respectively. Refer to Note 5.

Other restricted cash equivalents amounted to approximately \$9,192,000 as of June 30, 2017 and mainly include approximately \$7,791,000 of funds held in the construction fund for the Molecular Sciences Building.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

4. Cash and Cash Equivalents (continued)

The University Only (continued)

As of June 30, 2017 and 2016, the University's cash deposited in the banks amounted to approximately \$318,100,000 and \$198,024,000, respectively.

Blended Component Unit's Cash and Cash Equivalents

DUI's cash and cash equivalents as of June 30, 2017 and 2016 amounted to approximately \$3,602,000 and \$3,160,000, respectively, and mainly consisted of cash on hand and cash accounts in Puerto Rico commercial banks. These deposits are insured up to \$250,000 per bank by the federal depository insurance and the excess over the federal depository insurance is uncollateralized. These deposits are exposed to custodial credit risk. As of June 30, 2017 and 2016, DUI's cash deposited in the banks amounted to approximately \$4,039,000 and 3,343,000, respectively. DUI's uninsured and uncollateralized cash and cash equivalents that were exposed to custodial credit risk amounted to approximately \$3,789,000 and \$3,093,000 as of June 30, 2017 and 2016, respectively.

Discretely Presented Component Units' Cash and Cash Equivalents

The discretely presented component units' cash and cash equivalents as of June 30, 2017 and 2016, amounted to approximately \$16,678,000 and \$14,936,000, respectively, and mainly consisted of cash on hand and cash accounts in Puerto Rico commercial banks. As of June 30, 2017 and 2016, the discretely presented component units' cash deposited in the banks amounted to approximately \$17,663,000 and \$16,331,000, respectively. The discretely presented component units' uninsured and uncollateralized cash and cash equivalents that were exposed to custodial credit risk amounted to approximately \$197,000 and \$125,000 as of June 30, 2017 and 2016, respectively.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

5. Investments

The University's investments held at June 30, 2017, are summarized in the following table (expressed in thousands):

	Restricted Investments in:						Total
	Permanent Endowment Funds	Sinking Funds	Healthcare Deferred Compensation Plan	Construction Fund	Others	Unrestricted Investments	
University:							
U.S. Treasury notes	\$ 9,609	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 9,609
U.S. sponsored agencies bonds and notes	3,715	-	-	-	-	-	3,715
U.S. municipal bonds	-	-	-	-	-	2,712	2,712
Foreign government bonds	529	-	-	-	-	-	529
Mortgage-backed securities	19,227	-	-	-	-	-	19,227
Asset-backed securities	2,626	-	-	-	-	-	2,626
Corporate bonds	30,493	-	-	-	-	-	30,493
Common stock and convertibles	37,128	-	-	-	-	-	37,128
External investment pools	-	-	11,991	-	-	169	12,160
Nonparticipating guaranteed investment contracts	-	-	56,781	-	-	-	56,781
Certificates of deposit	155	-	-	-	5	149	309
Money market funds and others	-	30,774	24,239	-	-	-	55,013
Total University's Investments	103,482	30,774	93,011	-	5	3,030	230,302
DUI:							
U.S. sponsored agency notes	-	5,621	-	-	-	-	5,621
Money market funds	-	5,965	-	3,071	-	-	9,036
Total DUI's Investments	-	11,586	-	3,071	-	-	14,657
Total Primary Government	\$ 103,482	\$ 42,360	\$ 93,011	\$ 3,071	\$ 5	\$ 3,030	\$ 244,959
Current portion	\$ -	\$ 42,360	\$ -	\$ 3,071	\$ 5	-	\$ 45,436
Noncurrent portion	103,482	-	93,011	-	-	3,030	199,523
Total	\$ 103,482	\$ 42,360	\$ 93,011	\$ 3,071	\$ 5	\$ 3,030	\$ 244,959



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

5. Investments (continued)

The University's investments held at June 30, 2016, are summarized in the following table (expressed in thousands):

	Restricted Investments in:					Unrestricted Investments	Total
	Permanent Endowment Funds	Sinking Funds	Healthcare Deferred Compensation Plan	Construction Fund	Others		
The University Only:							
U.S. Treasury notes	\$ 10,123	\$ 54,862	\$ -	\$ -	\$ -	\$ -	\$ 64,985
U.S. sponsored agencies bonds and notes	2,881	-	-	-	-	-	2,881
U.S. municipal bonds	-	-	-	-	-	2,632	2,632
Foreign government bonds	921	-	-	-	-	-	921
Mortgage-backed securities	17,234	-	-	-	-	-	17,234
Asset-backed securities	3,332	-	-	-	-	-	3,332
Corporate bonds	25,018	-	-	-	-	-	25,018
Common stock and convertibles	40,195	-	-	-	-	-	40,195
External investment pools	-	-	12,032	-	-	-	12,032
Nonparticipating guaranteed investment contracts	-	-	47,618	-	-	-	47,618
Certificates of deposit	156	-	-	-	5	-	161
Money market funds and others	-	-	28,028	-	-	-	28,028
Total University's Investments	99,860	54,862	87,678	-	5	2,632	245,037
DUI:							
U.S. sponsored agency notes	-	5,848	-	-	-	-	5,848
Money market funds	-	5,366	-	3,067	-	-	8,433
Total DUI's Investments	-	11,214	-	3,067	-	-	14,281
Total	\$ 99,860	\$ 66,076	\$ 87,678	\$ 3,067	\$ 5	\$ 2,632	\$ 259,318
Current portion	\$ -	\$ 66,076	\$ -	\$ 3,067	\$ 5	\$ -	\$ 69,148
Noncurrent portion	99,860	-	87,678	-	-	2,632	190,170
Total	\$ 99,860	\$ 66,076	\$ 87,678	\$ 3,067	\$ 5	\$ 2,632	\$ 259,318

Restricted Investments in Sinking Funds

The University and DUI are required to maintain sinking funds held by trustees for the retirement of the "University System Revenue Bonds" and the "DUI AFICA Bonds". The Trustees shall, upon the receipt of the pledged revenues, make deposits to the credit of the sinking fund accounts.

The University's funds held by trustee at June 30, 2017 and 2016 amounted to approximately \$30,774,000 and \$54,862,000, respectively, and consisted of money market funds in 2017 and of U.S. Treasury notes purchased with remaining maturities of six months or less in 2016.

DUI's funds held by trustee at June 30, 2017 and 2016 amounted to approximately \$11,586,000 and \$11,214,000, respectively, and consisted of money market funds and a U.S. sponsored agency note purchased with remaining maturities of six months or less.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

5. Investments (continued)

Restricted Investments in Construction Fund

DUI maintains a Construction Fund account held by trustee, related to the issuance of the AFICA bonds. As of June 30, 2017 and 2016, the account balance amounted to approximately \$3,071,000 and \$3,067,000, respectively, and consisted of a money market fund.

Restricted Investments in Permanent Endowment Funds

Restricted investments held in the University's permanent endowment funds at June 30, 2017 and 2016 amounted to approximately \$103,482,000 and \$99,860,000, respectively. The corpus of these funds may not be expended and must remain with the University in perpetuity. Only the earnings from these funds may be expended.

For each permanent endowment fund, the University is mainly authorized by the donor to invest a percentage of total assets, with certain limitations, in the following types of investments: not less than 50% and no more than 80% in fixed income securities and not less than 20% and no more than 50% 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.

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

As of June 30, 2017, almost all the donors of the University's endowment funds only authorize the realized portion of the net appreciation of their investments (including interest and dividend income on investment and cash equivalents) to be spent in amounts that range from 75% to 100% in accordance with the donor specific instructions. Unrealized net appreciation on investments of the endowment funds is not available for authorization for expenditure by the Governing Board. As of June 30, 2017 and 2016, net appreciation of approximately \$8,503,000 and \$8,986,000, respectively, was restricted to specific purposes.

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

Investments designated to fund the University's Healthcare Deferred Compensation Plan, which consisted of external investment pools, nonparticipating guaranteed investment contracts and money market fund amounted to approximately \$93,011,000 and \$87,678,000 as of June 30, 2017 and 2016, respectively. At the participant'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 participant until termination, retirement, death or unforeseeable emergency. These investments are (until paid or made available to the participant or other beneficiary) solely the property and rights of the University, subject only to the claims of the University's general creditors in the event of the University's insolvency, as defined in the Trust Agreements. 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.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

5. Investments (continued)

Investments Designated to Fund the University's Healthcare Deferred Compensation (continued)

Investments designated to fund the University's Healthcare Deferred Compensation Plan include the Voya Retirement Insurance and Annuity Company ("Voya") Fixed Account, a nonparticipating guaranteed investment contract, which amounted to approximately \$56,781,000 and \$46,890,000 as of June 30, 2017 and 2016, respectively, and a deposit in a suspense account at Voya of approximately \$24,239,000 and \$27,755,000 as of June 30, 2017 and 2016, respectively.

On May 11, 2016, the plan participants of the University's Healthcare Deferred Compensation Plan of the Medical Sciences Campus recommended, by majority of more than fifty percent (96.9%) to terminate the University's Healthcare Deferred Compensation Plan. Its Board of Directors ratified such recommendation. On June 30, 2016, the Governing Board of the University ratified the termination of Voya Institutional Trust Company as Trustees of the Trust of the University's Healthcare Deferred Compensation Plan. The members of the Governing Board of the University were designated as the Successor Trustees of the Trust of the University's Healthcare Deferred Compensation Plan. In addition, the Governing Board of the University approved the dissolution of the University's Healthcare Deferred Compensation Plan and the distribution of the deferred funds to its participants. On August 22, 2016, Voya filed a complaint in the U.S. District Court for the District of Puerto Rico against the Governor of the Commonwealth, the University and its President. The complaint seeks relief from the Court relating to its administration of the Trust in light of the financial crisis in Puerto Rico and its effect on the University. Specifically, this complaint for declaratory relief seeks federal judicial review as expressly provided for by PROMESA of the issues arising under PROMESA, the Trust Agreements, and other relevant law, in light of the University's financial condition and its efforts to distribute all Plan assets. The University, Voya, the Oversight Board of PROMESA and FAFAA are participating in a mediation to attempt to resolve the case consensually. Voya has not yet transferred the plan assets to the University waiting for the resolution of this complaint by the U.S. District Court for the Puerto Rico District.

Credit Risk

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



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

5. Investments (continued)

Credit Risk (continued)

As of June 30, 2017, the University's credit quality distribution for securities is as follows (expressed in thousands):

	Carrying Value	Quality Rating						
		AAA	AA+ to AA	A+ to A-	BBB+ to BBB-	B	Unrated	No Risk
U.S. Treasury bonds and notes	\$ 9,609	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 9,609
U.S. sponsored agencies bonds and notes	9,336	-	9,336	-	-	-	-	-
U.S. municipal bonds	2,712	146	1,703	104	664	95	-	-
Foreign government bonds	529	-	-	529	-	-	-	-
Mortgage-backed securities	19,227	12,500	4,681	-	-	-	-	2,046
Asset-backed securities	2,626	2,626	-	-	-	-	-	-
Corporate bonds	30,493	6,842	6,917	16,140	594	-	-	-
Common stock and convertibles	37,128	-	-	-	-	-	37,128	-
External investment pools	12,160	-	-	-	-	-	11,991	169
Nonparticipating guaranteed investment contracts	56,781	-	-	56,781	-	-	-	-
Certificates of deposit	309	-	-	-	-	-	309	-
Money market funds	64,049	9,036	-	55,013	-	-	-	-
Total	\$ 244,959	\$ 31,150	\$ 22,637	\$ 128,567	\$ 1,258	\$ 95	\$ 49,428	\$ 11,824

As of June 30, 2016, the University's credit quality distribution for securities is as follows (expressed in thousands):

	Carrying Value	Quality Rating						
		AAA	AA+ to AA	A+ to A-	BBB+	B+	Unrated	No Risk
U.S. Treasury notes	\$ 64,985	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 64,985
U.S. sponsored agencies bonds and notes	8,729	215	8,514	-	-	-	-	-
U.S. municipal bonds	2,632	366	1,636	136	392	102	-	-
Foreign government bonds	921	-	-	921	-	-	-	-
Mortgage-backed securities	17,234	11,232	3,999	-	-	-	-	2,003
Asset-backed securities	3,332	3,332	-	-	-	-	-	-
Corporate bonds	25,018	2,132	6,517	16,006	363	-	-	-
Common stock and convertibles	40,195	-	-	-	-	-	40,195	-
External investment pools	12,032	-	-	-	-	-	12,032	-
Nonparticipating guaranteed investment contracts	47,618	-	-	47,618	-	-	-	-
Certificates of deposit	161	-	-	-	-	-	161	-
Money market funds	36,461	8,433	-	28,028	-	-	-	-
Total	\$ 259,318	\$ 25,710	\$ 20,666	\$ 92,709	\$ 755	\$ 102	\$ 52,388	\$ 66,988

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 and DUI 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, 2017, the custody of these investments is held by the trust departments of commercial banks in the name of the University and DUI and the portfolios are managed by brokerage firms.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

5. Investments (continued)

Impairment Loss on Deposits with Governmental Bank

Deposits held with GDB amounted to approximately \$92,147,000, \$91,975,000 and \$88,433,000 as of June 30, 2017, 2016 and 2015, respectively. Management concluded that the information available indicates that it is probable that an impairment loss on the University's certificates of deposit held with the GDB exists as of June 30, 2017, 2016 and 2015.

GDB faces significant risks and uncertainties and it currently does not have (and is not expected to have) sufficient liquid financial resources to meet its obligations in full. Pursuant to enacted legislation and executive orders by two separate government administrations, GDB has been ordered to suspend loan disbursements, to impose restrictions on the withdrawal and transfer of deposits from GDB and has been imposed a moratorium on its debt obligations, among other measures. On March 23, 2018, GDB ceased its operations and it is currently winding down in an orderly fashion under Title VI of PROMESA.

Based on an evaluation of the availability and recoverability of such funds, an impairment loss on deposits held with the GDB was recorded in the University's basic financial statements for the years ended June 30, 2016 and 2015 of approximately \$69,807,000 and \$21,668,000, respectively. The carrying value of the cash equivalents and investments in certificates of deposit held with GDB after the impairment charge amounted to approximately \$500,000 and \$66,745,000 as of June 30, 2016 and 2015, respectively. The realizable balance of the deposits held with the GDB was determined based on the corresponding actual collections received from the GDB on such deposits after year end. At June 30, 2017, the entire balance of the deposits held with GDB was considered not realizable. Deposits held with GDB increased by approximately \$672,000 in fiscal year 2017 for capitalized interest which collection was considered improbable. Thus, related interest income was not recorded in fiscal year 2017. Refer to Note 20 for the offset of the credit facilities with the GDB, on a dollar-for-dollar basis, by the amount of the University's deposits held at the GDB on November 29, 2018.

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 US Bank money market account (approximately \$30,744,000), the Voya Retirement Insurance and Annuity Company Fixed Account (a nonparticipating guaranteed investment contract) (approximately \$56,781,000) and a deposit in a suspense account at Voya (approximately \$20,860,000), represented 5% or more of the total investment portfolio at June 30, 2017.

At June 30, 2017 and 2016, the University had variable rate interest investments amounting to approximately \$866,000 and \$236,000, respectively.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

5. Investments (continued)

Interest Rate Risk (continued)

The following table summarizes the type and maturity of investments held by the University at June 30, 2017 (expressed in thousands):

	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 bonds and notes	\$ —	\$ 2,788	\$ 6,821	\$ —	\$ —	\$ 9,609
U.S. sponsored agencies bonds and notes	5,621	2,585	1,130	—	—	9,336
U.S. municipal bonds	—	128	1,338	1,246	—	2,712
Foreign government bonds	—	529	—	—	—	529
Mortgage-backed securities	—	354	11,120	7,753	—	19,227
Asset-backed securities	9	2,276	341	—	—	2,626
Corporate bonds	1,285	22,740	6,468	—	—	30,493
Certificates of deposit	309	—	—	—	—	309
Nonparticipating guaranteed investment contracts	—	56,781	—	—	—	56,781
External investment pools	2	409	74	—	11,675	12,160
Money market funds	39,810	24,239	—	—	—	64,049
Common stock and convertibles	—	—	—	—	37,128	37,128
Total	\$ 47,036	\$ 112,829	\$ 27,292	\$ 8,999	\$ 48,803	\$ 244,959

The following table summarizes the type and maturity of investments held by the University at June 30, 2016 (expressed in thousands):

	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	\$ 54,862	\$ 1,570	\$ 8,553	\$ —	\$ —	\$ 64,985
U.S. sponsored agencies bonds and notes	5,848	1,265	1,616	—	—	8,729
U.S. municipal bonds	—	131	1,434	1,067	—	2,632
Foreign government bonds	—	921	—	—	—	921
Mortgage-backed securities	—	93	5,639	11,502	—	17,234
Asset-backed securities	112	3,220	—	—	—	3,332
U.S. corporate bonds	3	16,852	8,163	—	—	25,018
Certificates of deposit	161	—	—	—	—	161
Nonparticipating guaranteed investment contracts	—	47,618	—	—	—	47,618
External investment pools	2	316	76	—	11,638	12,032
Money market funds	8,707	27,754	—	—	—	36,461
Common stock and convertibles	—	—	—	—	40,195	40,195
Total	\$ 69,695	\$ 99,740	\$ 25,481	\$ 12,569	\$ 51,833	\$ 259,318



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

5. Investments (continued)

Fair Value Hierarchy

The University categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure fair value of the assets. Level 1 inputs are quoted prices in an active market for identical assets; Level 2 inputs are significant other observable inputs; and Level 3 inputs are significant unobservable inputs (the University does not value any of its investments using level 3 inputs). Investments in nonparticipating guaranteed investment contracts, certificates of deposit and money market funds and others amounting to approximately \$121,139,000 and \$84,240,000 as of June 30, 2017 and 2016, respectively, are not classified in the fair value hierarchy below because they are carried at cost.

The following is a summary of the fair value hierarchy of the fair value of investments of the University as of June 30, 2017 and June 30, 2016 (expressed in thousands):

Investments by Fair Value Level	2017			2016		
	Total	Fair Value Measurements Using		Total	Fair Value Measurements Using	
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
U.S. Treasury notes	\$ 9,609	\$ —	\$ 9,609	\$ 64,985	\$ —	\$ 64,985
U.S. sponsored agencies bonds and notes	9,336	—	9,336	8,729	—	8,729
U.S. municipal bonds	2,712	—	2,712	2,632	—	2,632
Foreign government bonds	529	—	529	921	—	921
Mortgage-backed securities	19,227	—	19,227	17,234	—	17,234
Asset-backed securities	2,626	—	2,626	3,332	—	3,332
Corporate bonds	30,493	—	30,493	25,018	—	25,018
Common stock and convertibles	37,128	37,128	—	40,195	40,195	—
External investment pools	12,160	12,160	—	12,032	12,032	—
Total Investments by Fair Value Level	<u>\$ 123,820</u>	<u>\$ 49,288</u>	<u>\$ 74,532</u>	<u>\$ 175,078</u>	<u>\$ 52,227</u>	<u>\$ 122,851</u>

Investments classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets.

Investment income securities, including U.S. Treasury notes, U.S. sponsored agencies bonds and notes, U.S. municipal bonds, foreign government bonds, mortgage-backed securities, asset-backed securities and corporate bonds, classified in Level 2 of the fair value hierarchy are valued using matrix pricing techniques maintained by various pricing vendors. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices. Fair value is defined as the quoted market value on the last trading day of the period. These prices are obtained from various pricing sources by our custodian bank.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

6. Accounts Receivable

The University's accounts receivable, net of allowance for doubtful accounts as of June 30, 2017 and 2016 are as follows (expressed in thousands):

	2017			2016		
	Gross Balance	Allowance	Net Balance	Gross Balance	Allowance	Net Balance
Due from medical plans	\$ 113,113	\$ (104,227)	\$ 8,886	\$ 109,552	\$ (100,617)	\$ 8,935
Student tuition and fees	11,926	(8,996)	2,930	9,478	(7,465)	2,013
Other	16,970	(11,785)	5,185	12,887	(8,145)	4,742
Total accounts receivable	<u>142,009</u>	<u>(125,008)</u>	<u>17,001</u>	<u>131,917</u>	<u>(116,227)</u>	<u>15,690</u>
Due from Federal Government (see Note 7)	54,208	(20,624)	33,584	52,833	(20,384)	32,449
Due from related party (see Note 8)	114,433	(101,461)	12,972	111,277	(98,741)	12,536
Total	<u>\$ 310,650</u>	<u>\$ (247,093)</u>	<u>\$ 63,557</u>	<u>\$ 296,027</u>	<u>\$ (235,352)</u>	<u>\$ 60,675</u>

Component Units

The Component Units' accounts receivable, net of allowance for doubtful accounts as of June 30, 2017 and 2016 are as follows (expressed in thousands):

	2017			2016		
	Gross Balance	Allowance	Net Balance	Gross Balance	Allowance	Net Balance
The Hospital:						
Patient accounts	\$ 39,036	\$ (29,218)	\$ 9,818	\$ 44,220	\$ (35,673)	\$ 8,547
Others	726	-	726	665	-	665
Total the Hospital	<u>39,762</u>	<u>(29,218)</u>	<u>10,544</u>	<u>44,885</u>	<u>(35,673)</u>	<u>9,212</u>
UPRPS - others	128	-	128	347	-	347
MCC - others	329	(11)	318	417	(11)	406
Total	<u>\$ 40,219</u>	<u>\$ (29,229)</u>	<u>\$ 10,990</u>	<u>\$ 45,649</u>	<u>\$ (35,684)</u>	<u>\$ 9,965</u>

7. Due from Federal Government

Due from Federal Government, net of allowance for doubtful accounts as of June 30, 2017 and 2016 are as follows (expressed in thousands):

	2017			2016		
	Gross Balance	Allowance	Net Balance	Gross Balance	Allowance	Net Balance
The University Only	<u>\$ 54,208</u>	<u>\$ (20,624)</u>	<u>\$ 33,584</u>	<u>\$ 52,833</u>	<u>\$ (20,384)</u>	<u>\$ 32,449</u>
The Hospital	<u>\$ 2,905</u>	<u>\$ (1,891)</u>	<u>\$ 1,014</u>	<u>\$ 3,276</u>	<u>\$ (1,801)</u>	<u>\$ 1,475</u>

The University Only's Due from Federal Government accounts are mainly related to grants and contracts from Federal Government for research activity in the Sciences, Health Sciences, Engineering, Technology and the Arts. The Hospital's Due from Federal Government accounts are mainly related to inpatient acute care and outpatient services rendered to Medicare program beneficiaries and inpatient capital cost related to Medicare program beneficiaries.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

8. Related-Party Transactions

The University's related-party accounts receivable, net of allowance for doubtful accounts as of June 30, 2017 and 2016 are as follows (expressed in thousands):

	2017			2016		
	Gross Balance	Allowance	Net Balance	Gross Balance	Allowance	Net Balance
Due from Commonwealth's:						
Formula and other appropriations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Agencies	26,750	(23,156)	3,594	26,682	(21,963)	4,719
Total Due from Commonwealth	26,750	(23,156)	3,594	26,682	(21,963)	4,719
Due from Commonwealth's Component Units						
Municipalities	61,985	(54,469)	7,516	56,885	(50,180)	6,705
Due from Servicios Médicos Universitarios, Inc.	3,876	(2,968)	908	3,443	(3,111)	332
Due from the University Retirement System	21,769	(20,868)	901	24,253	(23,487)	766
Total	53	-	53	14	-	14
Total	<u>\$ 114,433</u>	<u>\$ (101,461)</u>	<u>\$ 12,972</u>	<u>\$ 111,277</u>	<u>\$ (98,741)</u>	<u>\$ 12,536</u>

Due from and Appropriations from Commonwealth of Puerto Rico

Due from Commonwealth's agencies mainly includes the accounts receivable from the Department of Health which amounted to approximately \$15,780,000 and \$15,160,000 at June 30, 2017 and 2016, respectively, for unpaid medical services provided by the faculty members of the Medical Sciences Campus of the University to the Commonwealth's health reform program patients and other services; and from the Department of Education which amounted to approximately \$2,426,000 and \$2,949,000 at June 30, 2017 and 2016, respectively, for contracts for professional development of public school teachers, autism programs and others.

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 fund revenues collected under the laws of the Commonwealth in the two fiscal years immediately preceding the current fiscal year (the Commonwealth formula appropriations). The Commonwealth formula appropriations amounted to approximately \$833,929,000 for the years ended June 30, 2017 and 2016. On April 7, 2013, Act No. 7 amended Act No. 2 of January 20, 1966, and revised the formula for the Commonwealth appropriations effective July 1, 2013.

On June 17, 2014, the Legislature of the Commonwealth enacted Act No. 66-2014 (the "Fiscal Sustainability Act"). The Fiscal Sustainability Act was a temporary fiscal emergency law designed to address the fiscal condition of the Commonwealth. Among other things, the Fiscal Sustainability Act froze the benefit under the formula-based appropriation of the University to the amount appropriated for fiscal year ended June 30, 2014. The Fiscal Sustainability Act remained in effect for three fiscal years ended on June 30, 2017.

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 approximately \$39,185,000 and \$35,964,000 for the years ended June 30, 2017 and 2016, respectively.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

8. Related-Party Transactions (continued)

Due from and Appropriations from Commonwealth of Puerto Rico (continued)

All Commonwealth formula and other appropriations for the fiscal years 2017 and 2016 were collected in the corresponding fiscal year.

Due from Commonwealth's Component Units

Due from Commonwealth's component units includes accounts receivable from the Puerto Rico Medical Service Administration ("PRMSA") which amounted to approximately \$44,655,000 and \$40,889,000 as of June 30, 2017 and 2016, respectively. These accounts receivable mainly come from contracted medical services provided by the faculty members of the Medical Sciences Campus of the University to the PRMSA.

In addition, due from Commonwealth's component units includes an account receivable from the Puerto Rico Tourism Company ("PRTC") which amounted to approximately \$5,026,000 and \$5,475,000 at June 30, 2017 and 2016, respectively. This account receivable includes unremitted distributions of income to be received by the University from PRTC under the Gambling Law (slot machines and others) by virtue of Act No. 36 of 2005 which are payable upon demand. Due from PRTC at June 30, 2017 and 2016 were collected in July 2017 and 2016, respectively. PRTC appropriations (nonoperating revenues) for the years ended June 30, 2017 and 2016, amounted to approximately \$61,523,000 and \$63,610,000, respectively, and are included as part of Commonwealth appropriations in the accompanying statements of revenues, expenses and changes in net position.

Due from Commonwealth's component units also includes accounts receivable from the Comprehensive Cancer Center of the University of Puerto Rico ("CCCUPR") which amounted to approximately \$3,583,000 and \$2,438,000 at June 30, 2017 and 2016, respectively. These accounts receivable mainly come from unpaid charges of salaries, fringe benefits and other expenses incurred in fiscal years 2015, 2016 and 2017 by certain professors of the Medical Science Campus of the University for Cancer research and investigations provided to the CCCUPR. The University collected approximately \$1.3 million in July 2017 and \$1.0 million in November 2018 of these accounts receivable as of June 30, 2017.

Due from Servicios Médicos Universitarios, Inc. (the "Hospital") mainly comes from contracted medical services provided by the faculty members of the Medical Science Campus of the University to the Hospital.

Due from the University of Puerto Rico Retirement System

The University has a due from the University of Puerto Rico Retirement System (the "Retirement System") of approximately \$54,000 and \$14,000 as of June 30, 2017 and 2016, respectively, which resulted from unpaid advances given by the University to the Retirement System. The amount due by the Retirement System was unsecured, non-interest bearing and payable upon demand.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

8. Related-Party Transactions (continued)

Other Related-Party Transactions

The University's accounts payable and accrued liabilities include the following related-party transactions as of June 30, 2017 and 2016 (expressed in thousands):

	<u>2017</u>	<u>2016</u>
Due to:		
Commonwealth's component units	\$ 20,959	\$ 18,988
Servicios Médicos Universitarios, Inc.	8,963	10,328
University's Retirement System	8,963	1,280
Total	<u>\$ 38,885</u>	<u>\$ 30,596</u>

Due to Commonwealth's component units include accounts payable to the Puerto Rico Medical Service Administration (PRMSA) of approximately \$14,387,000 and \$13,634,000 as of June 30, 2017 and 2016, respectively. These accounts payable mainly come from contracted medical services provided by the PRMSA to the University.

Due to Servicios Médicos Universitarios, Inc. (the "Hospital") mainly comes from rental income owed by the University to the Hospital and contracted medical services provided by the Hospital to the University.

Due to the University's Retirement System at June 30, 2017 mainly resulted for an unpaid additional pension contribution of approximately \$6.3 million to the University's Retirement System approved by the Governing Board of the University for the year ended June 30, 2017 that was paid to the University's Retirement System in November 2018. In addition, it includes the unpaid medical subsidy (post-employment benefit other than pension) of June 2017 of approximately \$2.4 million that was paid to the University's Retirement System in July 2017.

The Hospital's accounts payable and accrued liabilities include amounts due to the Commonwealth's component units of approximately \$138,000 as of June 30, 2016 for utilities expenditures (mainly electricity).

For additional related-party transactions, refer to Notes 4, 5, 9, 11, 12, 13, 14, and 15.

9. Interfund Balances and Transactions

The University and DUI have the following interfund balances and transactions:

Capital Lease Agreement

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



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

9. Interfund Balances and Transactions (continued)

Capital Lease Agreement (continued)

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

The University makes basic lease payments, payable monthly, in amounts sufficient to pay principal of and interest on the DUI's AFICA Bonds payable and are pledged to guarantee such payments. In addition, the University pays as supplemental lease payments, such amounts as may be required under the management contract then in effect for the cost of maintaining and repairing the Project. Under the term of the lease agreement, the University makes the lease payment directly to the AFICA Bonds trustee. At the expiration date of the agreement, the University may purchase the Project for \$1.

Also, DUI maintains a Debt Service Reserve Fund with the trustee at its required level to make payments of the AFICA Bonds whenever and to the extent that moneys to the credit of the Bond Fund are insufficient for such purpose. The initial required amount deposited in the Debt Service Reserve Fund was approximately \$5,702,000.

The agreement began on October 1, 2006 and expires on June 25, 2033. The outstanding liability at June 30, 2017 and 2016 on this capital lease was approximately \$55,594,000 and \$57,779,000, respectively. The effective interest rate was 6.19 % at June 30, 2017 and 2016.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

9. Interfund Balances and Transactions (continued)

Capital Lease Agreement (continued)

The activity of the principal balance of the capital lease obligation for the years ended June 30, 2017 and 2016 is as follows (expressed in thousands):

	<u>2017</u>	<u>2016</u>
Beginning Balance	\$ 57,779	\$ 59,833
Additions	—	—
Reductions	(2,185)	(2,054)
Ending Balance	55,594	57,779
Less current portion	2,321	2,185
Total noncurrent portion	<u>\$ 53,273</u>	<u>\$ 55,594</u>

During the years ended June 30, 2017 and 2016, the University paid approximately \$5,702,000 under the capital lease agreement. In July 2014, the trustee directed DUI to reduce loan repayments of the AFICA bonds by approximately \$1,838,000 for the fiscal year 2015 and similarly, the University reduced its basic lease payments by the same amount for partial credit for investment earnings on the trust accounts since inception of the lease. No such credits were granted in fiscal years 2017 and 2016. Similar credits are anticipated in future years to account for investment earnings not yet credited at June 30, 2016 and for future investment earnings, if any. The trustee also established that the required amount deposited in the Debt Service Reserve Fund of \$5.7 million (which amount is similar to the loan repayments and basic lease payments for fiscal year 2033) would be credited to both DUI and the University as loan repayments and basic lease payments, respectively, commencing in July 2032. The effect of the above credit results in amending capital lease obligation amortization, reducing the scheduled payments for the fiscal year 2015 and the effective interest rate on the capital lease obligation and thus the interest expense on the capital lease obligation. In addition, the effect of the above credit resulted in the reduction of the principal balance of the capital lease obligation by approximately \$1,059,000 during the year ended June 30, 2015. Future credit granted by the trustee, will have a similar effect, when so granted.

On June 30, 2016, the Governor of the Commonwealth signed EO 31, declaring the University in a state of emergency pursuant to Act No. 21. In compliance with EO 31, the University suspended the monthly payments of the Lease Agreement with DUI (which are paid directly to the trustee of the DUI's AFICA bonds) from July 2016 to May 2017.

On August 5, 2016 and monthly thereafter until April 2017, the trustee of the DUI's AFICA Bonds notified to the University that it failed to make the basic lease payment to the trustee since July 25, 2016 and that a default under the lease agreement with DUI constitutes an event of default under the DUI's AFICA Bonds Trust Agreement. As such, the University was in default of this obligation until April 2017. The trustee was not seeking any indebtedness from, enforce any judgment, or obtain possession of, or exercise control over, any property of or from, the Commonwealth or any of its instrumentalities, including DUI and the University, or exercise any act that is stayed by PROMESA, the Act No. 21, or the Executive Orders related thereto. In May 2017, the University reestablished the payments to trustee of the DUI's AFICA Bonds and paid all the basic lease payments due from July 2016 until May 2017 (approximately \$5.2 million).



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

9. Interfund Balances and Transactions (continued)

Capital Lease Agreement (continued)

Presently, the University has paid as agreed the monthly basic lease payments to the trustee of the DUI's AFICA Bonds and DUI has paid as agreed the scheduled principal and interest payments on its outstanding AFICA Bonds.

At June 30, 2017, the future minimum lease payments under the capital lease are as follows (expressed in thousands):

<u>Year Ending June 30,</u>	<u>Amount</u>
2018	\$ 5,699
2019	5,699
2020	5,701
2021	5,697
2022	5,701
2023-2027	28,495
2028-2032	28,503
2033 ⁽¹⁾	—
Total future minimum lease payments	85,495
Less amounts representing interest costs	(29,901)
Present value of minimum lease payments	<u>\$ 55,594</u>

⁽¹⁾ Minimum lease payments were reduced by \$5.7 million of the required amount

Other Transactions

On December 21, 2000, DUI executed the Qualified Operations and Management Agreement (the "Management Agreement") with the University for the operation, maintenance and management of Plaza Universitaria facilities. The Management Agreement has a term of 15 years, originally commencing on the earliest of January 1, 2003 or six months prior to the Opening Date, as defined, and may be extended for three additional five-year terms at the University's option. On April 7, 2008, DUI and the University formally agreed to amend certain clauses contained in the Management Agreement, including the commencement date, which was set as October 1, 2006.

Under the terms of the Management Agreement, DUI receive a monthly fixed management fee, which is subject to automatic annual increases reflecting increases in the Consumer Price Index. The fixed management fee was \$75,000 per month for the years ended June 30, 2017 and 2016. DUI also receive a reimbursable expenditures fee to cover expenditures incurred in operating and maintaining Plaza Universitaria facilities, at actual cost, and is not to be used to pay expenses that should otherwise be covered by the fixed management fee. The amount to be paid is determined by an annual operating budget prepared by DUI and approved by the University. The University must also fund non-routine capital expenditures, as defined.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

9. Interfund Balances and Transactions (continued)

Other Transactions (continued)

DUI's responsibilities under the Management Agreement also include the rental and related income derived from the student dormitory and commercial facilities, as well as the parking operation. Accordingly, DUI only act as an agent for the University in the collection and oversight of student dormitories rental, commercial facilities rental and related income, as well as the parking operation. DUI maintain separate cash accounts for such concepts, and periodically transfers funds from these accounts to the University. Rental and other miscellaneous income derived from the student dormitories, commercial facilities and parking operations amounted to approximately \$1,925,000 and \$2,492,000 for the years ended June 30, 2017 and 2016, respectively. DUI remitted approximately \$2,647,000 and \$2,234,000 to the University during the years ended June 30, 2017 and 2016, respectively, for amounts collected from student dormitories and commercial facilities and parking operations.

Net amount due by the University under the operations and management agreement amounted to approximately \$1,523,000 and \$1,889,000 as of June 30, 2017 and 2016, respectively.

During the years ended June 30, 2017 and 2016, the University incurred the following expenditures under the operations and management agreement (expressed in thousands):

	<u>2017</u>	<u>2016</u>
Fixed management fee	\$ 900	\$ 900
Reimbursable expenditures fee	2,646	2,889
Total	<u>\$ 3,546</u>	<u>\$ 3,789</u>

Interfund receivable and payable balances and transactions have been eliminated from the basic financial statements.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

10. Capital Assets

Changes in the University's capital assets for the years ended June 30, 2017 and 2016 are as follows (expressed in thousands):

	2017				
	Beginning Balance	Additions	Transfers	Disposals and Others	Ending Balance
Capital assets not being depreciated:					
Land	\$ 49,616	\$ —	\$ —	\$ —	\$ 49,616
Construction in progress and others	6,574	8,142	(4,589)	—	10,127
	56,190	8,142	(4,589)	—	59,743
Other capital assets:					
Land improvements	38,243	—	1,329	—	39,572
Buildings, fixed equipment, improvements and infrastructure	1,132,916	420	593	—	1,133,929
Equipment, software and library materials	321,831	11,990	2,667	(9,503)	326,985
Building and equipment under capital lease	99,489	—	—	—	99,489
	1,592,479	12,410	4,589	(9,503)	1,599,975
Less accumulated depreciation and amortization for:					
Land improvements	(24,932)	(1,332)	—	(122)	(26,386)
Buildings, fixed equipment, improvements and infrastructure	(440,135)	(28,415)	—	169	(468,381)
Equipment, software and library materials	(258,730)	(16,639)	—	7,621	(267,748)
Building and equipment under capital lease	(28,029)	(2,725)	—	8	(30,746)
	(751,826)	(49,111)	—	7,676	(793,261)
Other capital assets, net of accumulated depreciation	840,653	(36,701)	4,589	(1,827)	806,714
Capital assets, net	\$ 896,843	\$ (28,559)	\$ —	\$ (1,827)	\$ 866,457
	2016				
	Beginning Balance	Additions	Transfers	Disposals and Others	Ending Balance
Capital assets not being depreciated:					
Land	\$ 49,616	\$ —	\$ —	\$ —	\$ 49,616
Construction in progress and others	38,878	8,987	(39,509)	(1,782)	6,574
	88,494	8,987	(39,509)	(1,782)	56,190
Other capital assets:					
Land improvements	37,973	—	270	—	38,243
Buildings, fixed equipment, improvements and infrastructure	1,097,014	—	35,902	—	1,132,916
Equipment, software and library materials	315,382	19,019	3,337	(15,907)	321,831
Building and equipment under capital lease	99,489	—	—	—	99,489
	1,549,858	19,019	39,509	(15,907)	1,592,479
Less accumulated depreciation and amortization for:					
Land improvements	(23,553)	(1,379)	—	—	(24,932)
Buildings, fixed equipment, improvements and infrastructure	(414,270)	(25,826)	—	(39)	(440,135)
Equipment, software and library materials	(251,615)	(18,014)	—	10,899	(258,730)
Building and equipment under capital lease	(25,087)	(2,687)	—	(255)	(28,029)
	(714,525)	(47,906)	—	10,605	(751,826)
Other capital assets, net of accumulated depreciation	835,333	(28,887)	39,509	(5,302)	840,653
Capital assets, net	\$ 923,827	\$ (19,900)	\$ —	\$ (7,084)	\$ 896,843



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

10. Capital Assets (continued)

As of June 30, 2017 and 2016, the carrying value of the University's assets recorded under capital leases amounted to approximately \$68,743,000 and \$71,460,000, respectively. Amortization expense on these assets amounted to approximately \$2,725,000 and \$2,687,000 in 2017 and in 2016, respectively. In addition, the carrying value of the University's medical equipment that collateralized the term notes payable to a commercial bank (see Note 10) amounted to approximately \$355,000 as of June 30, 2016.

Capitalized interest on construction in progress amounted to approximately \$744,000 for the year ended June 30, 2016. In fiscal year 2017, no interest was capitalized because all additions to construction in progress were financing with operating funds.

On March 15, 2016, a fire destroyed a section of the Department of Chemical Engineering Building at the Mayaguez Campus. As a result, the University recorded an impairment charge of approximately \$1,245,000 for the destroyed equipment in the year ended June 30, 2016.

Component Units

Changes in the Component Units' capital assets for the years ended June 30, 2017 and 2016 are as follows (expressed in thousands):

	2017				
	Beginning Balance	Additions	Transfers	Disposals and Others	Ending Balance
Capital assets not being depreciated:					
Construction in progress	\$ 1,810	\$ —	\$ (739)	\$ —	\$ 1,071
	1,810	—	(739)	—	1,071
Other capital assets:					
Building, fixed equipment, improvements and infrastructure	6,364	36	739	—	7,139
Equipment, software and library materials	22,345	1,883	—	—	24,228
	28,709	1,919	739	—	31,367
Less accumulated depreciation and amortization for buildings, fixed equipment, improvements and infrastructure	(3,475)	(531)	—	—	(4,006)
Equipment, software and library materials	(17,296)	(1,330)	—	—	(18,626)
	(20,771)	(1,861)	—	—	(22,632)
Other capital assets, net of accumulated depreciation	7,938	58	739	—	8,735
Capital assets, net	\$ 9,748	\$ 58	\$ —	\$ —	\$ 9,806

	2016				
	Beginning Balance	Additions	Transfers	Disposals and Others	Ending Balance
Capital assets not being depreciated:					
Construction in progress	\$ 1,961	\$ 544	\$ (579)	\$ (116)	\$ 1,810
	1,961	544	(579)	(116)	1,810
Other capital assets:					
Building, fixed equipment, improvements and infrastructure	5,833	5	579	(53)	6,364
Equipment, software and library materials	20,848	1,497	—	—	22,345
	26,681	1,502	579	(53)	28,709
Less accumulated depreciation and amortization for buildings, fixed equipment, improvements and infrastructure	(3,060)	(465)	—	50	(3,475)
Equipment, software and library materials	(15,991)	(1,305)	—	—	(17,296)
	(19,051)	(1,770)	—	50	(20,771)
Other capital assets, net of accumulated depreciation	7,630	(268)	579	(3)	7,938
Capital assets, net	\$ 9,591	\$ 276	\$ —	\$ (119)	\$ 9,748



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

11. Noncurrent Liabilities

Changes in the University's noncurrent liabilities for the years ended June 30, 2017 and 2016 are as follows (expressed in thousands):

		2017							
		Beginning			Ending	Less Due			
		Balance	Additions	Reductions	Other	Balance	Within	Noncurrent	
								One Year	Liabilities
Long-term debt									
The University Only:									
Notes payable	\$	76,781	\$ -	\$ (375)	\$ -	\$ 76,406	\$ 76,406	\$ -	
Bonds payable		449,847	-	(20,965)	(1,750)	427,132	22,010	405,122	
Total University's long-term debt		526,628	-	(21,340)	(1,750)	503,538	98,416	405,122	
DUI's long-term debt- bonds payable		66,325	-	(2,315)	13	64,023	2,445	61,578	
Total long-term debt	\$	592,953	\$ -	\$ (23,655)	\$ (1,737)	\$ 567,561	\$ 100,861	\$ 466,700	
The University's other long-term liabilities									
Deferred compensation payable (see note 5)	\$	87,678	\$ -	\$ -	\$ 5,333	\$ 93,011	\$ -	\$ 93,011	
Claims liability (1)		22,277	-	(460)	(8,520)	13,297	1,170	12,127	
Compensated absences		154,804	-	(12,081)	2,980	145,703	26,272	119,431	
Net pension liability		1,796,727	209,976	-	-	2,006,703	-	2,006,703	
OPEB obligation		8,578	15,420	(9,845)	-	14,153	-	14,153	
Total University's other long-term liabilities	\$	2,070,064	\$ 225,396	\$ (22,386)	\$ (207)	\$ 2,272,867	\$ 27,442	\$ 2,245,425	
		2016							
		Beginning			Ending	Less Due			
		Balance	Additions	Reductions	Other	Balance	Within	Noncurrent	
								One Year	Liabilities
Long-term debt									
The University Only:									
Notes payable	\$	83,336	\$ 220	\$ (6,775)	\$ -	\$ 76,781	\$ 76,781	\$ -	
Bonds payable		471,611	-	(19,970)	(1,794)	449,847	20,965	428,882	
Total University's long-term debt		554,947	220	(26,745)	(1,794)	526,628	97,746	428,882	
DUI's long-term debt- bonds payable		68,501	-	(2,190)	14	66,325	2,315	64,010	
Total long-term debt	\$	623,448	\$ 220	\$ (28,935)	\$ (1,780)	\$ 592,953	\$ 100,061	\$ 492,892	
The University's other long-term liabilities									
Deferred compensation payable (see note 5)	\$	102,968	\$ -	\$ -	\$ (15,290)	\$ 87,678	\$ -	\$ 87,678	
Claims liability (1)		19,076	6,953	(3,752)	-	22,277	2,494	19,783	
Compensated absences		166,618	-	(8,023)	(3,791)	154,804	27,049	127,755	
Net pension liability		2,104,040	-	(307,313)	-	1,796,727	-	1,796,727	
OPEB obligation		7,633	11,467	(10,522)	-	8,578	-	8,578	
Total University's other long-term liabilities	\$	2,400,335	\$ 18,420	\$ (329,610)	\$ (19,081)	\$ 2,070,064	\$ 29,543	\$ 2,040,521	

(1) Includes a claim liability with federal agencies of approximately \$1,773,000 and \$5,648,000 at June 30, 2017 and 2016, respectively. See Note 14.

Notes payable and bonds payable are further discussed in Notes 12 and 13, respectively. Claim liability, net pension liability and OPEB obligation are further discussed in Notes 14, 15, and 16, respectively.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

12. Notes Payable

The University obtained a \$125 million line of credit with the Government Development Bank for Puerto Rico (“GDB”), a public corporation of the Commonwealth, for working capital purposes. This line of credit was converted into a ten-year term loan in October 2011 payable in monthly equal principal payments plus interest starting on October 1, 2013. The term loan is collateralized by the University’s accounts receivable from the Commonwealth of Puerto Rico and its agencies as well as by the Commonwealth of Puerto Rico income guaranteed appropriations under Act No. 2 of January 20, 1966, as amended. This term loan matures on October 1, 2022 and bears interest per annum equal to prime rate plus 150 basis points, with a floor of 6% (6% at June 30, 2017 and 2016). The University had not made the monthly payments of this term loan since May 2016. The balance outstanding of this term loan amounted to approximately \$48,286,000 at June 30, 2017 and 2016. Accrued interest payable of this term loan amounted to approximately \$3,477,000 and \$579,000 as of June 30, 2017 and 2016, respectively. This term loan was presented as a current long-term debt because the University is not in compliance with the GDB loan agreement.

In addition, the University had a \$75.0 million non-revolving line of credit facility with the GDB to complete certain construction projects of the University’s Program for Permanent Improvements. This line of credit bears interest per annum equal to prime rate plus 150 basis points, with a floor of 6% (6% at June 30, 2017 and 2016). The balance outstanding of this line of credit amounted to approximately \$28,120,000 at June 30, 2017 and 2016. Accrued interest payable of this line of credit amounted to approximately \$1,547,000 and \$141,000 as of June 30, 2017 and 2016, respectively. This line of credit expired on January 31, 2016 and the University had not made the monthly interest payments of this line of credit since September 2016.

GDB faces significant risks and uncertainties and it currently does not have (and is not expected to have) sufficient liquid financial resources to meet its obligations in full. Pursuant to enacted legislation and executive orders by two separate government administrations, GDB has been ordered to suspend loan disbursements, to impose restrictions on the withdrawal and transfer of deposits from GDB and has been imposed a moratorium on its debt obligations, among other measures. On March 23, 2018, GDB ceased its operations and it is currently winding down in an orderly fashion under Title VI of PROMESA.

Total amount deposited in the GDB amounted to approximately \$92.1 million as of June 30, 2017 and are deemed fully impaired as further discussed in Note 5. In May 2016, the Governing Board of the University authorized its president to cancel the term loan and the expired line of credit with the GDB using the University’s funds deposited in the GDB. The University had not paid these credit facilities with GDB because it and the GDB had not reached an agreement to cancel these credit facilities or to determine how these credit facilities will be managed. Refer to Note 20 for the offset of the credit facilities with the GDB, on a dollar-for-dollar basis, by the amount of the University’s deposits held at the GDB on November 29, 2018.

In January 2012, the University entered into two term loan agreements with a commercial bank for a total amount of \$2.4 million for the acquisition of medical equipment for use by the Medical Sciences Campus. These term loans matured on February 1, 2017 and bore interest per annum equal to 4%. The balance outstanding of these terms loan amounted to \$375,000 at June 30, 2016. The last debt service payments on these term loans amounted to approximately \$375,000 in principal and \$6,000 in interest for a total debt service of approximately \$381,000 in fiscal year 2017.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

12. Notes Payable (continued)

Notes Payable – Component Unit

Servicios Médicos Universitarios, Inc. (the “Hospital”) has notes payable amounting to approximately \$20,184,000 and \$21,892,000 as of June 30, 2017 and 2016, respectively.

A summary of the Hospital’s notes payable at June 30, 2017 and 2016 follows (expressed in thousands):

	<u>2017</u>	<u>2016</u>
Term loan payable with GDB (see note 5)	\$ 10,760	\$ 12,224
Non-interest bearing notes payable to:		
Puerto Rico Aqueduct and Sewer Authority	270	450
Puerto Rico Electric Power Authority	8,281	8,881
Supplier	612	–
Term loan payable with a commercial bank	261	338
	<u>20,184</u>	<u>21,893</u>
Less: current portion	2,557	2,586
Noncurrent portion	<u>\$ 17,627</u>	<u>\$ 19,307</u>

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 approximately \$23,361,000 into a term loan and extended the maturity date to June 30, 2025. As part of the term loan agreement, the Hospital made a down payment of \$2,700,000. The term loan is payable in 192 monthly installments of principal and interest of approximately \$172,000 and bears interest per annum equal to prime rate plus 150 basis points (4.75% at June 30, 2017 and 2016). The loan is guaranteed by the University.

The non-interest-bearing notes payable to Puerto Rico Aqueduct and Sewer Authority (“PRASA”) and to Puerto Rico Electric Power Authority (“PREPA”), component units of the Commonwealth, resulted from trade accounts payable to PRASA and PREPA that were restructured into an unsecured long-term debts. The PRASA note is payable in monthly installments of approximately \$15,000 and matures on December 15, 2018. The PREPA note is payable in monthly installments of approximately \$50,000 and matures on March 28, 2031.

In June 2015, the Hospital entered into a term loan agreement with a commercial bank for a total amount of \$410,000 for the acquisition of medical equipment. The term loan is payable in 60 monthly payments of approximately \$7,900. The term loan is collateralized with the acquired medical equipment, mature on June 4, 2020 and bears interest per annum equal to 5.95%.

In September 2016, the Hospital entered into a non-interest-bearing note with a supplier for a total amount of \$720,000 for the acquisition of equipment. The note is payable in 60 monthly installments of approximately \$12,000 and matures on November 30, 2021.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

12. Notes Payable (continued)

Notes Payable – Component Unit (continued)

The Hospital must comply with certain operating and financial covenants, among other requirements established in the loan agreements. At June 30, 2017 and 2016, the Hospital was in compliance with such covenants.

The activity of the principal balance of the long- term debt for the years ended June 30, 2017 and 2016 is as follows (expressed in thousands):

	2017	2016	
Beginning Balance	\$ 21,893	\$ 14,706	
Additions	720	9,482	
Reductions	(2,429)	(2,295)	
Ending Balance	\$ 20,184	\$ 21,893	

The table below represents debt service payments on long-term debt as of June 30, 2017. Although interest rates on variable rate debt change over time, the calculations included in the table below assume that the variable rate on June 30, 2017 will remain the same for their term.

<u>Fiscal Year</u> <u>Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
	(In thousands)		
2018	\$ 2,557	\$ 490	\$ 3,047
2019	2,565	408	2,973
2020	2,565	323	2,888
2021	2,561	235	2,796
2022	2,546	146	2,692
2023-2027	5,109	54	5,163
2028-2031	2,281	–	2,281
	\$ 20,184	\$ 1,656	\$ 21,840

MCC has a \$250,000 unsecured line of credit facility with a commercial bank at prime rate plus 250-basis points. At June 30, 2017 and 2016, there is no outstanding balance on this line of credit.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

13. Bonds Payable

University's 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 relating to its educational facilities construction program and to cancel and refinance previous debts incurred. The following is the balance of the University's bonds payable as of June 30, 2017 and 2016 (dollars expressed in thousands):

<u>Series</u>	<u>2017</u>	<u>2016</u>	<u>Annual Interest Rate (%)</u>	<u>Due Date June 30, 2017</u>
P - Serial	\$ 155,940	\$ 170,440	5.00%	2018-2026
P - Term	47,645	47,645	5.00%	2027-2030
Q - Serial	74,825	81,290	5.00%	2018-2026
Q - Term	132,415	132,415	5.00%	2027-2036
	<u>410,825</u>	<u>431,790</u>		
Plus unamortized premium	16,307	18,057		
Total	<u>\$ 427,132</u>	<u>\$ 449,847</u>		

At June 30, 2017, the University's bonds payable require payments of principal and interest as follows (expressed in thousands):

<u>Fiscal Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$ 22,010	\$ 20,541	\$ 42,551
2019	23,115	19,441	42,556
2020	24,270	18,285	42,555
2021	25,480	17,071	42,551
2022	26,760	15,798	42,558
2023 to 2027	130,715	58,128	188,843
2028 to 2032	97,665	28,380	126,045
2033 to 2037	60,810	7,786	68,596
	<u>\$ 410,825</u>	<u>\$ 185,430</u>	<u>\$ 596,255</u>

Interest on these bonds is payable each June 1 and December 1. Bonds maturing after June 1, 2016 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.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

13. Bonds Payable (continued)

Blended Component Unit's Bonds

On December 21, 2000, the Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority ("AFICA"), a component unit of the Commonwealth, 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 Project), (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 Project, (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.

The blended component unit's AFICA bonds payable at June 30, 2017 and 2016, consist of (dollars expressed in thousands):

Description	Interest Rate	Maturity	2017	2016
Serial Bonds	5.63%	July 1, 2016	\$ —	\$ 2,315
Serial Bonds	5.63%	July 1, 2017	2,445	2,445
Serial Bonds	5.63%	July 1, 2018	2,580	2,580
Serial Bonds	5.63%	July 1, 2019	2,725	2,725
Serial Bonds	5.00%	July 1, 2020	2,880	2,880
Serial Bonds	5.00%	July 1, 2021	3,020	3,020
Serial Bonds	5.00%	July 1, 2033	50,520	50,520
Total			64,170	66,485
Less unamortized discount			(147)	(160)
Total			\$ 64,023	\$ 66,325

At June 30, 2017, the blended component unit's AFICA bonds payable require payment of principal and interest as follows (expressed in thousands):

Fiscal Year Ending June 30	Principal	Interest	Total
2018	\$ 2,445	\$ 3,188	\$ 5,633
2019	2,580	3,047	5,627
2020	2,725	2,898	5,623
2021	2,880	2,749	5,629
2022	3,020	2,602	5,622
2023 to 2027	17,535	10,523	28,058
2028 to 2032	22,385	5,557	27,942
2033 to 2035	10,600	536	11,136
	\$ 64,170	\$ 31,100	\$ 95,270



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

13. Bonds Payable (continued)

Blended Component Unit's Bonds (continued)

Interest on these 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.

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

Pledged Revenues and Debt Covenants

The University's 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.

In addition, the DUI's AFICA bonds are subordinated to the University's bonds and are collateralized by the pledge of, and a second 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.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

13. Bonds Payable (continued)

Pledged Revenues and Debt Covenants (continued)

The University's revenues pledged were as follows for the years ended June 30, 2017 and 2016 (dollars expressed in thousands):

	<u>2017</u>	<u>2016</u>
Pledged Revenues:		
Tuition and other fees	\$ 94,743	\$ 91,525
Student fees	5,692	4,658
Rental and other charges received for the right of use and occupancy of the facilities in the University system	1,838	2,593
Interest on investment of University funds, excluding funds invested pursuant to Article VI of the Trust Agreement	731	712
Funds paid to the University in respect to overhead allowance on federal research projects	12,333	15,506
Other income (1)	25,965	30,941
Total Pledged Revenues	<u>141,302</u>	<u>145,935</u>
Sinking Fund Reserve Interest	197	274
Total Pledged Revenues Plus Interest	<u>\$ 141,499</u>	<u>\$ 146,209</u>
Aggregate Debt Service:		
Principal and Interest Requirement	<u>\$ 42,554</u>	<u>\$ 42,558</u>
Senior Debt Service Coverage Ratio	<u>3.33</u>	<u>3.44</u>
DUI's AFICA Bonds (Subordinate to the University's Bonds)	<u>\$ 5,637</u>	<u>\$ 5,639</u>
Aggregate Debt Service	<u>\$ 48,191</u>	<u>\$ 48,197</u>
Total Debt Service Ratio	<u>2.94</u>	<u>3.03</u>

1) Includes \$25 million of PRTC appropriations under the Gambling Law (slot machines and others) in fiscal years 2017 and 2016.

The Trust Agreements governing the bonds issued require a ratio of total pledged revenues plus interest earned on reserve account to principal and interest requirements for the University's bonds of at least 1.5 to 1 (total debt service coverage ratio). At June 30, 2017, the University was in compliance with the total debt service coverage ratio requirement.

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

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



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

13. Bonds Payable (continued)

Pledged Revenues and Debt Covenants (continued)

- *Redemption Account* - such amount, if any, after making the deposit to the Bond Service Account, as may be required to make the amount then to its credit equal to the amortization requirements, if any, for the fiscal year in which such deposit is made for the term bonds of each series then outstanding plus redemption premiums, if any.
- *Reserve Account* - such amount, if any, after making the deposit to the above accounts as may be required to make the amount then to its credit equal to the maximum principal and interest (less any federal debt service grant payments) requirements for any year thereafter, on account of all bonds then outstanding.

Monies in the University's Bond Service Account shall be used only for the payment of principal on the serial bonds and interest on all bonds. Monies in the University's Reserve Account shall first be used for the payment of interest on the bonds and maturing principal of the bonds whenever monies in the University's Bond Service Account are insufficient and thereafter for the purpose of making the deposits to the credit of the University's Redemption Account on account of the amortization requirements for the term bonds for the then current or any previous fiscal year whenever and to the extent that the pledged revenues are insufficient for such purpose.

Monies in the University's 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.

In addition, the Trust Agreement required the University to comply with other covenants. At June 30, 2017, the University was not in compliance with the following covenants: maintain a required level of the reserve account balance equal to the maximum aggregate principal and interest requirements; provide its audited financial statements not later than six months after the end of each fiscal year; and provide an Officer's Certificate of No Defaults not later than 210 days after the end of each fiscal year. Also, the University and the Commonwealth did not file within 305 days after the end of each fiscal year, core financial information and operating data (including audited financial statements) for the prior year to each Nationally Recognized Municipal Securities Information Repository ("NRMSIR") and with any Commonwealth state information depository ("SID") in compliance with the requirements of Rule 15c2-12 ("Continuing Disclosures"), as amended, promulgated by the Securities and Exchange Commission (the SEC). The noncompliance of the required level of the reserve account was cured with a payment of \$20 million made by the University to the Trustee on September 1, 2017, as explained below.

In compliance with EO 31 signed by the Governor of Puerto Rico on June 30, 2016, the University suspended the monthly payments to the trustee of the Trust Agreement that govern the University System Revenue Bonds and the monthly payments of the Lease Agreement with DUI from July 2016 to May 2017.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

13. Bonds Payable (continued)

Pledged Revenues and Debt Covenants (continued)

On August 19, 2016, the U.S. Bank Trust National Association, in its capacity as Trustee for the University of Puerto Rico System Revenue Bonds (Series P and Q Bonds), filed a civil lawsuit under the United States Court, District of Puerto Rico against the Commonwealth and its Governor, the University and its President. The motion seeks relief from the stay of PROMESA, or Executive Orders related thereto, and a preliminary injunction against the Commonwealth's diversion and expropriation of pledged revenues, which constitute the University's Bonds collateral. On June 29, 2017, the Trustee and the University, at the direction of FAFAA, entered into a letter agreement providing that the University will transfer certain amounts in respect of pledged revenue, as defined in the trust agreement, to the Trustee on condition, among others, that through August 31, 2017 (the Compliance Period) the Trustee not institute, commence, or continue certain legal proceedings against the University, the Commonwealth or any other agency, instrumentality, or municipality thereof during the Compliance Period, except in certain enumerated circumstances. As agreed in the letter agreement, the University paid \$20 million on June 30, 2017 and an additional \$20 million on September 1, 2017 and continued to pay monthly to the trustee the \$4 million of pledged revenues. The University commits to transfer to the Trustee, to hold or make payments or distributions as provided under the trust agreement, in lieu of the transfer of an equivalent amount of the pledged revenues received by the University from the date hereof through August 31, 2017 as provided in the trust agreement.

The letter agreement has been extended nine times and the new Compliance Period is June 30, 2019. Pursuant to the letter agreement and the nine standstill extension agreements, during the compliance period, holders of the majority in amount of the bonds and the Trustee at the direction of the University's bondholders will negotiate in good faith towards a restructuring of the bonds. In addition, the trustee agreed not to institute or commence certain legal proceedings and the University agreed to transfer the following monthly payments of pledged revenues to the trustee to be applied in accordance with the trust agreement governing the Series P and Q Bonds during the new Compliance Period:

- in consideration for extending the new Compliance Period until May 31, 2018, the University agreed to transfer to the Trustee \$4 million monthly from July 2017 to May 2018;
- in consideration for extending the new Compliance Period until December 31, 2018, the University agreed to transfer to the Trustee the following monthly payments: \$4.0 million of the June 2018 Payment on or before July 15, 2018; \$2.0 million of the July 2018 Payment on or before August 5, 2018; \$3.0 million of the August 2018 Payment on or before August 25, 2018; \$2.3 million of the September 2018 Payment on or before September 25, 2018; \$2.3 million of the October 2018 Payment on or before October 25, 2018; \$3.0 million of the November 2018 Payment on or before November 25, 2018; and \$3.0 million of the December 2018 Payment, less a credit for any amount as of November 30, 2018 in the Trustee's Bond Service Account and Reserve Account that is, in the aggregate, in excess of \$68,606,318, on or before December 25, 2018; and
- in consideration for extending the new Compliance Period until June 30, 2019, the University agreed to transfer to the Trustee the following monthly payments: \$2.9 million of the January 2019 Payment on or before January 25, 2019; \$2.9 million of the February 2019 Payment on or before February 25, 2019; \$2.9 million of the March 2019 Payment on or before March 25, 2019; \$2.9 million of the April 2019 Payment on or before April 25, 2019; \$2.9 million of the May 2019 Payment on or before May 25, 2019; and \$2.9 million of the June 2019 Payment, less a credit for any amount as of May 30, 2019 in the Trustee's Bond Service Account and Reserve Account that is, in the aggregate, in excess of \$75,395,125, on or before June 30, 2019.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

13. Bonds Payable (continued)

Pledged Revenues and Debt Covenants (continued)

In addition, the University and FAFAA shall provide the trustee with detailed plans and specifications for repairing, replacing or reconstructing the University's property that was damaged or destroyed by Hurricane Maria as these plans are approved by the University. The University shall deposit all proceeds of casualty insurance policies or direct federal aid (the "Repair Funds") in segregated accounts of the University at a commercial bank. The University shall deposit proceeds of casualty insurance in a separate account and shall deposit proceeds of direct federal aid in one or more separate accounts to facilitate the audit of the expenditure of such funds. All Repair Funds in excess of \$1,000,000 shall be used pursuant to a written requisition. On or before the fifteenth (15th) calendar day of each month, the University will submit the preceding month's Requisitions to the trustee, as set forth below. Pursuant to extended letter agreement, the majority bondholders expand their direction to instruct the trustee not to call a default during the pendency of the new Compliance Period if by the fifteenth (15th) calendar day of each month the University sends to the trustee copies of the preceding month's Requisitions. On the fifteenth (15th) calendar day of each month the University or FAFAA will provide, or cause relevant agencies to provide, the trustee with all project requests, progress or other reports provided to the Federal Emergency Management Agency (FEMA) or to any casualty insurance company with respect to the expenditure of Repair Funds during the preceding month.

Discussions with respect to a consensual restructuring of the University's bonds are continuing. Presently, the University has paid as agreed the scheduled principal and interest payments on its outstanding Series P and Q Bonds and has complied with the letter agreement, as extended, with the Trustee.

DUI, the blended component unit, is required to maintain a bond fund consisting of three accounts, where all the capital lease agreement (which are paid by the University directly to the trustee of the DUI's AFICA bond) and required payments are to be deposited in the following order:

- *Interest Account* – Each month, 1/6 of the amount due and payable on the next interest payment date.
- *Principal Account* - Each month, 1/12 of the principal amount payable for all serial bonds maturing on the next July 1.
- *Sinking Fund Account* – Beginning on July 25, 2021 and each month thereafter, 1/12 of the sinking fund requirement for each bond year for the term bonds then outstanding; and any remaining amounts after attaining the required balances in the Interest and Principal Accounts.

In addition, the blended component unit is required to maintain a *Debt Service Reserve* fund with a required balance of approximately \$5,702,000 which was created from the bond proceeds. Funds are to be used to cure deficiencies in any of the bond fund accounts but must be replenished. In the event funds decline in value below 90% of the required balance, the fund must be replenished in monthly installments of 1/12 of the deficiency.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

13. Bonds Payable (continued)

Pledged Revenues and Debt Covenants (continued)

Also, the blended component unit's 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 at a redemption price equal to 100% of the principal amount thereof plus accrued interest. The blended component unit complied with the sinking fund requirements at June 30, 2017.

On August 5, 2016 and monthly thereafter until April 2017, the trustee of the DUI's AFICA Bonds notified to the University that it failed to make the basic lease payment to the trustee since July 25, 2016 and that a default under the lease agreement with DUI constitutes an event of default under the DUI's AFICA Bonds Trust Agreement. As such, the University was in default of this obligation until April 2017. The trustee was not seeking any indebtedness from, enforce any judgment, or obtain possession of, or exercise control over, any property of or from, the Commonwealth or any of its instrumentalities, including DUI and the University, or exercise any act that is stayed by PROMESA, the Act No. 21, or the Executive Orders related thereto. In May 2017, the University reestablished the payments to the trustee of the DUI's AFICA Bonds (approximately \$475,000 monthly) and paid all the basic lease payments due from July 2016 until May 2017 (approximately \$5.2 million). Presently, DUI has paid as agreed the scheduled principal and interest payments on its outstanding AFICA Bonds.

14. Commitments and Contingent Liabilities

Claims Liability

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

The University was insured through January 1993 under claims-made insurance policies with respect to medical malpractice risks for \$250,000 per occurrence up to an annual aggregate of \$500,000. The University has been a self-insured for such risks since that date. Under Law Number 98 of August 24, 1994, the responsibility of the University is limited to a maximum amount of \$75,000 per person, or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Self-insured risk liabilities are reported when it is probable that a loss has occurred, and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. The process used in computing claims liabilities does not necessarily result in an exact amount, because actual claims liabilities depend upon such complex factors as inflation, changes in legal doctrines, and damage awards. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

14. Commitments and Contingent Liabilities (continued)

Claims Liability (continued)

Changes in the claims liability amount for medical malpractice in the years ended June 30, 2017 and 2016 were (expressed in thousands):

	2017	2016
Claims payable - July 1	\$ 8,939	\$ 8,565
Incurred claims and changes in estimates	(304)	792
Payments for claims and adjustments expenses	(460)	(418)
Claims payable - June 30	\$ 8,175	\$ 8,939

In September 2013, the Federal Centers for Disease Control and Prevention (“CDC”) issued a preliminary report, which indicated that bacteria affected several patients in the Hospital’s Intensive Care Unit during a period of time. Also, as of June 30, 2015, there are known judicial and extra-judicial claims related with this matter against the University, the Hospital, the Commonwealth and other defendants. As permitted by Law Number 98 of August 24, 1994, maximum claims loss against the University and the Hospital is limited to \$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. It is the opinion of the University and the Hospital’s managements and its legal counsel that the outcome of these claims would not have a material effect on the University and the Hospital’s financial statements.

In addition, the University is a defendant in several lawsuits other than medical malpractice arising out of the normal course of business. Management has recorded an accrual of approximately \$3,349,000 and \$7,689,000 as of June 30, 2017 and 2016, respectively, to cover claims and lawsuits that may be assessed against the University. The accrual at June 30, 2017 and 2016, includes approximately \$2.3 million and \$6.3 million, respectively, for the claim of the Plaza Universitaria Project’s general contractor submitted in October 2003 against the University and DUI for extended overhead (field and main office). On September 10, 2018, the Plaza Universitaria Project’s general contractor, the University and DUI signed a settlement agreement in which the University and DUI committed to paid \$2,300,000 and \$1,550,000, respectively, for a total consideration of \$3,850,000. On September 11, 2018, the Puerto Rico First Court of Instance approved the settlement agreement. In November 2018, the University and DUI made the corresponding payments to the Plaza Universitaria Project’s general contractor. The University continues to carry commercial insurance for these risks of loss. See note 20.

Federal Assistance Programs

On April 6, 2017, a student stoppage at the University interrupted the operations of all campuses for up to 93 days, but less in other cases. This student stoppage was prompted as a result of student opposition to the annual reductions in the Commonwealth’s formula appropriations to the University as ordered by the Oversight Board of PROMESA. As a result of the student stoppage at the University, eight of the eleven units that comprise the University of Puerto system are on probation by the Middle States Commission on Higher Education, the regional accreditation entity.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

14. Commitments and Contingent Liabilities (continued)

Federal Assistance Programs (continued)

In the fourth quarter of fiscal year 2017, the U.S. Department of Education notified each campus of the University that they failed the financial responsibility requirements under the U.S. Department of Education regulations due to its failure to submit in a timely fashion acceptable compliance and financial statement audits. As a result, the eleven campuses of the University are under provisional certifications with the U.S. Department of Education for initial or continued participation in any of the student financial assistance programs authorized by Title IV of the Higher Education Act of 1965, as amended (Title IV HEA Programs). These provisional certifications place the eleven campuses of the University on a heightened cash monitoring payment method and expire between June 30, 2018 and December 31, 2018.

Each campus of the University agreed to participate in the Title IV, HEA Programs under the U.S. Department of Education's cash monitoring method and comply with the provisions under the Zone alternative. Starting with academic year 2017-2018, the eleven campuses of the University will be operating on limited Title IV eligibility and will be placed on the Heightened Cash Monitoring I (HCM-1) method of payment requiring enhanced reporting and documentation until further written notice from the U.S. Department of Education. Under the HCM-1 method payment, each campus of the University must first make disbursements to eligible students and parents and pay any credit balances due before it requests or receives funds for the amount of those disbursements from the U.S. Department of Education in accordance with 34 CFR 668.162 (d). The funding request may not exceed the amount of the actual disbursements that were made to the students and parents including in the funding request. Expenditures of Federal Awards under Title IV HEA programs amounted to approximately \$250.9 million for the year ended June 30, 2017.

In September 2017, the University received from the U.S. Department of Justice a Claim Letter/Notice of Intent to File Suit on behalf of the National Science Foundation ("NSF"), the National Aeronautics and Space Administration and the United States Department of Energy to take action in the Federal Court against the University for violations of the False Claims Act as a result of an examination of federal grants received by two units of the University. The claim sought treble damages amounted to approximately \$5.6 million, including \$300,000 for penalties. At June 30, 2017 and 2016, the University accrued approximately \$1.8 million and \$5.6 million, respectively for this claim. On September 27, 2018, the University settled this claim with the federal agencies for approximately \$1,773,000. On November 20, 2018, the University paid this claim.

As a result of the examination of federal awards explained above, effective April 23, 2012, the NSF suspended the federal awards for research and development in the two involved units of the University because the University had not corrected the time and effort reporting deficiencies as established in its Corrective Action Plan related to previous audits' findings. NSF did not reimburse expenditures incurred on and after April 23, 2012 by the University in the involved units. Most of the research and training activities under grants affected by the Suspension Status continued with funding from the University. Significant interactions between NFS and the University has led to a robust body of Effort Reporting System policies and procedures, the creation of a system-wide Office for Research Compliance and Integrity and an overarching committee for continuous assessment and creation of sponsored programs, policies and procedures. On November 21, 2013, NSF lifted its suspension of the two involved units of the University.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

14. Commitments and Contingent Liabilities (continued)

Federal Assistance Programs (continued)

The University participates in a number of federal financial assistance programs. These programs are subject to audits in accordance with the provisions of the Office of Management and Budget (OMB) *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (“Uniform Guidance”) 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, beyond any amount accrued at June 30, 2017, will not be material to the University’s financial statements.

Construction Commitments

Construction commitments at June 30, 2017 and 2016, entered by the University, amounted to approximately \$62.6 million and \$58.0 million, respectively.

Operating Lease Agreements

The University rents a building of an outside clinic of the medical practice plan of the Medical Sciences Campus under a non-cancelable long-term operating lease agreement which expires in April 2021. This lease contains escalation clauses providing for increased rental. Rent charged to operations, including common area maintenance, taxes and other charges, amounted to approximately \$1,763,000 and \$1,751,000 in fiscal years 2017 and 2016, respectively.

At June 30, 2017, the minimum annual future rentals, without considering renewal options, are approximately as follows (expressed in thousands):

Fiscal Year Ending June 30	Amount
2018	\$ 1,347
2019	1,031
2020	115
2021	86
	\$ 2,579

Servicios Médicos Universitarios, Inc. (the “Hospital”) is obligated under the terms and conditions of various non-cancelable long-term operating lease agreements for equipment which expire in fiscal year 2017. Aggregate rent expense was approximately \$37,000 and \$34,000 for the years ended June 30, 2017 and 2016, respectively. At June 30, 2017, the minimum annual future rentals, without considering renewal options, is approximately \$37,000 due in fiscal year ending June 30, 2018.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

14. Commitments and Contingent Liabilities (continued)

Operating Lease Agreements (continued)

In addition, the Hospital leases to physicians and other third parties office facilities located in the Hospital’s premises under rent agreements, some of which are renewed annually. Rent income for the years ended June 30, 2017 and 2016 amounted to approximately \$533,000 and \$400,000, respectively. At June 30, 2017, total future minimum rental income on operating leases, are approximately as follows (expressed in thousands):

<u>Fiscal Year Ending June 30</u>	<u>Amount</u>
2018	\$ 536
2019	539
2020	543
	\$ 1,618

Guaranty Commitment

The University guarantees the Hospital’s long-term debt (a term loan and a line of credit) with the Government Development Bank for Puerto Rico amounting to approximately \$10,760,000 and \$12,224,000 at June 30, 2017 and 2016, respectively, which matures on June 30, 2025. See Note 12.

Blended Component Unit

Desarrollos Universitarios, Inc. (“DUI”) operates the Plaza Universitaria facilities for use by students and other persons and entities related to or conducting business with the University community, or other activities conducted in such facility.

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. On October 24, 2017, the Puerto Rico First Court of Instance issued a partial declaratory judgement ordering DUI to pay the retainage amount under the construction contract of about \$1.6 million, plus interest, to the Plaza Universitaria Project’s general contractor. DUI appealed this partial declaratory judgement. On September 10, 2018, the Plaza Universitaria Project’s general contractor, the University and DUI signed a settlement agreement in which the University and DUI committed to paid \$2,300,000 and \$1,550,000, respectively, for a total consideration of \$3,850,000. On September 11, 2018, the Puerto Rico First Court of Instance approved the settlement agreement. In November 2018, the University and DUI made the corresponding payments to the Plaza Universitaria Project’s general contractor.

DUI has also been named as a defendant in various collections of monies claims entered by subcontractors of the general contractor. DUI has requested, in such instances, to retain from any sums due to the general contractor, after final liquidation, the amounts owed by the general contractor to these subcontractors.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

14. Commitments and Contingent Liabilities (continued)

Discretely Presented Component Unit

Since inception, the Hospital, based on the opinion of its legal counsel, is considered an instrumentality of the Commonwealth. Under Law Number 98 of August 24, 1994, the responsibility of the Hospital for claim losses 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. Based on the review of these facts and circumstances, the Hospital's management has recorded a provision for claims losses of \$150,000 for each of the fiscal years ended June 30, 2017 and 2016, and has recorded an accrual of approximately \$1,543,000 and \$1,426,000 as of June 30, 2017 and 2016, respectively, to cover claims and lawsuits that may be assessed against the Hospital.

Medical malpractice claims have been asserted against the Hospital and are currently at various stages of litigation. It is the opinion of the Hospital's legal counsel and the Hospital's management that recorded accruals are adequate to provide for potential losses resulting from pending or threatened litigation, as well as claims from unknown incidents that may be asserted arising from services provided to patients.

15. University of Puerto Rico Retirement System

Plan Description and Membership – The University of Puerto Rico Retirement System (the “Retirement 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, visiting professors and employees of its blended component unit and discretely presented component units. It is qualified and exempt from Puerto Rico and United States income taxes. The System is not subject to the requirements of the Employees Retirement Income Security Act of 1974 (“ERISA”). The Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the plan. That report may be obtained by writing to the University of Puerto Rico Retirement System at P.O. Box 21769, San Juan, Puerto Rico 00931-1769 or at www.retiro.upr.edu.

As of June 30, 2016 and 2015, the dates of the most recent actuarial valuations, membership in the Retirement System consisted of the following:

	<u>2016</u>	<u>2015</u>
Retirees and beneficiaries currently receiving benefits	8,417	8,247
Terminated plan participants entitled to but not yet receiving benefits	445	443
Terminated non-vested plan participants entitled to return of their contributions	8,143	7,985
Current participating employees	10,438	10,644
Total membership	<u>27,443</u>	<u>27,319</u>



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

15. University of Puerto Rico Retirement System (continued)

The benefits provided to members of the Retirement System are established by the Governing Board of the University (the Governing Board). Directions of the Governing Board are communicated through a document named "Certification". Benefit provisions vary depending on the date of membership. The responsibility for the proper operation and administration of the Retirement System is vested on the Governing Board which then assigns duty to its Financial Affairs and Retirement System Committee. Decisions are made by the Governing Board upon recommendation of its Financial Affairs and Retirement System Committee.

The Trust of the University Retirement System is a "de facto trust" since 1945. In July 2016, the University filed the Deed of Confirmation and Acknowledgment of Trust of the University Retirement System in which the University as the Original Settlor and the University through its Governing Board as the Original Trustee hereby confirm, restate and acknowledge the inception of the Pension Plan and its Trust Fund in accordance to the provisions of the laws of the Commonwealth of Puerto Rico, specifically, the provisions of Act No. 219-2012.

The Retirement System provides retirement, disability and death benefits to participants and beneficiaries.

Retirement Benefits

Participants are entitled to annual retirement benefits at any age after 30 years of service; or at age 58 after 10 years of service; or at age 55 after 25 years of service. No cost-of-living adjustments have been granted by the Governing Board since July 1, 2007.

The amount of service retirement annuity is as follows:

- For those participants who have completed 20 years of service by July 1, 1979:
 - Before age 65 – for participants with at least 30 years of service: 75% of average compensation if age 55 at beginning date; 65% if under age 55. If the participant completed 30 years of service before July 1973, the annuity is increased by 2% of average compensation for each year of service beyond 30 and before July 1973, but to no more than 85% of average compensation.
 - Before age 65 – for participants with less than 30 years of service: 1.5% of average compensation per year of service for participants with 20 or fewer years. Percentage increases by .05% for each year in excess of 20 years up to maximum of 1.95% per year. Amount is reduced by .5% for each month the participant is under age 58 at the time the annuity begins.
 - After age 65 – same as before age 65.
 - Average compensation – the average of the highest-paid 36 months of service without limit on compensation.
 - Minimum annuity – \$250 per month.
- For all participants who were affected under Certification No. 37 (1978-79) and who have not completed 20 years of service by July 1, 1979 and for those participants who entered into the Retirement System on or after July 1, 1978 until December 31, 1989, including those participants that later elected Certification No. 54 (1989-90) or Certification No. 55 (1989-90) of the Governing Board:



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

15. University of Puerto Rico Retirement System (continued)

Retirement Benefits (continued)

- Before age 65 – for participants with at least 30 years of service: 75% of average compensation. Amount is reduced by .5% for each month the member of Certification No. 37 is under age 58 at time annuity begins or reduced by 1/3% for each month the participant of Certification No. 54 or Certification No. 55 is under age 55 at time annuity begins if the member had less than 25 years of service as of July 1, 2015 and reduced from age 55 for members with 25 or more years of service as of July 1, 2015.
- Before age 65 – for participants with less than 30 years of service: 1.5% of average compensation per year of service for the participants with 20 or fewer years. Percentage increases by .05% for each year in excess of 20 years up to a maximum of 1.95% of average compensation per year of service. Amount is reduced by .5% for each month the participant who did not elect Certification No. 54 or Certification No. 55 is under age 58 at time annuity begins. Amount is reduced by 1/3% for each month the participant of Certification No. 54 or Certification No. 55 is under age 58 at time annuity begins if member had less than 25 years of service as of July 1, 2015 and reduced from age 55 for members with 25 or more years of service as of July 1, 2015.
- After age 65 – for a participant who elected Certification 54 or Certification No. 55, if the participant elected full supplement (Certification No. 54), the annuity is the same as before age 65; otherwise, the annuity is reduced by .5% of average compensation for each year of service up to 30 years. If the participant did not elect Certification 54 or Certification No. 55, the benefit is coordinated and the annuity is reduced by .5% of average compensation in excess of Social Security wage base in effect at the retirement date for each year of service up to 30 years; if the participant had less than 30 years of service and was under age 58 at the beginning date, coordination adjustment is made before application of .5% reduction per month under age 58.
- Average compensation – the average of the highest-paid 36 months of service, with a compensation cap of \$35,000 per year.
- Minimum annuity – \$250 per month.
- For all participants entering into the Retirement System on or after January 1, 1990:
 - Before age 65 – for participants with at least 30 years of service: 75% of average compensation. Amount is reduced by 1/3% for each month the member is under age 55 at time annuity begins if the member had less than 25 years of service as of July 1, 2015 and reduced from age 55 for members with 25 or more years of service as of July 1, 2015.
 - Before age 65 – for participants with less than 30 years of service: 1.5% of average compensation per year of service for participants with 20 or fewer years. Percentage increases by .05% for each year in excess of 20 years up to a maximum of 1.95% of average compensation per year of service. Amount is reduced by 1/3% for each month the participant is under age 58 at time annuity begins if the member had less than 25 years of service as of July 1, 2015 and reduced from age 55 for members with 25 or more years of service as of July 1, 2015 and reduced from age 55 for members with 25 or more years of service as of July 1, 2015.
 - After Age 65 – same as for before age 65.
 - Average compensation – the average of the highest-paid 36 months of service, with a compensation cap of \$35,000 per year.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

15. University of Puerto Rico Retirement System (continued)

Retirement Benefits (continued)

- Minimum annuity – \$250 per month.

Effective July 1, 1998, the Retirement System was amended by Certification No. 94 (1997-98) of the Governing Board, to offer participants an increase from \$35,000 to \$50,000 in the maximum compensation subject to withholding contributions. The participants who elected this benefit paid retroactively to July 1, 1979 or to their first day of employment, if later, the differences in withholding contributions for prior year compensations exceeding \$35,000 and up to a maximum of \$35,000 plus 8% interest. Effective July 1, 1998, all new participants contribute 9% of their compensation up to \$50,000.

Effective July 1, 2002, the Retirement System was amended, by Certification No. 139 (2001-2002) of the Governing Board, to offer participants an increase from \$50,000 to \$60,000 in the maximum compensation subject to withholding contribution. The participants who elected this benefit paid retroactively to July 1, 1979 or their first day of employment, if later, the differences in withholding contributions for prior year compensations exceeding \$35,000 or \$50,000, as applicable, and up to a maximum of \$60,000. The \$60,000 compensation limit was increased by 3% every two years until June 30, 2014. Effective July 1, 2014, the maximum compensation for Certification No. 139 (2001-2002) of the Governing Board was frozen at \$69,556.44 by Certification No. 70 (2013-2014) of the Governing Board.

Disability Benefits

Employees who become disabled receive annual disability benefits regardless of service if disability is due to occupational causes or after 15 years of service if disability is due to non-occupational causes. If the employee is also eligible for a retirement annuity, the benefit payable is the higher of the two. Disability benefit annuity is paid as follows:

- Before age 65 – if service related, 50% of final compensation (subject to applicable compensation cap). If not services related, 90% of member's regular retirement benefit payable by the applicable retirement formula above.
- After age 65 – reduced to amount payable by the applicable retirement annuity; however, if that amount plus primary Social Security benefit is less than disability retirement annuity, then the retirement annuity is increased by the amount necessary to match the disability annuity.
- Minimum annuity – \$250 per month.

Death Benefits

- Pre-retirement death benefit – if the death of an employee is service related, a death benefit annuity equals to 50% of the final annual compensation plus \$120 (\$240 if widow not receiving benefit) per year for each child under age 18 (21 if at school) is paid to the employee's beneficiaries. Maximum family benefit is 75% of the employee's final annual compensation. If death is non-service related, a lump-sum is paid equal to the employee's contributions plus one year's final compensation, but not less than \$6,000.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

15. University of Puerto Rico Retirement System (continued)

Death Benefits (continued)

- Post retirement death benefits – employee’s contributions are refunded to the extent that they exceed retirement payments already made, unless reversionary annuity was elected. Minimum payment is \$600. In addition, 50% of retirement annuity is payable to surviving spouse until death or remarriage or until they become eligible for Social Security benefits. The minimum annuity is \$75 per month and the maximum annuity is \$150 per month.

Reversionary Annuity

Member may elect to receive a reduced annuity in order to provide a lifetime benefit after death to a spouse or relative. The benefit to the spouse or relative may be as low as \$25 per month or as high as 100% of the member’s reduced annuity. This option is not permitted if member retires on a disability annuity.

Christmas Bonus

- A \$400 annual bonus is given to all retired participants.

If a participant terminates after rendering 10 years of service, and does not withdraw his contributions, the participant receives a retirement annuity payable beginning at age 60 based on the applicable retirement benefit formula.

Non-vested Termination Benefits

If a participant terminates before rendering 10 years of service, the right to receive the portion of his accumulated plan benefits attributable to the University’s contributions is forfeited. However, the employee is entitled to receive, in a lump-sum payment, the value of his accumulated contributions. Refund of a participant’s own contributions may also be obtained after 10 years of service, but the vested benefit is lost.

Funding Policy

The contribution requirements of participants and the University are established and may be amended by the Governing Board. Plan members are required to contribute as follows:

1. Participants who have completed 20 years of service by July 1, 1979:
 - If full supplement election: 7% of the monthly compensation.
 - If no full supplement election: 4% of the monthly compensation up to \$350, plus 6.5% of the excess.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

15. University of Puerto Rico Retirement System (continued)

Funding Policy (continued)

2. For all participants who were affected under Certification No. 37 (1978-79) and who have not completed 20 years of service by July 1, 1979 and for those participants who entered into the Retirement System on or after July 1, 1978 until December 31, 1989 and who did not elect Certification No. 54 (1989-90) or Certification No. 55 (1989-90) of the Governing Board:
 - Only no full supplement election: 5% of the monthly compensation up to \$2,916.67 for members with 25 years of service as of July 1, 2015, and 6% of the monthly compensation up to \$2,916.67 for members with less than 25 years of service as of July 1, 2015.
3. For all participants who were affected under Certification No. 37 (1978-79) and who have not completed 20 years of service by July 1, 1979 and for those participants who entered into the Retirement System on or after July 1, 1978 until December 31, 1989 and later elected Certification No. 54 (1989-90) or Certification No. 55 (1989-90) of the Governing Board:
 - If full supplement election: 7% of the monthly compensation up to \$2,916.67 for members with 25 or more years of service as of July 1, 2015 and 8% of the monthly compensation up to \$2,916.67 for members with less than 25 years of service as of July 1, 2015.
 - If no full supplement election: 4% of the monthly compensation up to \$350.00, plus 6.5% of the monthly compensation in excess up to \$2,916.67 for members with 25 or more years of service as of July 1, 2015 and 5% of the monthly compensation up to \$350.00, plus 6.5% of the monthly compensation in excess up to \$2,916.67 for members with less than 25 years of service as of July 1, 2015.
4. For all participants entering into the Retirement System on or after January 1, 1990:
 - Only full supplement election: 8% of the monthly compensation up to \$2,916.67 for members with 25 or more years of service as of July 1, 2015 and 9% of the monthly compensation up to \$2,916.67 for members with less than 25 years of service as of July 1, 2015.
 - If Certification No. 94 (1997-98) of the Governing Board election: 9% of the monthly compensation up to \$4,166.67 for members with 25 or more years of service as of July 1, 2015 and 10% of the monthly compensation up to \$4,166.67 for members with less than 25 years of service as of July 1, 2015.
 - If Certification No. 139 (2001-2002) of the Governing Board election: 11% of monthly compensation up to \$5,796.42 for members with 25 or more years of service as of July 1, 2015 and 12% of the monthly compensation up to \$5,796.42 for members with less than 25 years of service as of July 1, 2015.
 - Effective July 1, 2015, all new participants will be covered under Certification No. 139 (2001-2002) of the Governing Board and will pay 12% of the monthly compensation up to \$5,796.42.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

15. University of Puerto Rico Retirement System (continued)

Funding Policy (continued)

Contribution rates to the Retirement System are annually established by the Governing Board of the University and they are mainly based on an actuarially determined rate recommended by an independent actuary at the beginning of the fiscal year. The actuarially determined rate is the estimated amount to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded liability. The University is required to contribute the difference between the total contribution rate approved by the Governing Board of the University and the contribution rate of employees.

For the years ended June 30, 2017 and 2016, the average active employee contribution rate was 8.1% and 7.9%, respectively, of annual pay, and the University’s average contribution rate was 17.7% and 16.8%, respectively, of annual payroll. The actuarially determined employer contribution rate takes into account payment of administrative expenses. Therefore, administrative expenses are paid out of the trust fund. The University contributed 15.2% and 17.3% of covered-employee payroll in 2017 and 2016, respectively. The University’s contributions to the Retirement System amounted to approximately \$78,755,000 and \$77,811,000 for the years ended June 30, 2017 and 2016, respectively.

The contributions of the University were originally designed to fund, together with the contributions of the participants, the current service cost on a current basis and the estimated accrued benefit cost attributable to qualifying service prior to the establishment of the Retirement System over a 40-year period, but as a result of increasing benefits without a correlative increase in employer’s contributions, they fall short of accomplishing the necessary funding.

Net Pension Liability

As permitted by GASB, the University’s net pension liability as of June 30, 2017 and 2016 were measured as of June 30, 2016 and 2015, respectively, and the total pension liability used to calculate the net pension liability was determined by actuarial valuations with beginning-of-year census data that were rolled forward to June 30, 2016 and 2015, respectively, and assuming no liability gains and losses. The components of the employer’s net pension liability as of June 30, 2017 and 2016 were as follows (dollars in thousands):

	2017	2016
Total pension liability	\$ 3,339,371	\$ 3,139,723
Plan’s fiduciary net position	1,332,668	1,342,996
Employer’s net pension liability	\$ 2,006,703	\$ 1,796,727
 Plan’s fiduciary net position as a percentage of the total pension liability	 39.91%	 42.77%



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

15. University of Puerto Rico Retirement System (continued)

Net Pension Liability (continued)

Changes in the net pension liability for the years ended June 30, 2017 and 2016 are as follows (in thousands):

	2017			2016		
	Total Pension Liability	Plan Fiduciary Net Position	Net Pension Liability	Total Pension Liability	Plan Fiduciary Net Position	Net Pension Liability
Balance at beginning of year	\$ 3,139,723	\$ 1,342,996	\$ 1,796,727	\$ 3,428,068	\$ 1,324,028	\$ 2,104,040
Changes for the year:						
Service cost	46,571	-	46,571	48,107	-	48,107
Interest	194,184	-	194,184	177,334	-	177,334
Benefit changes	(14,671)	-	(14,671)	(45,209)	-	(45,209)
Difference between expected and actual experience	(4,733)	-	(4,733)	(323,974)	-	(323,974)
Changes in assumptions or other inputs	160,911	-	160,911	32,269	-	32,269
Contributions - employer	-	78,004	(78,004)	-	88,251	(88,251)
Contributions - employee	-	38,640	(38,640)	-	35,594	(35,594)
Net investment income	-	59,009	(59,009)	-	75,373	(75,373)
Benefit payments	(182,614)	(182,614)	-	(176,872)	(176,872)	-
Administrative expenses and others	-	(3,367)	3,367	-	(3,378)	3,378
Net changes	199,648	(10,328)	209,976	(288,345)	18,968	(307,313)
Balance at end of year	<u>\$ 3,339,371</u>	<u>\$ 1,332,668</u>	<u>\$ 2,006,703</u>	<u>\$ 3,139,723</u>	<u>\$ 1,342,996</u>	<u>\$ 1,796,727</u>

For the years ended June 30, 2017 and 2016, the University recognized pension expense (credit) of approximately \$42,650,000 and (\$49,350,000), respectively.

As of June 30, 2017 and 2016, the University reported deferred outflows of resources and deferred inflows of resources from pension activities as follows (in thousands):

Source	2017		2016	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Employer contributions made subsequent to the measurement date	\$ 78,775	\$ -	\$ 77,811	\$ -
Differences between expected and actual experience	-	172,913	-	246,653
Changes in assumptions or other inputs	138,627	-	24,568	5,546
Net difference between projected and actual earnings on plan investments	2,766	-	-	49,219
Total	<u>\$ 220,168</u>	<u>\$ 172,913</u>	<u>\$ 102,379</u>	<u>\$ 301,418</u>

Deferred outflows of resources related to pensions resulting from the University contributions subsequent to the measurement date which amounted to \$78,775,000 and \$77,811,000 as of June 30, 2017 and 2016, respectively, is recognized as a reduction of the net pension liability in the year ended June 30, 2018 and 2017, respectively.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

15. University of Puerto Rico Retirement System (continued)

Amounts reported as deferred inflows of resources from pension activities at June 30, 2017 will be recognized in the pension expense (credit) as follows (in thousands):

Year Ending June 30:	
2018	\$ (41,220)
2019	(41,220)
2020	38,260
2021	12,660
Total	\$ (31,520)

Actuarial Methods and Assumptions

The actuarial cost method used to measure the total pension liability at June 30, 2016 and 2015 was the individual entry age normal cost method. The actuarial valuations used the following actuarial method and assumptions:

	2017	2016
Measurement Date	June 30, 2016	June 30, 2015
Valuation Date	June 30, 2015	June 30, 2014
Amortization Method for Unfunded		
Actuarial Accrued Liability	Level percentage of payroll, closed	Level percentage of payroll, closed
Remaining Amortization Period	29 years	30 years
Asset Valuation Method	5-year smoothed market	5-year smoothed market
Inflation	3.00% per year	3.00% per year
Investment Rate of Return	7.75% per annum, compounded annually, net of investment expenses, including inflation	7.75% per annum, compounded annually, net of investment expenses, including inflation
Municipal Bond Index	3.01%, as per Bond Buyer General Obligation 20-Bond Municipal Bond Index	3.82%, as per Bond Buyer General Obligation 20-Bond Municipal Bond Index
Discount Rate	5.89% per annum	6.37% per annum
Projected Salary Increases	3.75% per year, including inflation	3.75% per year, including inflation

The mortality tables used in the June 30, 2016 and 2015 actuarial valuations were as follows:

- Pre-retirement Mortality - RP-2000 Healthy Annuitant Mortality Table for ages 50 and greater and the RP-2000 Combined Mortality Table for ages less than 50 projected for future mortality improvements to 2020 using Scale BB, set back 5 years for males and set forward 1 year for females.
- Post-retirement Healthy Mortality - RP-2000 Healthy Annuitant Mortality Table for ages 50 and greater and the RP-2000 Combined Mortality Table for ages less than 50 projected for future mortality improvements to 2020 using Scale BB, set back 5 years for males and set forward 1 year for females.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

15. University of Puerto Rico Retirement System (continued)

Actuarial Methods and Assumptions (continued)

- Post-retirement Disabled Mortality - RP-2000 Disabled Mortality Table projected for future mortality improvements to 2020 using Scale BB, set back 5 years for males and set forward 2 years for females.

There was no change in the actuarial assumptions that affected the measurement of the total pension liability since the prior measurement date.

Changes of Benefit Terms

Effective July 1, 2015, the Retirement System has been amended to change the non-service related disability eligibility from 10 to 15 years of service and to provide a benefit equal to 90% of the member's accrued benefit. The retirement System was also amended to provide the following changes for members with less than 25 years of service as of July 1, 2015: 1) increase member contribution rates by 1% and 2) change the early retirement reduction for members retiring with 30 or more years of service from 4% per year for ages before 55 to 4% per year for ages before 58. New members on and after April 1, 2015 up until June 30, 2015 will contribute 11% of pay. New members on and after July 1, 2015 will contribute 12% of pay.

Long-term Expected Rate of Return

The long-term expected rate of return on pension plan investments was determined using log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

The target asset allocation and best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2016 and 2015 are summarized in the following table:

Asset Class	Target Allocation	2016 Long-term Expected Real Rate of Return	2015 Long-term Expected Real Rate of Return
Domestic large cap equity	40%	6.65%	6.65%
International equity	10%	7.00%	7.00
Domestic small/mid cap equity	10%	7.90%	7.90
Fixed income	28%	0.80%	0.80
Loans and mortgages	12%	5.70%	5.70
Total	100%		



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

15. University of Puerto Rico Retirement System (continued)

Date of Depletion and Discount Rate

The asset basis for the date of depletion projection is the pension plan's fiduciary net position. The pension plan's fiduciary net position is not expected to be available to make all projected future benefit payments of current active and inactive members. Therefore, the discount rate for calculating the total pension liability is equal to the single equivalent interest rate (SEIR) that results in the same actuarial present value as the long-term expected rate of return applied to benefit payments, to the extent that the pension plan's fiduciary net position is projected to be sufficient to make projected benefit payments, and the tax free municipal bond index rate applied to benefit payments, to the extent that the pension plan's fiduciary net position is not projected to be sufficient.

The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rate and that the Plan contributions will be made at rates equal to the difference between actuarially determined contribution rates and the member rate.

Effective June 30, 2015, the contribution rates reflect amortization of the Retirement System's unfunded actuarial accrued liability over a closed 40 – year period in accordance with Certification No. 146 (2014-2015) of the Governing Board issued on June 4, 2015.

Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members until the plan year ending June 30, 2045. Therefore, the long-term expected rate of return on pension plan investments of 7.75% was applied to all periods of projected benefit payments through June 30, 2045 and the applicable municipal bond index rate of 3.01%, based on the Bond Buyer General Obligation 20-year Municipal Bond Index published monthly by the Board of Governors of the Federal Reserve System as of June 30, 2016, was applied to all periods of projected benefit payments after June 30, 2045. The SEIR of 5.89% that discounts the entire projected benefit stream to the same amount as the sum of the present values of the two separate benefit payments streams was used to determine the total pension liability as of June 30, 2016.

The SEIR at June 30, 2015 was 6.37% based on the long-term expected rate of return on pension plan investments of 7.75% applied to all periods of projected benefit payments through June 30, 2044 and the applicable municipal bond index rate of 3.82% as of June 30, 2015 applied to all periods of projected benefit payments after June 30, 2044.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

15. University of Puerto Rico Retirement System (continued)

Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability at June 30, 2017 and 2016 calculated using the discount rate of 5.89% and 6.37%, respectively, as well as what it would be if it were calculated using a discount rate of 1 percent-point lower or 1 percent-point higher than the current rate (dollars in thousands):

2017			2016		
1% decrease (4.89%)	Current discount rate (5.89%)	1% increase (6.89%)	1% decrease (5.37%)	Current discount rate (6.37%)	1% increase (7.37%)
\$ 2,382,209	\$ 2,006,703	\$ 1,688,137	\$ 2,144,842	\$ 1,796,727	\$ 1,501,031

16. Post-Employment Benefits Other Than Pensions (“OPEB”)

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

The University provides the following OPEB:

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

At June 30, 2017 and 2016, membership in the OPEB Program consisted of the following:

	2017	2016
Retirees and beneficiaries currently receiving benefits	8,362	8,188
Current participating employees	10,438	10,644
Total membership	18,800	18,832

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



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

16. Post-Employment Benefits Other Than Pensions (“OPEB”) (continued)

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

The following tables show the components of the University’s annual OPEB cost for the fiscal years ended June 30, 2017 and 2016, the amount contributed to the OPEB Program, the change in the University’s net obligation and the funded status of the OPEB Program (dollars expressed in thousands):

	2017	2016
Annual required contribution (ARC)	\$ 15,620	\$ 11,493
Interest on the net OPEB obligation	233	237
Adjustments to ARC	(433)	(263)
Annual OPEB cost	15,420	11,467
Employer contribution	(9,845)	(10,522)
Change in the net OPEB obligation	5,575	945
Net OPEB obligation - beginning of year	8,578	7,633
Net OPEB obligation - end of year	\$ 14,153	\$ 8,578
Percentage of annual OPEB cost contributed	63.85%	91.76%

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

The following table shows the University’s funded status of the OPEB Program as of July 1, 2016 and 2015, the most recent actuarial valuation dates (dollars expressed in thousands):

	2016	2015
Actuarial Accrued liability (AAL)	\$ 218,200	\$ 211,811
Unfunded AAL	\$ 218,200	\$ 211,811
Funded ratio	0%	0%



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

16. Post-Employment Benefits Other Than Pensions (“OPEB”) (continued)

The three-year trend information is as follows (dollars expressed in thousands):

Fiscal Year Ended	Annual OPEB Cost	Percentage of OPEB Cost Contributed	Net OPEB Obligation
6/30/2017	\$ 15,420	63.8%	\$ 14,153
6/30/2016	\$ 11,467	91.8%	\$ 8,578
6/30/2015	\$ 12,005	82.7%	\$ 7,633

OPEB Actuarial Valuation – The University’s other Post-Employment Benefits Program actuarial valuations were conducted by Cavanaugh Macdonald Consulting, LLC as of July 1, 2016 and 2015 member of the American Academy of Actuaries. As permitted by GASB Statement No. 45, the actuarial valuation is performed every two years.

	2017	2016
Significant Actuarial Methods and Assumptions:		
Actuarial valuation date	July 1, 2016	July 1, 2015
Actual cost method	Entry age normal	Entry age normal
Amortization method	Level dollar amortization over 30 years (open basis)	Level dollar amortization over 30 years (open basis)
Percentage Electing to Receive:		
Medical Subsidy	85% (applied to current and future retirees)	85% (applied to current and future retirees)
Tuition Remission	0.7%	0.7%
Tuition Remission	\$605 per retiree in fiscal 2017, increasing 4.0% per year thereafter	\$582 per retiree in fiscal 2016, increasing 4.0% per year thereafter
Payroll Growth	Not applicable.	Not applicable.
Discount Rate	2.7% per annum	3.1% per annum

The mortality tables used in the July 1, 2016 and 2015 actuarial valuations were as follows:

- Mortality for Healthy Participants- RP-2000 Healthy Annuitant Mortality Table for ages 50 and older and the RP-2000 Combined Mortality Table for ages less than 50 projected for future mortality improvements to 2020 using Scale BB, set back 5 years for males and set forward 1 year for females.
- Mortality for Disabled Participants – RP-2000 Disabled Mortality Table projected for future mortality improvements to 2020 using Scale BB, set back 5 years for males and set forward 2 years for females.

The mortality assumption was updated to match that used by the University’s Retirement System based on their most recent experience study.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

16. Post-Employment Benefits Other Than Pensions (“OPEB”) (continued)

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

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

Calculations are based on the types of benefits provided at the time of each valuation and on the pattern of sharing of costs between the employer and members to that point. The projections of benefits for financial reporting purposes do 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.

17. The Hospital’s Management Business Plan and Operation - Component Unit

In prior years (up to June 30, 2009 and in 2014), the Hospital had experienced significant operating losses having an accumulated net position deficiency of approximately \$3,559,000 as of June 30, 2017. 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 patients 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 approximately \$31,109,000 as of June 30, 2017.

In addition, during the month of September 2013, the Federal Centers for Disease Control and Prevention issued a preliminary report, which indicated that bacteria affected several patients in the Hospital’s Intensive Care Unit during a period of time. This situation caused a significant decrease in the hospital utilization during the year ended June 30, 2014, resulting in a decrease in the Hospital’s net position of approximately \$2,137,000. The epidemiological monitoring by the Department of Health, as a result of this situation, ceased in August 2014.

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, 2017.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

17. The Hospital's Management Business Plan and Operation - Component Unit (continued)

The University has expressed its commitment to provide the Hospital with the necessary financial support, if needed, to continue its operations.

The Hospital's management, with the assistance of its Board of Directors, is working with a management plan toward its operational activities as well as the Hospital's ability to generate sufficient cash flows to cover its current obligations and to improve the Hospital's public image and its physical facilities. Some of these measures had an impact in the Hospital's operations and as a result, the Hospital reported operating income for the years ended June 30, 2010 to June 30, 2013 and for the years ended June 30, 2015 to June 30, 2017. For the year ended June 30, 2017, the Hospital reported an increase in its net position of approximately \$3,944,000.

18. Functional Information

The University's operating expenses by functional classification during the years ended June 30, 2017 and 2016 were as follows (expressed in thousands):

Functional Classification	2017						
	Salaries and Benefits	Scholarships and Fellowships	Supplies and other Services	Utilities	Depreciation and Amortization	Other Expenses	Total
Instruction	\$ 360,107	\$ 2,742	\$ 10,528	\$ 80	\$ -	\$ 817	\$ 374,274
Research	47,884	12,591	24,436	282	-	5,470	90,663
Public service	42,297	1,283	13,016	708	-	184	57,488
Academic support	68,264	2,949	19,349	33	-	136	90,731
Student services	40,943	396	12,868	2	-	254	54,463
Institutional support	114,822	249	27,466	2,244	-	798	145,579
Operations and maintenance	73,365	19	31,257	35,333	-	357	140,331
Student aid	4,140	173,097	1,109	-	-	148	178,494
Independent operations	34	1	43	-	-	-	78
Patient service	53,061	65	1,545	216	-	918	55,805
Auxiliary enterprises	100	42	1,112	3	-	52	1,309
Depreciation and amortization	-	-	-	-	49,111	-	49,111
	<u>\$ 805,017</u>	<u>\$ 193,434</u>	<u>\$ 142,729</u>	<u>\$ 38,901</u>	<u>\$ 49,111</u>	<u>\$ 9,134</u>	<u>\$ 1,238,326</u>

Functional Classification	2016						
	Salaries and Benefits	Scholarships and Fellowships	Supplies and other Services	Utilities	Depreciation and Amortization	Other Expenses	Total
Instruction	\$ 308,250	\$ 4,525	\$ 9,380	\$ 181	\$ -	\$ -	\$ 322,336
Research	43,765	13,822	23,999	371	-	9,076	91,033
Public service	40,673	1,529	12,994	699	-	180	56,075
Academic support	59,801	3,232	20,048	61	-	1,641	84,783
Student services	34,440	543	9,518	2	-	2,106	46,609
Institutional support	99,882	376	28,900	2,395	-	10,317	141,870
Operations & maintenance	64,477	16	29,628	33,277	-	58	127,456
Student aid	3,516	161,382	762	1	-	-	165,661
Independent operations	47	1	6	-	-	-	54
Patient service	46,466	58	3,889	173	-	-	50,586
Auxiliary enterprises	119	38	1,755	2	-	-	1,914
Depreciation and amortization	-	-	-	-	47,906	-	47,906
	<u>\$ 701,436</u>	<u>\$ 185,522</u>	<u>\$ 140,879</u>	<u>\$ 37,162</u>	<u>\$ 47,906</u>	<u>\$ 23,378</u>	<u>\$ 1,136,283</u>



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

19. University Only Financial Statements

The following tables present the financial information pertaining only to the University (excluding its blended component unit):

Statements of Net Position (Deficit) as of June 30, 2017 and 2016
(Dollars in Thousands):

	2017	2016
Assets		
Current assets:		
Cash and cash equivalents	\$ 289,320	\$ 181,726
Restricted cash and cash equivalents	13,494	2,731
Restricted investments at fair value:		
Deposited with trustee and others	30,779	54,867
Accounts receivable, net	17,001	15,690
Due from Federal Government, net	33,584	32,449
Due from related parties, net:		
Commonwealth of Puerto Rico (Commonwealth)	3,594	4,719
Commonwealth's component units	7,516	6,705
University of Puerto Rico Retirement System	53	14
University of Puerto Rico	—	—
Others	1,809	1,098
Inventories	2,882	2,832
Other assets	1,767	3,421
Total current assets	401,799	306,252
Noncurrent assets:		
Restricted cash and cash equivalents	6,941	4,283
Restricted investments at fair value:		
Endowment funds	103,482	99,860
Healthcare Deferred Compensation Plan	93,011	87,678
Other long-term investments at fair value	3,030	2,632
Notes receivable, net	5,125	6,232
Capital assets (net of accumulated depreciation and amortization):		
Land and other nondepreciable assets	59,743	56,190
Depreciable assets	806,714	840,653
Other assets	402	257
Total noncurrent assets	1,078,448	1,097,785
Total assets	1,480,247	1,404,037
Deferred outflows of resources:		
Deferred refunding loss	1,943	2,225
Deferred outflows from pension activities	220,168	102,379
Total deferred outflows of resources	222,111	104,604
Total assets and deferred outflows of resources	1,702,358	1,508,641
Liabilities		
Current liabilities:		
Accounts payable and accrued liabilities	78,858	62,084
Current portion of long-term debt:		
Notes payable	76,406	76,781
Bonds payable	22,010	20,965
Internal balance - obligation under capital lease, current portion	2,321	2,185
Other current liabilities:		
Claims liability	1,170	2,494
Compensated absences	26,272	27,049
Total current liabilities	207,037	191,558
Noncurrent liabilities:		
Long-term debt, net of current portion:		
Bonds payable	405,122	428,882
Internal balance - obligation under capital lease, net of current portion	53,273	55,594
Other long-term liabilities:		
Deferred compensation plan	93,011	87,678
Claims liability	12,127	19,783
Compensated absences	119,431	127,755
Net pension liability	2,006,703	1,796,727
Other postemployment benefit obligation	14,153	8,578
Total noncurrent liabilities	2,703,820	2,524,997
Total liabilities	2,910,857	2,716,555
Deferred inflows of resources from pension activities		
	172,913	301,418
Total liabilities and deferred inflows of resources	3,083,770	3,017,973
Net position (deficit):		
Net investment in capital assets	390,426	393,465
Restricted, nonexpendable:		
Scholarships and fellowships	48,830	42,758
Research	48,708	51,046
Other	17,642	13,793
Restricted, expendable:		
Loans	8,058	7,649
Capital projects	15,966	8,661
Debt service	25,119	49,139
Unrestricted (deficit)	(1,936,161)	(2,075,843)
Total net position (deficit)	\$ (1,381,412)	\$ (1,509,332)



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

19. University Only Financial Statements (continued)

Statements of Revenues, Expenses and Changes in Net Position (Deficit) for the Years Ended June 30, 2017 and 2016 (Dollars in Thousands):

	2017	2016
Revenues		
Operating revenues:		
Tuitions and fees (net of scholarship allowances and others of \$60,780 in 2017 and \$58,246 in 2016)	\$ 47,666	\$ 48,476
Net patient services revenue and other (net of provision for (credit to) allowances of \$(23) in 2017 and \$10,301 in 2016)	75,801	61,830
Federal grants and contracts (net of provision for allowances of \$188 in 2017 and \$3,234 in 2016)	90,337	95,476
Commonwealth grants and contracts (net of provision for allowances of \$13,045 in 2017 and \$6,974 in 2016)	6,204	11,399
Nongovernmental grants and contracts (net of provision for allowances of \$2,094 in 2017 and \$10,415 in 2016)	9,917	2,565
Sales and services of educational departments	11,565	11,968
Auxiliary enterprises (net of provision for (credit to) allowances of \$(332) in 2017 and \$290 in 2016)	2,128	1,925
Other operating revenues	9,914	12,714
Total operating revenues	253,532	246,353
Operating expenses:		
Salaries:		
Faculty	370,553	361,322
Exempt staff	238,668	245,134
Nonexempt wages	341	706
Benefits:		
Pension cost (credit) (see Note 15)	42,650	(49,350)
Other benefits	152,468	143,244
Scholarships and fellowships	193,434	185,522
Supplies and other services	143,322	141,792
Utilities	38,664	36,855
Depreciation and amortization	49,111	47,906
Other expenses	9,081	23,325
Total operating expenses	1,238,292	1,136,456
Operating loss	(984,760)	(890,103)
Nonoperating revenues (expenses):		
Commonwealth and other appropriations	934,418	932,503
Federal Pell Grant program	189,364	178,729
Gifts	8,337	9,265
Net investment income	6,123	5,433
Impairment loss on deposits with governmental bank (note 5)	-	(69,807)
Impairment loss on capital assets	-	(1,245)
Interest on capital assets - related debt	(25,183)	(25,553)
Interest on notes payable	(2,897)	(3,047)
Other nonoperating revenues (expenses), net	2,509	538
Net nonoperating revenues (expenses)	1,112,671	1,026,816
Income before other revenues	127,911	136,713
Capital appropriations	-	-
Additions to term and permanent endowments	9	30
Change in net position	127,920	136,743
Net position (deficit):		
Beginning net position (deficit)	(1,509,332)	(1,646,075)
End of year	\$ (1,381,412)	\$ (1,509,332)



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

19. University Only Financial Statements (continued)

**Statements of Cash Flows for the Years Ended June 30, 2017
and 2016 (Dollars in Thousands):**

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities		
Tuition and fees	\$ 48,548	\$ 49,276
Grants and contracts	104,490	127,154
Patient services	75,574	71,107
Payments to employees	(609,825)	(606,397)
Payments for benefits	(221,844)	(255,475)
Payments for scholarships and fellowships	(193,434)	(185,522)
Payments to suppliers	(154,086)	(157,583)
Payments for utilities	(38,664)	(36,854)
Loans issued to students, net of collections	27	(235)
Auxiliary enterprises	1,818	2,249
Sales and services educational department and others	21,723	25,933
Net cash used in operating activities	<u>(965,673)</u>	<u>(966,347)</u>
Cash flows from noncapital financing activities		
Commonwealth and other appropriations	934,418	952,503
Federal Pell program	189,364	178,729
Endowment gifts	9	30
Principal paid on noncapital debt	-	(6,241)
Interest paid on notes payable	-	(2,649)
Federal direct student loan program receipts	52,758	51,084
Federal direct student loan program disbursements	(52,773)	(51,084)
Gifts and grants for other than capital purposes	8,336	9,265
Other non-operating receipts	3,156	538
Net cash provided by noncapital financing activities	<u>1,135,268</u>	<u>1,132,175</u>
Cash flows from capital and related financing activities		
Purchases of capital assets	(20,552)	(28,006)
Proceeds from capital debt	-	220
Principal paid on capital debt and lease	(23,525)	(22,558)
Interest paid on capital debt and lease	(25,394)	(28,087)
Decrease (increase) in deposit with trustees and others	24,087	(152)
Net cash used in capital and related financing activities	<u>(45,384)</u>	<u>(78,583)</u>
Cash flows from investing activities		
Proceeds from sales and maturities of investments	35,369	62,157
Purchases of investments	(41,891)	(107,277)
Collections of interest and dividend income on investments	3,364	4,210
Advances to the University of Puerto Rico (UPR) Retirement System	(53)	-
Collections of advances to the UPR Retirement System	14	38,607
Contribution from component unit	1	640
Net cash used in investing activities	<u>(3,196)</u>	<u>(1,663)</u>
Net change in cash and cash equivalents	<u>121,015</u>	<u>85,582</u>
Cash and cash equivalents:		
Beginning of year	188,740	103,158
End of year	<u>\$ 309,755</u>	<u>\$ 188,740</u>



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

19. University Only Financial Statements (continued)

**Statements of Cash Flows for the Years Ended June 30, 2017
and 2016 (Dollars in Thousands) (continued):**

	2017	2016
Reconciliation of operating loss to net cash used in operating activities		
Operating loss	\$ (984,760)	\$ (890,103)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	49,111	47,906
Provision for doubtful accounts	17,872	36,080
Changes in operating assets and liabilities and deferred outflows and inflows of resources:		
Decrease (increase) in:		
Grants and contracts receivables	(19,531)	(5,365)
Prepaid expenses, inventories and other	2,566	3,605
Deferred outflows of resources from pension activities	(117,789)	(14,128)
Increase (decrease) in:		
Accounts payable and accrued liabilities	(4,198)	3,114
Accrued salaries, wages, benefits and other liabilities	9,585	(34,423)
Net pension liability	209,976	(307,313)
Deferred inflows of resources from pension activities	(128,505)	194,280
Net cash used in operating activities	\$ (965,673)	\$ (966,347)
Supplemental schedule of noncash investing, capital and financing activities:		
Unrealized gains on investments	\$ 2,831	\$ 1,362
Amortization of:		
Bonds premiums (discounts)	\$ 1,794	\$ 1,794
Deferred refunding loss	\$ 292	\$ 292
Impairment loss on deposits with governmental bank (note 4)	\$ -	\$ 69,807



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

20. Subsequent Events

On August 19, 2016, the U.S. Bank Trust National Association, in its capacity as Trustee for the University of Puerto Rico System Revenue Bonds (Series P and Q Bonds), filed a civil lawsuit under the United States Court, District of Puerto Rico against the Commonwealth and its Governor, the University and its President. The motion seeks relief from the stay of PROMESA, or Executive Orders related thereto, and a preliminary injunction against the Commonwealth's diversion and expropriation of pledged revenues, which constitute the University's Bonds collateral. On June 29, 2017, the Trustee and the University, at the direction of FAFAA, entered into a letter agreement providing that the University will transfer certain amounts in respect of pledged revenue, as defined in the trust agreement, to the Trustee on condition, among others, that through August 31, 2017 (the Compliance Period) the Trustee not institute, commence, or continue certain legal proceedings against the University, the Commonwealth or any other agency, instrumentality, or municipality thereof during the Compliance Period, except in certain enumerated circumstances. As agreed in the letter agreement, the University paid \$20 million on June 30, 2017 and an additional \$20 million on September 1, 2017 and continued to pay monthly to the trustee the \$4 million of pledged revenues. The University commits to transfer to the Trustee, to hold or make payments or distributions as provided under the trust agreement, in lieu of the transfer of an equivalent amount of the pledged revenues received by the University from the date hereof through August 31, 2017 as provided in the trust agreement.

The letter agreement has been extended nine times and the new Compliance Period is June 30, 2019. Pursuant to the letter agreement and the nine standstill extension agreements, during the compliance period, holders of the majority in amount of the bonds and the Trustee at the direction of the University's bondholders will negotiate in good faith towards a restructuring of the bonds. In addition, the trustee agreed not to institute or commence certain legal proceedings and the University agreed to transfer the following monthly payments of pledged revenues to the trustee to be applied in accordance with the trust agreement governing the Series P and Q Bonds during the new Compliance Period:

- in consideration for extending the new Compliance Period until May 31, 2018, the University agreed to transfer to the Trustee \$4 million monthly from July 2017 to May 2018;
- in consideration for extending the new Compliance Period until December 31, 2018, the University agreed to transfer to the Trustee the following monthly payments: \$4.0 million of the June 2018 Payment on or before July 15, 2018; \$2.0 million of the July 2018 Payment on or before August 5, 2018; \$3.0 million of the August 2018 Payment on or before August 25, 2018; \$2.3 million of the September 2018 Payment on or before September 25, 2018; \$2.3 million of the October 2018 Payment on or before October 25, 2018; \$3.0 million of the November 2018 Payment on or before November 25, 2018; and \$3.0 million of the December 2018 Payment, less a credit for any amount as of November 30, 2018 in the Trustee's Bond Service Account and Reserve Account that is, in the aggregate, in excess of \$68,606,318, on or before December 25, 2018; and
- in consideration for extending the new Compliance Period until June 30, 2019, the University agreed to transfer to the Trustee the following monthly payments: \$2.9 million of the January 2019 Payment on or before January 25, 2019; \$2.9 million of the February 2019 Payment on or before February 25, 2019; \$2.9 million of the March 2019 Payment on or before March 25, 2019; \$2.9 million of the April 2019 Payment on or before April 25, 2019; \$2.9 million of the May 2019 Payment on or before May 25, 2019; and \$2.9 million of the June 2019 Payment, less a credit for any amount as of May 30, 2019 in the Trustee's Bond Service Account and Reserve Account that is, in the aggregate, in excess of \$75,395,125, on or before June 30, 2019.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

20. Subsequent Events (continued)

In addition, the University and FAFAA shall provide the trustee with detailed plans and specifications for repairing, replacing or reconstructing the University's property that was damaged or destroyed by Hurricane Maria as these plans are approved by the University. The University shall deposit all proceeds of casualty insurance policies or direct federal aid (the "Repair Funds") in segregated accounts of the University at a commercial bank. The University shall deposit proceeds of casualty insurance in a separate account and shall deposit proceeds of direct federal aid in one or more separate accounts to facilitate the audit of the expenditure of such funds. All Repair Funds in excess of \$1,000,000 shall be used pursuant to a written requisition. On or before the fifteenth (15th) calendar day of each month, the University will submit the preceding month's Requisitions to the trustee, as set forth below. Pursuant to extended letter agreement, the majority bondholders expand their direction to instruct the trustee not to call a default during the pendency of the new Compliance Period if by the fifteenth (15th) calendar day of each month the University sends to the trustee copies of the preceding month's Requisitions. On the fifteenth (15th) calendar day of each month the University or FAFAA will provide, or cause relevant agencies to provide, the trustee with all project requests, progress or other reports provided to the Federal Emergency Management Agency (FEMA) or to any casualty insurance company with respect to the expenditure of Repair Funds during the preceding month.

Discussions with respect to a consensual restructuring of the University's bonds are continuing. Presently, the University has paid as agreed the scheduled principal and interest payments on its outstanding Series P and Q Bonds and complied with the letter agreement, as extended, with the Trustee.

In September 2017, the University received from the U.S. Department of Justice a Claim Letter/Notice of Intent to File Suit on behalf of the National Science Foundation ("NSF"), the National Aeronautics and Space Administration and the United States Department of Energy to take action in the Federal Court against the University for violations of the False Claims Act as a result of an examination of federal grants received by two units of the University. The claim sought treble damages amounted to approximately \$5.6 million, including \$300,000 for penalties. On September 27, 2018, the University settled this claim with the federal agencies for approximately \$1,773,000. On November 20, 2018, the University paid this claim.

On September 6, 2017, Hurricane Irma did some damages to the island of Puerto Rico and then on September 20, 2017, the island of Puerto Rico suffered the complete devastation caused by Hurricane Maria, causing catastrophic wind and water damage to Puerto Rico's infrastructure, home and businesses.

As a result of the Hurricane Maria, most of the island's population was left without electrical power and there was significant disruption to the water distribution system. Other basic utility and infrastructure services such as communications, ports and transportation were also materially affected, causing a significant disruption to the island's economic activity. The entire island of Puerto Rico will need a massive infrastructure rebuilding program.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

20. Subsequent Events (continued)

Immediately after the landfall of the Hurricane Maria on Puerto Rico, the President of the United States of America issued a state of emergency declaration for Puerto Rico, as a U.S territory. The order mandates federal assistance through the Department of Homeland Security and the Federal Emergency Management Agency (FEMA) be made available to assist in local and territorial recovery efforts.

Some of the University's eleven campuses were more affected than others, but all were impacted in some way. A few days after Hurricane Maria, many of the University employees, as well as students and other volunteers, returned to the campuses and to the University's central Administration to begin the rebuilding process. At the end of October and the beginning of November 2017, administrative and academic functions had resumed at basically all areas and units that comprise the University System.

The University's costs associated with repairing the damages sustained by the hurricanes could range from \$130 million to \$140 million. Part of these costs are expected to be covered by insurance funds and by disaster-relief funds granted by FEMA. The University's commercial property and fine arts insurance coverages have an aggregate lost limit of \$100 million each. On September 28, 2018, the insurance company was intervened by the Puerto Rico Insurance Commissioner for insolvency under a "rehabilitation order" for the insurance company before the Court of First Instance, Superior Court of San Juan. The order designates the Puerto Rico Insurance Commissioner, as "rehabilitator" and orders him to take possession of the insurer's assets, in protection of the interests of the policyholders with claims, creditors of the insurer and the public in general. On November 8, 2018, the University settled this claim with the insurance company for a total consideration of \$50.0 million (\$57.0 million less \$7.0 million of deductible amounts). Presently, the University has received advanced funds from the insurance company of approximately \$38.8 million and from FEMA of approximately \$1.0 million for these natural disasters.

On July 1, 2018, the commercial property and fine arts insurance policies expired. On October 1, 2018, the University contracted these policies with another insurance carrier with effective date from October 1, 2018 to June 30, 2019.

On August 1, 2017, the University presented to the Oversight Board of PROMESA its fiscal plan for the ensuing ten years. The fiscal plan included a series of expense reduction measures complemented with revenue enhancing initiatives, including tuitions hikes, which in the aggregate will add up to \$512 million in Commonwealth appropriations reductions by fiscal year 2026.

On August 26, 2017, the Oversight Board of PROMESA announced, through a letter from its Executive Director, that the University fiscal plan will not be certified as submitted above. The letter requested to the University Governing Board develop a new version of the fiscal plan correcting several deficiencies that the Oversight Board of PROMESA identified.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

20. Subsequent Events (continued)

After the passages of Hurricane Irma and Maria in September 2017, the Oversight Board of PROMESA requested the University to submit a revised fiscal plan for the ensuing five years. On April 5, 2018 (as revised on September 7, 2018), the University submitted its revised fiscal plan for the fiscal years 2018 to 2023. On April 20, 2018 (as amended on June 29, 2018 and October 23, 2018), the Oversight Board of PROMESA certified its own University fiscal plan. For a more detail of the University fiscal plans, refer to Note 2.

On October 24, 2017, the Puerto Rico First Court of Instance issued a partial declaratory judgement ordering DUI to pay the retainage amount under the construction contract of about \$1.6 million, plus interest, to the Plaza Universitaria Project's general contractor. DUI appealed this partial declaratory judgement. On September 10, 2018, the Plaza Universitaria Project's general contractor, the University and DUI signed a settlement agreement in which the University and DUI committed to paid \$2,300,000 and \$1,550,000, respectively, for a total consideration of \$3,850,000. On September 11, 2018, the Puerto Rico First Court of Instance approved the settlement agreement. In November 2018, the University and DUI made the corresponding payments to the Plaza Universitaria Project's general contractor.

On May 15, 2017, the Puerto Rico Fiscal Agency and Financial Advisory Authority (FAFAA) and the Government Development Bank for Puerto Rico (GDB) entered into a Restructuring Support Agreement (the "RSA") with a significant portion of the GDB's creditors. The parties to the RSA agreed to undertake a financial restructuring of the GDB pursuant to a Qualifying Modification under Title VI of PROMESA (the "Qualifying Modification"). On August 9, 2018, the GDB commenced the solicitation of votes on the Qualifying Modification and on August 10, 2018 commenced an action to obtain court approval of the Qualifying Modification. Following the conclusion of voting on September 12, 2018, the GDB announced that it received the necessary votes from holders of claims subject to the Qualifying Modification (the "Participating Bond Claims") to approve the Qualifying Modification, as required under PROMESA. On November 6, 2018, the Qualifying Modification was approved by the Federal Court. On November 29, 2019, the FAFAA and the GDB announced the consummation of the Qualifying Modification.

Under the Qualifying Modification, holders of Participating Bond Claims exchanged their Participating Bonds claims for bonds issued by a newly created public instrumentality, the GDB Debt Recovery Authority, and the GDB transferred to such entity its municipal loan portfolio, a portion of its public entity loan portfolio, its real estate owned assets and its unencumbered cash.



University of Puerto Rico
Notes to Financial Statements (continued)
June 30, 2017

20. Subsequent Events (continued)

Pursuant to Act No. 109-2017, also known as the Government Development Bank for Puerto Rico Debt Restructuring Act (the “GDB Restructuring Act”), claims on account of deposits held by the Commonwealth and other public entities, including the University, will be exchanged for interest in the Public Entity Deed of Trust created pursuant to the GDB Restructuring Act. Specifically, pursuant to the GDB Restructuring Act, on the closing date of the Qualifying Modification (the “Closing Date”), the balance of liabilities owed between the Commonwealth and its agents, instrumentalities and affiliates, including the University (each a “Non-Municipal Government Entity”) and the GDB will be determined by applying the outstanding balance of any deposits held at GDB in a Non-Municipal Government Entity’s name against the outstanding balance of any loan of such Non-Municipal Government Entity owed to the GDB or of any bond or note of such Non-Municipal Government Entity held by the GDB as of such date. Those Non-Municipal Government Entities having net claims against the GDB, after giving effect to the foregoing adjustment, including the University, will receive their pro rata share of interests in the Public Entity Trust (PET), which will be deemed to be full satisfaction of any and all claims such Non-Municipal Government Entity may have against GDB. The assets of the PET (the “PET Assets”) will consist of, among other items, a \$890 million claim against the Commonwealth, which is the subject of a proof of claim filed in the Commonwealth Title III case under PROMESA. A portion of the PET Assets will be transferred to the PET on the Closing Date and the remainder of the PET Assets, or any portion thereof, will be transferred to the PET in one or more transactions, as set forth in the Public Entity Deed of Trust (as defined in the GDB Restructuring Act). Under the GDB Restructuring Act, the transfer of the PET Assets by the GDB to the PET will be an irrevocable, non-voidable, and absolute transfer of all the GDB’s legal and equitable right, title, and interest in the PET Assets.

As a result of the Qualifying Modification, on November 29, 2018, the credit facilities the University owed to the GDB (approximately \$88.1 million, including accrued interest, as of November 29, 2018) were fully offset on a dollar-for-dollar basis by the amount of the University’s deposits held at the GDB (approximately \$94.6 million, including accrued interest, as of November 29, 2018) and such facilities were extinguished. The remainder of the University’s recovery on account of its deposits at the GDB (approximately \$6.5 million) will depend upon the recovery received by the Public Entity Trust on account of the PET Assets.

DRAFT

Required Supplementary Information



University of Puerto Rico
Schedule of Changes in the University's Net Pension Liability and Related Ratios
Years Ended June 30, 2017, 2016 and 2015
(Dollars in thousands) (Unaudited)

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Total Pension Liability:			
Service cost	\$ 46,571	\$ 48,107	\$ 49,499
Interest	194,184	177,334	173,630
Changes in benefit terms	(14,671)	(45,209)	-
Differences between expected and actual experience	(4,733)	(323,974)	-
Changes in assumptions	160,911	32,269	(24,034)
Benefit payments, including refunds of member contributions	(182,614)	(176,872)	(169,163)
Net change in total pension liability	199,648	(288,345)	29,932
Total pension liability, beginning	3,139,723	3,428,068	3,398,136
Total pension liability, ending (a)	<u>\$ 3,339,371</u>	<u>\$ 3,139,723</u>	<u>\$ 3,428,068</u>
Fiduciary Net Position:			
Contributions - employer	\$ 78,004	\$ 88,251	\$ 91,689
Contributions - member	38,640	35,594	37,900
Net investment income	59,009	76,684	206,595
Benefit payments	(182,614)	(176,872)	(169,163)
Administrative expenses and others	(3,367)	(4,689)	(4,566)
Net change in plan net position	(10,328)	18,968	162,455
Fiduciary net position, beginning	1,342,996	1,324,028	1,161,573
Fiduciary net position, ending (b)	<u>\$ 1,332,668</u>	<u>\$ 1,342,996</u>	<u>\$ 1,324,028</u>
Employer's Net Pension Liability - Ending (a) - (b)	<u>\$ 2,006,703</u>	<u>\$ 1,796,727</u>	<u>\$ 2,104,040</u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	39.91%	42.77%	38.62%
Covered-Employee Payroll	\$ 515,994	\$ 516,226	\$ 515,856
Employer's Net Pension Liability as a Percentage of Covered-Employee Payroll	388.90%	348.05%	407.87%

Note: The University's net pension liability at year end was measured at beginning of year (measurement date) and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation with beginning-of-year census data that was rolled forward to the measurement date, and assuming no liability gains and losses.

Schedule is intended to show information for ten years. Additional years will be displayed as they become available.



University of Puerto Rico
Schedule of the University's Contributions – Pension Plan
Last 10 Years (Dollars in thousands) (Unaudited)

Fiscal Year Ended June 30	Actuarial Determined Contribution (ADC) (1)	Contributions in Relation to the Actuarial Determined Contribution	Contribution Deficiency (Excess)	Covered Employee Payroll	Contributions as a Percentage of Covered Employee Payroll (2)
2016	\$ 86,635	\$ 78,004	\$ 8,631	\$ 515,994	15.12%
2015	89,255	88,251	1,004	516,226	17.10%
2014	78,204	91,689	(13,485)	515,856	17.77%
2013	77,772	88,481	(10,709)	491,291	18.01%
2012	72,186	75,140	(2,954)	491,063	15.30%
2011	68,487	70,761	(2,274)	526,820	13.43%
2010	63,722	71,177	(7,455)	558,961	12.73%
2009	64,072	72,605	(8,533)	577,227	12.58%
2008	59,246	81,553	(22,307)	543,538	15.00%
2007	57,524	78,311	(20,787)	518,237	15.11%

- (1) The actuarially determined contribution for fiscal years 2016, 2015 and 2014 were determined by actuarial valuations with beginning-of-year census data that were rolled forward to June 30, 2016 2015 and 2014, respectively, and assumed no gains or losses. Prior year actuarial valuations were made using end-of-year census data.
- (2) ADC Rate for each fiscal year comes from actuarial valuation at start of that fiscal year (e.g., the June 30, 2016, Required Contribution was established in the June 30, 2015 actuarial valuation).
- (3) The Governing Board of the University approved with the recommendation of the Plan Retirement Board (Certification No. 146 fiscal year 2014-2015) a 40-year closed amortization beginning on July 1, 2015.

See notes to required supplementary information.



University of Puerto Rico
Notes to Schedule of University's Contributions – Pension Plan
Last 10 Years

The Governing Board of the University establishes contribution rates to the Retirement System mainly based on an actuarially determined rate recommended by an independent actuary at the beginning of the fiscal year. The actuarially determined rate is the estimated amount to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded liability. The University is required to contribute the difference between the total contribution rate approved by the Governing Board of the University and the contribution rate of employees. The actuarially determined employer contribution rate takes into account payment of administrative expenses. Therefore, administrative expenses are paid out of the trust fund.

The contributions of the University were originally designed to fund, together with the contributions of the participants, the current service cost on a current basis and the estimated accrued benefit cost attributable to qualifying service prior to the establishment of the Retirement System over a 40-year period, but as a result of increasing benefits without a correlative increase in employer's contributions, they fall short of accomplishing the necessary funding.

During fiscal years 2014 and 2013, the University made additional contributions to the Retirement System of approximately \$10.5 million and \$10.0 million, respectively, to fund its actuarial deficit.

Starting in fiscal year 2015, with the adoption of Governmental Accounting Standards Board (GASB) Statement No. 67, *Financial Reporting for Pension Plans – an Amendment of GASB Statement No. 25* and GASB Statement No. 68, *Accounting and Financial Reporting for Pension - an Amendment of GASB Statement No. 27*, the discount rate for calculating the total pension liability is equal to the single equivalent interest rate (SEIR) that results in the same actuarial present value as the long-term expected rate of return applied to benefit payments, to the extent that the pension plan's fiduciary net position is projected to be sufficient to make projected benefit payments, and the tax free municipal bond index rate applied to benefit payments, to the extent that the pension plan's fiduciary net position is not projected to be sufficient. Before fiscal year 2015, the discount rate for calculating the total pension liability was equal to the projected investment of return.

The actuarially determined contributions were developed using a One-Year Lag methodology, under which the actuarial valuation determines the employer contribution for the second following year (e.g. Fiscal Year 2016 contributions were determined using an actuarial valuation as of June 30, 2014). The methods and assumptions used to determine the actuarially determined contribution are as follows:



University of Puerto Rico

Notes to Schedule of University's Contributions – Pension Plan Last 10 Years (continued)

	2017	2016	2015	2014	2013
Valuation date	June 30, 2015 (Lag)	June 30, 2014 (Lag)	June 30, 2013 (Lag)	June 30, 2012 (Lag)	June 30, 2011 (Lag)
Actuarial cost method	Entry age normal	Entry age normal	Entry age normal	Entry age normal	Entry age normal
Amortization method	Level percentage of payroll, closed	Level percentage of payroll, closed	Level percentage of payroll, open	Level percentage of payroll, open	Level percentage of payroll, open
Remaining amortization period	29 years- constant (open basis)	30 years- constant (open basis)	30 years- constant (open basis)	30 years- constant (open basis)	30 years- constant (open basis)
Asset valuation method	5-year smoothed market	5-year smoothed market	5-year smoothed market	5-year smoothed market	5-year smoothed market
Inflation	3.00% per year	3.00% per year	3.50% per year	3.50% per year	3.50% per year
Investment rate of return	7.75% per annum, compounded annually, net of investment expenses and including inflation	7.75% per annum, compounded annually, net of investment expenses and including inflation	8.00% per annum, compounded annually, net of investment expenses and including inflation	8.00% per annum, compounded annually, net of investment expenses and including inflation	8.00% per annum, compounded annually, net of investment expenses and including inflation
Municipal bond index	3.01% per annum, as per Bond Buyer General Obligation 20-Bond Municipal Bond Index	3.82% per annum, as per Bond Buyer General Obligation 20-Bond Municipal Bond Index	4.35% per annum, as per Bond Buyer General Obligation 20-Bond Municipal Bond Index	Not applicable	Not applicable
Discount rate	5.89% per annum	6.37% per annum	5.31% per annum	8.00% per annum	8.00% per annum
Projected salary increases	3.75% per year, including inflation	3.75% per year, including inflation	5.00% per year, including inflation	5.00% per year, including inflation	5.00% per year, including inflation
Mortality:					
Pre-retirement Mortality	RP-2000 Healthy Annuitant Mortality Table for ages 50 and greater and the RP-2000 Combined Mortality Table for ages less than 50 projected for future mortality improvements to 2020 using Scale BB, set back 5 years for males and set forward 1 year for females	RP-2000 Healthy Annuitant Mortality Table for ages 50 and greater and the RP-2000 Combined Mortality Table for ages less than 50 projected for future mortality improvements to 2020 using Scale BB, set back 5 years for males and set forward 1 year for females	RP-2000 Employee Annuitant Mortality Table, projected to 2026 using Scale AA	RP-2000 Mortality Table, projected 7 years for annuitants and 15 years for non-annuitants using Scale AA	RP-2000 Mortality Table, projected 7 years for annuitants and 15 years for non-annuitants using Scale AA
Post-retirement Healthy Mortality	RP-2000 Healthy Annuitant Mortality Table for ages 50 and greater and the RP-2000 Combined Mortality Table for ages less than 50 projected for future	RP-2000 Healthy Annuitant Mortality Table for ages 50 and greater and the RP-2000 Combined Mortality Table for ages less than 50 projected for future	RP-2000 Healthy Annuitant Mortality Table, projected to 2018 using Scale AA	RP-2000 Mortality Table, projected 7 years for annuitants and 15 years for non-annuitants using Scale AA	RP-2000 Mortality Table, projected 7 years for annuitants and 15 years for non-annuitants using Scale AA
Post-retirement Disabled Mortality	RP-2000 Disabled Mortality Table projected for future mortality improvements to 2020 using Scale BB, set back 5 years for males and set forward 2 years for females	RP-2000 Disabled Mortality Table projected for future mortality improvements to 2020 using Scale BB, set back 5 years for males and set forward 2 years for females	100% of disabled life mortality rates from Social Security Actuarial Study No. 75	100% of disabled life mortality rates from Social Security Actuarial Study No. 75	100% of disabled life mortality rates from Social Security Actuarial Study No. 75



University of Puerto Rico
Notes to Schedule of University's Contributions – Pension Plan
Last 10 Years (continued)

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Valuation date	June 30, 2010 (Lag)	June 30, 2009 (Lag)	June 30, 2008 (Lag)	June 30, 2007 (Lag)	June 30, 2006 (Lag)
Actuarial cost method	Entry age normal	Entry age normal	Entry age normal	Entry age normal	Entry age normal
Amortization method	Level percentage of payroll, open	Level percentage of payroll, open	Level percentage of payroll, open	Level percentage of payroll, open	Level percentage of payroll, open
Remaining amortization period	30 years- constant (open basis)	30 years- constant (open basis)	30 years- constant (open basis)	30 years- constant (open basis)	30 years- constant (open basis)
Asset valuation method	5-year smoothed market	5-year smoothed market	5-year smoothed market	5-year smoothed market	5-year smoothed market
Inflation	3.50% per year	3.50% per year	3.50% per year	3.50% per year	3.50% per year
Investment rate of return	8.00% per annum, compounded annually, net of investment expenses and including inflation	8.00% per annum, compounded annually, net of investment expenses and including inflation	8.00% per annum, compounded annually, net of investment expenses and including inflation	8.00% per annum, compounded annually, net of investment expenses and including inflation	8.00% per annum, compounded annually, net of investment expenses and including inflation
Municipal bond index	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
Discount rate	8.00% per annum	8.00% per annum	8.00% per annum	8.00% per annum	8.00% per annum
Projected salary increases	5.00% per year, including inflation	5.00% per year, including inflation	5.00% per year, including inflation	5.00% per year, including inflation	5.00% per year, including inflation
Mortality:					
Pre-retirement Mortality	1994 Group Annuity Mortality Table	1994 Group Annuity Mortality Table	1994 Group Annuity Mortality Table	1994 Group Annuity Mortality Table	1994 Group Annuity Mortality Table
Post-retirement Healthy Mortality	1994 Group Annuity Mortality Table	1994 Group Annuity Mortality Table	1994 Group Annuity Mortality Table	1994 Group Annuity Mortality Table	1994 Group Annuity Mortality Table
Post-retirement Disabled Mortality	100% of disabled life mortality rates from Social Security Actuarial Study No. 75	100% of disabled life mortality rates from Social Security Actuarial Study No. 75	100% of disabled life mortality rates from Social Security Actuarial Study No. 75	100% of disabled life mortality rates from Social Security Actuarial Study No. 75	100% of disabled life mortality rates from Social Security Actuarial Study No. 75



University of Puerto Rico
Schedule of Funding Progress -
Postemployment Benefits other than Pensions Program
(Dollars in thousands) (Unaudited)

Postemployment Benefits Other Than Pensions Program					
Actuarial Valuation Date	Actual value of Assets (a)	Actual Liability (AAL) (b)	UAAL (b - a)	Funded Ratio (a / b)	
7/1/2016	\$ -	\$ 218,200	\$ (218,200)	-%	
7/1/2015	-	211,811	(211,811)	-	
7/1/2014	-	241,317	(241,317)	-	
7/1/2013	-	209,184	(209,184)	-	
7/1/2011	-	197,324	(197,324)	-	
7/1/2009	-	189,417	(189,417)	-	
7/1/2007	-	184,233	(184,233)	-	

Other Financial Information



University of Puerto Rico
Schedules of Changes in the University's Sinking Fund Reserve
Years Ended June 30, 2016 and 2015 (Dollars in thousands) (Unaudited)

	2017			2016		
	Bond Service Account	Bond Reserve Account	Total	Bond Service Account	Bond Reserve Account	Total
Additions:						
Transfer from Bond Reserve Account	\$ 42,555	\$ -	\$ 42,555	\$ -	\$ -	\$ -
Transfer from unrestricted current funds	20,000	-	20,000	42,528	-	42,528
Interest earned on investments	-	197	197	98	176	274
Total receipts	62,555	197	62,752	42,626	176	42,802
Deductions:						
Payments of bond interest	21,590	-	21,590	22,588	-	22,588
Payments of bond principal	20,965	-	20,965	19,970	-	19,970
Net decrease in fair value of investments	-	29	29	68	13	81
Transfer to Bond Service Account	-	42,555	42,555	-	-	-
Legal fees and related expenses	-	1,720	1,720	-	-	-
Total disbursements	42,555	44,304	86,859	42,626	13	42,639
Net increase (decrease) for the year	20,000	(44,107)	(24,107)	-	163	163
Balances at beginning of year	-	54,885	54,885	-	54,722	54,722
Balance at end of year	\$ 20,000	\$ 10,778	\$ 30,778	\$ -	\$ 54,885	\$ 54,885

Note: The University's Sinking Fund assets as of June 30, 2017 and 2016 consisted of the following:

	2017	2016
Investments- Money market funds	\$ 30,774	\$ -
Investments- U.S. Treasury notes	-	54,862
Accrued interest receivable	4	23
Total	\$ 30,778	\$ 54,885

Report on Internal Control and on Compliance

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*

Governing Board
University of Puerto Rico

We have audited, in accordance with the 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, the financial statements of the business-type activities and the aggregate discretely presented component units of the University of Puerto Rico (the “University”) as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the University’s basic financial statements and have issued our report thereon dated _____. Our report includes a reference to other auditors who audited the financial statements of Servicios Medicos Universitarios, Inc. (the “Hospital”), Desarrollos Universitarios, Inc., University of Puerto Rico Parking System, Inc. and Materials Characterization Center, Inc. (collectively, the “Component Units”) as described in our report on the University’s financial statements. The financial statements of the Hospital and the Component Units were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the University’s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the University’s internal control.

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 material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described below, we identified a deficiency in internal control that we consider to be a material weakness.

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

2016-001 - Financial Statement Close Process

Criteria

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

Condition

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

- Multiple audit/post-closing entries that were not initially identified by the University's internal controls were required to properly record revenue and expense activity, accounts receivable activity, cash activity, prepaid expenses activity and certain liabilities. These entries were considered material to the financial statements.
- The compilation of financial data and reconciliation processes are not completed in a timely manner. The lack of procedures and controls in these areas resulted in inefficiencies during the financial statements preparation process.
- The accounting and financial reporting operations of certain units of the University, specifically the Medical Sciences Campus and the Mayagüez Campus, are not able to detect or prevent accounting errors effectively nor efficiently which resulted in multiple audit adjustments.

Cause

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

Effect

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

Recommendations

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

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

The University should consider changing or reinforcing the organizational structure to improve monitoring controls over the accounting and financial reporting functions of units. The accounting and financial reporting responsibilities should be centralized and units should report 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.

Management's Response

Management will improve the annual closing process, by designing and implementing effective monitoring controls over the financial information. General ledger accounts will be timely reviewed and properly supported with reconciliations, roll-forward schedules and other appropriate documentation.

All accounting judgments and estimates will be properly supported and reviewed. The University will ensure that its accounting personnel in all Units have the appropriate training to effectively perform the financial statement close process.

The University will evaluate 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 will also be evaluated to determine if all units should respond directly, timely and effectively to the Central Administration Finance Director and Controller.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and 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 in accordance with *Government Auditing Standards*.

The University's Response to Finding

The University's response to the finding identified in our audit was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

_____, 2018

Stamp No. _____
affixed to
original of
this report.