

***Puerto Rico System of Annuities and
Pensions for Teachers***

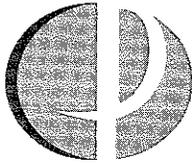
*Basic Financial Statements and
Required Supplementary Information for the
Years Ended June 30, 2007 and 2006; and
Independent Auditors' Report*

Puerto Rico System of Annuities and Pensions for Teachers

*Basic Financial Statements, and Required Supplementary Information, for the
Years Ended June 30, 2007 and 2006; and Independent Auditors' Report*

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PARISSI P.S.C.

Certified Public Accountants, Tax & Business Advisors

Independent Auditors' Report

The Board of Trustees
Puerto Rico System of Annuities and Pensions for Teachers
San Juan, Puerto Rico

We have audited the accompanying statements of plan net assets of the Puerto Rico System of Annuities and Pensions for Teachers (the System) as of June 30, 2007 and 2006 and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the System at June 30, 2007 and 2006 and the changes in its net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis presented on pages 2 through 6 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming opinions on the financial statements of the System. The schedule of employer contributions and funding progress are included on pages 30 and 31 are presented for purposes of additional analysis and is not a required part of the basic financial statements. These schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

San Juan, Puerto Rico
March 26, 2008

Parissi, P.S.C.

Stamp No. 2293987 was affixed
to the original of this report
License No. 88 Exp. December 1, 2008.



Puerto Rico System of Annuities and Pensions for Teachers

*Management's Discussion and Analysis
Years Ended June 30, 2007 and 2006*

The Puerto Rico System of Annuities and Pensions for Teachers (the System) presents management's overview of the administrative and operational activities that had an impact on the System's net assets for the fiscal years ended June 30, 2007 and 2006. The System administers retirement and other participant benefits, such as personal, cultural and mortgages loans, occupational and non-occupational disability annuities and death benefits.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the System's basic financial statements, which are comprised of the following: 1) Statements of Plan Net Assets, 2) Statements of Changes in Plan Net Assets, and 3) Notes to Basic Financial Statements. Required Supplementary information is also presented to supplement the basic financial statements.

Statements of Plan Net Assets and Statements of Changes in Plan Net Assets

Both these statements provide information about the overall financial status of the System. The Statements of Plan Net Assets include all of the System's assets and liabilities, with a difference reported as net assets held in trust for pension benefits. The Statements of Changes in Plan Net Assets disclose changes in the System's net assets during the fiscal year. Comparative information for the years ended June 30, 2007 and 2006 is presented.

Notes to Basic Financial Statements

The notes to basic financial statements provide additional information that is essential for an understanding of the data provided in the Statements of Plan Net Assets and Changes in Plan Net Assets.

Required Supplementary Information

The required supplementary information consists of two schedules and related notes concerning the funded status of the pension plan administered by the System.

Financial Highlights

The System's net assets as of June 30, 2006 increased from approximately \$2,807 million to \$3,163 million as of June 30, 2007. The increase was primarily due to the net appreciation in the fair value of the System's investment portfolio. The amount of \$3,163 million in total net assets consists of the following:

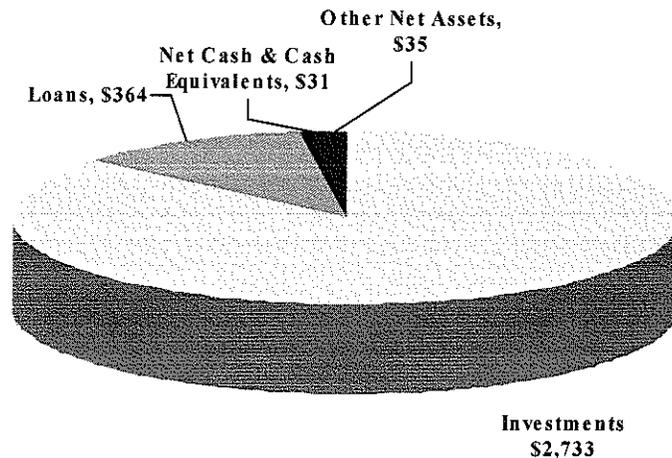
- \$2,733 million in investments
- \$364 million in loans to plan members
- \$31 million in net cash and cash equivalents
- \$35 million in other net assets (liabilities)

Puerto Rico System of Annuities and Pensions for Teachers

Management's Discussion and Analysis

Years Ended June 30, 2007 and 2006

Total net assets table (in millions):



Following is a comparison of certain items within the financial statements:

- The System's assets exceeded liabilities by \$3,163 million (net assets) for the fiscal year ended June 30, 2007 when compared to the prior year which assets exceeded liabilities by \$2,807 million.
- The fair value of the System's investments (excluding loans to participants) at June 30, 2007 amounted to \$2,733 million, compared to \$2,396 million at June 30, 2006.
- Administrative expenses remained basically the same amounting to \$22.9 million for the year ended June 30, 2007 and \$22.7 million for the year ended June 30, 2006.
- The System's funded ratio of the actuarial accrued liability at June 30, 2007 was 41%.

Financial Analysis of the System

The System provides retirement benefits to teachers within the public education system of the Commonwealth of Puerto Rico. The System's net assets held in trust for benefits at June 30, 2007 amounted to approximately \$3,163 million, an increase of approximately \$356 million from approximately \$2,807 million at June 30, 2006. Additions to the System's net assets held in trust for benefits include employer and member contributions, as well as investment income. For fiscal year 2007, employer and member contributions decreased by approximately \$4.5 million, from approximately \$249 million during fiscal year 2006 to approximately \$244 million during fiscal 2007. The decrease is mainly due to a reduction in teachers' headcount and no salary increase by the Department of Education. During fiscal year 2007, the System received employee contributions related to the employees working at the System who elected to transfer from the Government Employees Retirement System (GERS) benefit structure to the System's benefit structure, the transfers from the GERS amounted to approximately \$8.1 million. The System recognized a net appreciation in the fair value of investments of approximately \$406 million for fiscal year 2007.

Puerto Rico System of Annuities and Pensions for Teachers

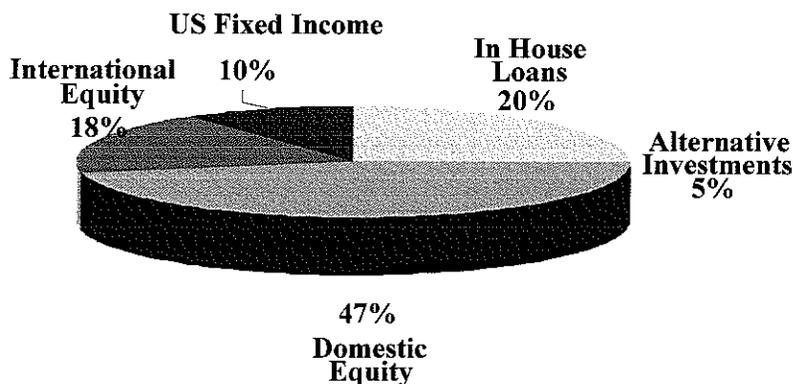
Management's Discussion and Analysis

Years Ended June 30, 2007 and 2006

In fiscal year 2004, the System started a re-engineering and mechanization project that involves different areas; such as Pensions and Finance. As of June 30, 2007, \$5.8 million was capitalized as a result of the project in progress (an increase of approximately \$1.1million with respect to fiscal year 2006).

In January 2007 the System decided to exercise its option to redeem the bonds in whole effective March 15, 2007 at the applicable redemption price (102%) plus interest accrued to the date fixed for redemption. On March 15, 2007 the bonds were paid in full and the pledged collateral was released and contributed to the System's investment portfolio (see Note 9 to financial statements).

During the fiscal year ended June 30, 2007 there were no changes in the System's asset allocation and manager structure. The asset mix of the fund generated a positive gross return of 17.44% for the year ended June 30, 2007. The target asset mix is as follows:



Following is a general description of how the markets behaved during fiscal year 2007 in general, by asset class, and how it impacted the Fund's performance.

Economy and Market Overview

Global markets rebounded at the start of fiscal 2007 as falling oil prices, a break in the US Fed's long-term rate hike campaign, and moderating inflation helped to rally the world's financial markets. However, growth in the U.S. economy continued to slow in the third quarter of 2006 pulled down by a sharpening downturn in the housing market and a cautious consumer. Over the course of 2006, GDP growth slowed, cycling down from the robust 5.6% in the first quarter to 2.6% and 2.0% in the second and third quarters, but the stronger fourth quarter economic data on employment, trade, incomes, inflation and production, a plunge in oil prices, and a sudden burst in consumer confidence all provided for a stronger than expected fourth quarter of 2006 bringing GDP growth for 2006 to 3.3%. Growth in the Euro zone and Japan also was much more solid than a year ago and China and India continued to expand rapidly. The global economy began to see steady, synchronized growth for the first time in years as corporate profits were coming in strong and M&A activity was high. By late February 2007 however, global markets experienced a sharp decline led by a correction in the Chinese stock market. Despite this downturn, the US equity markets produced positive returns but lagged the non-US equity markets. Although the fiscal year began with a strong dollar, it continued to weaken through out the remaining three quarters. World Financial Markets moved higher again in the final quarter of the fiscal year benefiting from strong economic growth, healthy M&A activity and solid corporate earnings.

Puerto Rico System of Annuities and Pensions for Teachers

Management's Discussion and Analysis

Years Ended June 30, 2007 and 2006

After surging in April and May global markets faded in June due to interest rate concerns and less attractive financing sources for hedge funds. The yield curve continued its flattening trend during the year but remained inverted in anticipation of another rate cut which had not materialized by fiscal year end. The overall investment themes for fiscal year 2007 were that stocks beat bonds, large cap led small cap, value beat growth, and non-US equities out performed US equities.

Domestic Equity Overview

The US Equity markets started off the fiscal year well out performing their non-US equity counterpart in the third quarter of 2006. Although returns continued to surge during the fourth quarter of 2006, the non-US segment of the market really took off besting the US for the remainder of the fiscal year. First quarter 2007 US equity returns retreated, but by fiscal year end, the US market as measured by the Russell 3000 posted a 20.07% return for the fiscal year ending June 30, 2007, its best showing in three years, although behind its non-US counterpart (EAFE posted a 27.01% return for the same period.) Based upon the Russell indices, large cap stocks led the way in a reversal from recent trends. Value continued to best growth except in small cap where growth eked out a small gain over value. Within the Russell 3000 all sectors except financials and utilities had positive performance for each quarter of the fiscal year.

At June 30, 2007, the System held \$1,538 million in U.S. equity securities which represents approximately 49% of the total investment portfolio. During fiscal year ended June 30, 2007, investments in U.S. equity securities earned gross returns of approximately 19.75%.

International Equity Overview

Non-U.S. Equity Markets continued to deliver strong performance during fiscal 2007. The MSCI EAFE Index was up 27.01% for the period, helped in part by a weaker dollar. Continental Europe led the way with the Pacific region trailing. Japan lagged the broader market for most of the period. Emerging Markets were once again the best performing area.

As of June 30, 2007, the System held \$681 million in foreign equity securities which represents approximately 22% of the total investment portfolio. During fiscal year ended June 30, 2007, these securities earned a gross return of 25.52%.

Fixed Income Overview

Bond market fundamentals deteriorated over the course of fiscal 2007. Although the third quarter of 2006 was the best quarter for bonds in the previous four years, performance deteriorated into negative territory by the last quarter of the fiscal year due to a temporary re-pricing of risk, shifting expectations of future US Federal Reserve monetary policy, and fears of inflation. The bond market as measured by the Lehman Brothers Aggregate Index returned 6.12% for the fiscal year ending June 30, 2007. High Yield, however, continued to out perform all styles.

As of June 30, 2007, the System held \$468 million in domestic fixed income securities which represents approximately 15% of the total investment portfolio. The System's fixed income money managers had a gross return of 6.41% for the fiscal year ended June 30, 2007.

Puerto Rico System of Annuities and Pensions for Teachers

*Management's Discussion and Analysis
Years Ended June 30, 2007 and 2006*

Total Fund Performance

During the fiscal year 2007 the System posted double digit returns mostly as a result of the strong performance of the international and domestic equity markets. The System's large cap domestic equity portfolio had strong absolute performance, but the individual active managers trailed their benchmarks. Small Cap domestic equity on the other hand had robust absolute and relative performance due to the solid gains posted by the System's small cap value manager. International equity was the best performing asset class for the System. However, both managers employed by the System in this space failed to beat the broad market index. And despite the fact that it was a tough market for bond managers, the System's fixed income portfolio posted a respectable return for the fiscal year. Two out of the three bond managers for the System were able to add value over the index for the period.

Other Investments and Transactions

At June 30, 2007 and 2006, the System held \$364.1 million and \$352.3 million in loans to participants, respectively, which represents approximately 12% of the total investment portfolio. As of June 30, 2007 these loans consist of \$103 million in mortgage loans, \$260 million in personal loans and \$1 million in cultural trip loans. The loans to participants had a gross return of 9.65% for the fiscal year ended June 30, 2007.

As of June 30, 2007 the System has participation in Limited Partnerships of Private Equity Investments for an approximate value of \$46.6 million which represents approximately 2% of the investment portfolio. These investments had a gross return of 25.21% (time-weighted calculation, or 11.06% under internal rate of return calculation) for the fiscal year ended June 30, 2007.

The System earns additional investment income by lending investment securities to brokers via its custodian's securities lending program. The brokers provide collateral to the System and generally use the borrowed securities to cover short sales and failed trades. The cash collateral received from the brokers is invested in order to earn interest. For fiscal year 2007, income from the custodian's securities lending activity amounted to approximately \$890,000.

Funding Status

The System performs an actuarial valuation of its assets and obligations at least every other year. The most recent actuarial valuation was performed as of June 30, 2007. According to such valuation, the System's unfunded liability amounted to approximately \$4.6 billion with a capitalization level of 41%.

As a means to protecting the System's financial health, Law 91 of March 29, 2004 established the practice of requiring an actuarial study and identifying the funding prior to granting new benefits.

Requests for Information

This financial report is designed to provide a general overview of the System's financial status, comply with related laws and regulations, and demonstrate commitment to public accountability. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Puerto Rico System of Annuities and Pensions for Teachers, Capital Center Building, #235 Arterial Hostos Ave., North Tower, 8th Floor, Hato Rey, P.R. 00919-1879.

Puerto Rico System of Annuities and Pensions for Teachers
Statements of Plan Net Assets
Years Ended June 30, 2007 and 2006

		June 30,	
		2007	2006
		(In Thousands)	
Assets			
Cash:			
Cash and cash equivalents	\$	33,542	53,515
Cash restricted		—	1,717
Cash deposited with Government Development Bank for Puerto Rico		3,123	2,993
Total cash		<u>36,665</u>	<u>58,225</u>
Investments, at fair value:			
Bonds		468,452	463,474
Stocks		2,218,033	1,886,625
Total investments at fair value		<u>2,686,485</u>	<u>2,350,099</u>
Other investments:			
Private equity investments		46,686	46,215
Total investments		<u>2,733,171</u>	<u>2,396,314</u>
Loans to plan members:			
Mortgage		102,684	104,830
Personal		260,066	246,074
Cultural trips		1,371	1,429
Total loans to plan members		<u>364,121</u>	<u>352,333</u>
Total Investments and Loans		<u>3,133,957</u>	<u>2,806,872</u>
Accounts receivable:			
Receivable for investments sold		12,242	12,163
Accrued interest and dividends receivable		6,312	6,371
Other		14,640	14,932
Total accounts receivable		<u>33,194</u>	<u>33,466</u>
Capital assets		25,890	25,665
Other assets		700	691
Total Assets		<u>3,193,741</u>	<u>2,866,694</u>
Liabilities			
Investments purchased		11,258	11,422
Cash overdraft in cash with fiscal agent		5,619	13,949
Accounts payable		4,152	3,043
Obligation under capital lease		35	57
Accrued expenses		4,470	4,289
Line of credit		4	4
Escrow funds of mortgage loans and guarantee insurance reserve for loans to plan members		4,916	5,988
Bonds payable		—	20,430
Other liabilities		567	625
Total liabilities		<u>31,021</u>	<u>59,807</u>
Net assets held in trust for pension benefits	\$	<u>3,162,720</u>	<u>2,806,887</u>

The accompanying notes are an integral part of the financial statements.

Puerto Rico System of Annuities and Pensions for Teachers

Statements of Changes in Plan Net Assets

Years Ended June 30, 2007 and 2006

	Years Ended	
	June 30,	
	2007	2006
	(In Thousands)	
Additions:		
Contributions:		
Participating employees	\$ 127,809	129,473
Employer	116,320	119,199
Contributions transferred from other systems	12,396	921
Special	<u>57,960</u>	<u>61,066</u>
Total contributions	<u>314,485</u>	<u>310,659</u>
Investment income:		
Interest income	65,367	57,899
Dividends income	13,654	14,684
Net appreciation in fair value of investments	<u>406,131</u>	<u>258,182</u>
	<u>485,152</u>	<u>330,765</u>
Less investment expense	<u>6,217</u>	<u>5,792</u>
Net investment income	<u>478,935</u>	<u>324,973</u>
Other income	<u>1,299</u>	<u>13,085</u>
Total additions	<u>794,719</u>	<u>648,717</u>
Deductions:		
Benefits paid to participants:		
Annuities and death benefits	364,998	332,425
Special benefits	45,564	42,837
Refunds of contributions	5,447	5,056
Administrative expenses	<u>22,877</u>	<u>22,651</u>
Total deductions	<u>438,886</u>	<u>402,969</u>
Net increase in net assets held in trust for pension benefits	<u>355,833</u>	<u>245,748</u>
Net assets held in trust for pension benefits		
Beginning of year	<u>2,806,887</u>	<u>2,561,139</u>
End of year	<u>\$ 3,162,720</u>	<u>2,806,887</u>

The accompanying notes are an integral part of the financial statements.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Puerto Rico System of Annuities and Pensions for Teachers (the System) was created by Act No. 91 of March 29, 2004 that superseded Act No. 218 of May 6, 1951. The System is considered an integral part of the Commonwealth of Puerto Rico (the Commonwealth) financial reporting and is included in the Commonwealth's financial statements as a pension fund. The System, as a governmental retirement plan, is excluded from the provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

The responsibility for the proper operation and administration of the System is vested in a Board of Trustees (the Board). The Board is comprised of nine members, as follows:

- Three Ex-Oficio members which are the Secretary of the Treasury, the Secretary of Education, and the President of the Government Development Bank for Puerto Rico, or their respective representatives;
- One member who is a representative of a teacher's organization designated by the Governor of the Commonwealth of Puerto Rico;
- Three teachers of the System, one of which represents currently certified teachers in active service, and two who represent retired teachers. These three teachers are appointed by the Governor of the Commonwealth of Puerto Rico.
- One member who is a representative of the entity that represents the proper unit under Act No. 45 of February 25, 1998, as amended.
- One additional member, as representative of the public interest, with knowledge of and experience in the administration and operation of financial systems, appointed by the Governor of the Commonwealth of Puerto Rico.

The following are significant accounting policies followed by the System in the preparation of its financial statements:

Basis of Presentation

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with the provisions of Governmental Accounting Standards Board Statement No. 25 (GASB Statement No. 25), "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans". Participating employee and employer contributions are recognized as revenues in the period in which the employee services are rendered. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

During the year ended June 30, 2007, the System adopted the provisions of the Statement of Governmental Accounting Standards Board No. 43 (GASB No. 43), *Financial Reporting for Postemployment Benefits Plans Other Than Pension Plans*, the objective of which is to establish uniform standards of financial reporting by state and local governmental entities for other post employment benefits plan. This statement provides standards for measurement, recognition and display of the asset, liabilities, net assets and changes in net assets and for related disclosures.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles (GAAP) in the United States requires management to make estimates and assumptions that affect the reported amounts of net assets held in trust for pension benefits, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions to net assets held in trust for pension benefits during the reporting period. Actual results could differ from those estimates.

Cash and Cash equivalents, Cash with Fiscal Agent, Restricted Cash

Cash and cash equivalents consist of “overnight deposits” with the custodian bank and a commercial bank. Cash with fiscal agent represents a fund account the System has at the Department of Treasury for the payment of payroll expenses for the year ended June 30, 2007 and for the payment of payroll and administrative expenses for the year ended June 30, 2006. Restricted cash deposited with the Government Development Bank for Puerto Rico (GDB) consists of life insurance premium payments received from in-house loans’ holders; and the restricted cash deposited with a commercial bank represents an escrow account for the bonds payable.

Investments

Investments are carried at fair value. The fair value of notes, bonds and stocks is based on quotations obtained from national securities exchanges. Securities transactions are accounted for on the trade date. Realized gains and losses on securities are determined by the average cost method and are included in the statement of changes in plan net assets.

The fair value of private equity fund investments is determined by the applicable fund manager.

Loans to Plan Members

Mortgages, personal and cultural trip loans to plan members are stated at their outstanding principal balance. No allowance for uncollectible amounts has been established since loans to plan members are collected through payroll withholding and secured by mortgage deeds, plan members’ contributions and any unrestricted amount remaining in the escrow funds. Maximum amounts that may be loaned to plan members for mortgage and cultural trip loans are \$100,000 (\$150,000 if the spouse is also a plan member) and \$5,000, respectively. The maximum amount of personal loan to be granted to current participating employees is up to 90% of their contributions and \$3,000 in the case of retirees currently receiving benefits.

Capital Assets

Capital assets include building, furniture and equipment, capital leases and projects in progress. The System defines capital assets as assets, which have an initial individual cost of \$500 or more at the date of acquisition and have a useful life of four or more years. Capital assets are recorded at historical cost or at estimated historical cost if actual historical cost is not available. Donated capital assets are recorded at their estimated fair value at time of donation.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

Capital assets are depreciated on the straight-line method over the assets estimated useful life. There is no depreciation recorded for projects in progress. The estimated useful lives of capital assets are as follows:

	<u>Years</u>
Buildings	40
Buildings improvements	10
Equipments, furniture, fixtures, and vehicles	4-10

Long-Lived Assets

The System reviews the carrying amount of its long-lived assets and identifies assets for possible impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Any long-lived asset held for disposal is reported at the lower of their carrying amount or fair value less cost to sell.

Guarantee Insurance Reserve for Loans to Plan Members

Premiums collected and benefits claimed are recorded as additions and deductions of the guarantee insurance reserve for life insurance on loans to plan members, respectively.

Future Adoption of Accounting Pronouncements

The GASB has issued the following accounting standards that have effective dates after June 30, 2007:

- GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Post-employment Benefits Other than Pensions*, which is effective for fiscal years beginning after December 15, 2006.
- GASB Statement No. 48, *Sales and Pledges of Receivable and Future Revenues and Intra-Entity Transfer of Assets and Future Revenue*, which is effective for fiscal year beginning after December 15, 2006.
- GASB Statement No. 50, *Pension Disclosures*- an amendment of GASB Statements No. 25 and No. 27, which is effective for periods beginning after June 15, 2007.
- GASB Statement No. 51, *Intangible Assets*, which is effective for periods beginning after June 15, 2009.
- GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, which is effective for periods beginning after June 15, 2008.

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

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

2. PLAN DESCRIPTION

The System is a defined benefit plan sponsored by the Commonwealth. Substantially, all active teachers of the Commonwealth's Department of Education are covered by the System under the terms of Act No. 91 of March 29, 2004 that superseded Act No. 218 of 1951. The new law gives the System's active employees as of March 29, 2004 the option to participate in the plan. Employees recruited by the System after the approval of the new law become members of the plan. All active teachers of the Department of Education at the date of employment become plan members of the System. Licensed teachers working in private schools or other educational organizations can be members of the System at their own choice as long as the required employer and employee contributions are satisfied.

At June 30, 2007 the membership consisted of approximately:

Retirees and beneficiaries currently receiving benefits	29,000
Current participating employees	<u>48,500</u>
Total membership	<u><u>77,500</u></u>

The plan members of the System are eligible for the benefits described below:

Retirement Annuity

Plan members are eligible for monthly benefit payments determined by the application of stipulated benefit ratios to the plan member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by the System. The annuity for which a plan member is eligible is limited to a minimum of \$300 per month and a maximum of 75% of the average compensation.

The plan members are eligible for retirement annuity upon complying with the following:

<u>Age</u>	<u>Years of Creditable Services</u>	<u>Retirement Annuity Compensation</u>
Fifty (50)	Thirty (30) or more	75% of average compensation
Under fifty (50)	Thirty (30) or more	65% of average compensation
Sixty (60)	At least Ten (10) but less than Twenty-five (25)	1.8% of average compensation times years of service
Fifty (50)	At least Twenty-five (25) but less than Thirty (30)	1.8% of average compensation times years of service
Fourty-Seven (47) but less than Fifty (50)	At least Twenty-five (25) but less than Thirty (30)	95% of the annual pension that would have received with 50 years of age

Puerto Rico System of Annuities and Pensions for Teachers

*Notes to Basic Financial Statements
Years Ended June 30, 2007 and 2006*

Deferred Retirement Annuity

A participating employee who terminates service before age 60, after having accumulated a minimum of ten years of creditable services, qualifies for a deferred retirement annuity payable beginning at age 60. A participating employee who has completed 25 or more years of creditable services and is under the age of 47 at termination, qualifies for a deferred retirement annuity payable beginning at age 47. The vested rights described above are provided if his/her contributions to the System are left within the System until the attainment of the respective retirement age.

Occupational Disability Annuity

A participating employee, who as a direct result of the performance of his/her occupation becomes disabled, is eligible for an annuity of 1.8% of average compensation based on the highest sixty (60) months or the number of months of creditable services, if less than five years, recognized by the System, times years of creditable services; but not less than \$300 per month.

Non-occupational Disability Annuity

A participating employee disabled for causes not related to his/her occupation, and with at least five years of credited service, is eligible for an annuity of 1.8% of average compensation based on the highest sixty months (60) recognized by the System, times years of service; but not less than \$300 per month.

Death Benefits

Pre-retirement

- The beneficiaries receive the contributions made to the plan and 2% interest accumulated as of the date of death (after discounting debts with the System), plus an amount equal to the annual compensation of the member at the time of death.

Post-retirement

- The surviving spouse receives 50% of the retiree's pension and if there are children under 22 years of age or disabled (until disability ceases) they receive the other 50% of the pension. If there is no surviving spouse or children that qualify, the beneficiaries receive the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death, limited to a minimum of \$1,000.

Cost-of-Living Adjustments

Act No. 62 of 1992 provided, subject to the approval of the Legislature, for increases of 3% every three years in pensions to those plan members with three or more years of retirement. In years 1995, 1998, 2001, 2004 and 2007 the Legislature has replicated the benefit granted per Act No. 62. This benefit is funded by the Commonwealth.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

Refunds

A participating employee who ceases his/her employment with the Commonwealth without right to a retirement annuity has the right to a refund of the employee contributions paid to the System plus any interest earned thereon.

Early Retirement Program

On January 27, 2000 Act No. 44 was approved, which provided that effective March 9, 2000, plan members are eligible for early retirement upon attaining the age of 50 and 28 years of services in the first year of implementation and age 50 and 25 years of service in subsequent years. Those who select early retirement under these conditions will receive monthly benefits equal to 75% of their average compensation, which is computed based on the highest thirty-six months of compensation recognized by the System. Effective July 31, 2001 the option for early retirement was closed. Employees and Employers special contributions related with the program lasted until fiscal year ended June 30, 2006.

3. FUNDING POLICY

The law requires the employer to contribute 8.5% of the applicable payroll. Participating employees are required to contribute 9% of their compensation. Commonwealth contributions should ultimately cover any deficiency between the participating employees' contributions and the System's pension benefit obligations and administrative costs. The employer and participants' contributions will be evaluated at least every five years.

The special contributions of approximately \$57,960,000 and \$61,066,000 in 2007 and 2006, respectively, represent the contribution from the General Fund of the Commonwealth for the benefits granted by special laws.

Calculations of the present value of benefits under the System were made by consulting actuaries as of June 30, 2007, using the entry age normal actuarial cost method. Significant assumptions underlying the actuarial computations include: (a) assumed rate of return on investments of 8%, net of investment expense; (b) assumed compound rate of wage increases of 3.5% per year; and (c) assumed mortality rate based on the Group Annuity Table for 2000.

The actuarial accrued liability as of June 30, 2007 was approximately \$7,756,000,000. As of June 30, 2007, the unfunded actuarial accrued liability was approximately \$4,593,000,000.

4. DEPOSITS AND INVESTMENTS

Pursuant to the provisions of Act No. 91 of March 29, 2004 that superseded Act No. 218 of 1951, as amended, the System may invest in different types of securities, including domestic, international and fixed income securities, among others.

Deposits

Cash with fiscal agent has an overdraft of approximately \$5,619,000 and \$13,949,000 as of June 30, 2007 and 2006, respectively.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

Restricted cash of approximately \$1,717,000 as of June 30, 2006 was held in escrow by a commercial bank, as trustee (the Trustee), for purposes of servicing the bonds payable. As of June 30, 2007 there was no restricted cash for such purpose (see Note 9).

Custodial credit risk for deposits is the risk that in the event of bank failure, the System may not be able to recover deposits that are in the possession of an outside party. The System has bank deposits not collateralized with the GDB. Cash deposited with GDB amounted to approximately \$3,123,000 and \$2,993,000 as of June 30, 2007 and 2006, respectively.

Investments

The following table shows the market value of the investments in marketable securities held by the System as of June 30, 2007 and 2006 (in thousands):

	<u>2007</u>	<u>2006</u>
US Government and agencies' securities	\$ 294,767	294,288
US Corporate bonds	<u>173,685</u>	<u>169,186</u>
Total bonds	468,452	463,474
US Corporate stocks	1,537,530	1,330,419
Non-US Corporate stocks	<u>680,503</u>	<u>556,206</u>
Total stocks	<u>2,218,033</u>	<u>1,886,625</u>
Private equity investments	<u>46,686</u>	<u>46,215</u>
Total Investments	<u>\$ 2,733,171</u>	<u>2,396,314</u>

Cash and cash equivalents and investments included approximately \$29,384,000 as of June 30, 2006, held as pledge collateral by the custodian bank in connection with the bonds payable (see Note 9).

The System's investments are exposed to custodial credit risk, credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. Following is a description of these risks as of June 30, 2007.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System 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, 2007 securities investments were registered in the name of the System and were held in the possession of the System's custodian bank, State Street Bank and Trust.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

Credit Risk

The System's investment guidelines prohibit the investments in securities with maturity dates beyond thirty years. All fixed income securities at the time of purchase must be of investment grade quality. Positions that drift below investment grade should be reported to a management representative of the System and monitored carefully. The portfolio is not expected to have more than 5% invested in securities that have drifted after purchase below investment grade quality. All issues shall be rated investment grade by at least two of the nationally recognized rating agencies. The portfolio is expected to maintain a minimum weighted average credit quality of either "A" or better using either Moody's or Standard and Poor's credit ratings.

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Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

Moody's Rating	Investment Type	Market Value (in thousands)	
		2007	2006
Aaa	US Government Issues	\$ 147,226	170,231
Aaa	Mortgage Backed Securities	137,326	86,424
Aaa	Asset Backed Securities	4,614	34,819
Aaa	Corporate Bonds	3,172	3,376
		<u>292,338</u>	<u>294,850</u>
Aa1	Corporate Bonds	3,123	3,019
Aa1	Asset Backed Securities	480	—
Aa1	Mortgage Backed Securities	307	—
		<u>3,910</u>	<u>3,019</u>
Aa2	Corporate Bonds	11,480	1,812
Aa3	Corporate Bonds	26,543	21,823
Aa3	Mortgage Backed Securities	—	306
		<u>26,543</u>	<u>22,129</u>
A1	Corporate Bonds	25,705	20,071
A2	Corporate Bonds	17,775	6,968
A2	Other Asset Backed Securities	475	512
A2	Mortgage Backed Securities	100	602
		<u>18,350</u>	<u>8,082</u>
A3	Corporate Bonds	18,278	27,932
A3	Mortgage Backed Securities	498	201
		<u>18,776</u>	<u>28,133</u>
Baa1	Corporate Bonds	18,727	19,198
Baa2	Corporate Bonds	25,472	36,174
Baa2	Mortgage Backed Securities	469	—
Baa2	Other Asset Backed Securities	—	482
		<u>25,941</u>	<u>36,656</u>
	Sub Total	\$ 441,770	433,950

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

Moody's Rating	Investment Type	Market Value (in thousands)	
		2007	2006
	Balance Forward	\$ 441,770	433,950
Baa3	Corporate Bonds	18,551	20,719
Ba1	Corporate Bonds	3,378	3,325
Ba3	Corporate Bonds	—	238
B1	Corporate Bonds	255	—
B2	Corporate Bonds	—	1,806
NA	Other Asset Backed Securities	1,317	—
NA	Corporate Bonds	996	—
NA	Mortgage Backed Securities	66	233
		<u>2,379</u>	<u>233</u>
NR	Mortgage Backed Securities	1,889	477
WR	Corporate Bonds	<u>230</u>	<u>2,726</u>
	Total Bonds and Notes	\$ <u>468,452</u>	<u>463,474</u>

Concentration of Credit Risk

There are no investments in any one issuer that represent 5% or more of total investments as of June 30, 2007. The System's investment guidelines specify that no more than 5% of a manager's assets at market shall be invested in the securities of any single issuer.

Interest Rate Risk

The System is expected to achieve capital preservation and income generation by investing in a diversified portfolio of marketable, investment grade core fixed income securities. The System's investment guidelines specify that the duration of the portfolio is expected to vary no more than between 75% and 125% of the duration of the respective benchmark. Securities with maturity dates beyond thirty years are prohibited.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

The following table summarizes the investments on debt securities of the System at June 30, 2007 (in thousands):

	Maturity from	Fair Value	Investment Maturities (In Years)			
			Less than 1	1-5	More than 5-10	More than 10
US Government and agencies securities	(2007-2047)	\$ 294,767	26,701	46,048	44,021	177,997
Corporate Bonds	(2008-2037)	<u>173,685</u>	<u>608</u>	<u>39,953</u>	<u>47,464</u>	<u>85,660</u>
Total Bonds and Notes		<u>\$ 468,452</u>	<u>27,309</u>	<u>86,001</u>	<u>91,485</u>	<u>263,657</u>

As of June 30, 2007, investments maturities are as follows:

<u>Maturity</u>	<u>Maximum Maturity</u>
Less than one year	6%
One to five years	18%
More than five to ten years	20%
More than ten years	56%

Foreign Currency Risk

The international portfolio is expected to achieve long-term, aggressive capital appreciation by investing in Core EAFE (Europe Australasia and the Far East) securities. The portfolio is expected to be broadly diversified with respect to exposures to countries, economic sectors, industries and individual stock. No single issue is expected to exceed 5% (at market) of the portfolio.

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Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

Investments exposed to foreign currency risk as of June 30, 2007 and 2006 are as follows:

Investment Type	Local Currency	Market Value	
		(in thousands)	
		2007	2006
Foreign Currency	Euro Currency	\$ 916	—
Foreign Currency	Danish Krone	507	—
Foreign Currency	Pound Sterling	79	—
Foreign Currency	Japanese Yen	75	312
Foreign Currency	Australian Dollar	39	2
Foreign Currency	Singapore Dollar	5	18
Foreign Currency	South African Rand	—	719
Foreign Currency	Swiss Franc	—	27
Foreign Currency	New Turkish Lira	—	1
Total cash exposed to foreign currency risk		\$ 1,621	1,079
Shares in a Commingled Fund	Various (Refer to countries below)	\$ 340,523	278,495
Common Stock	Euro Currency	86,498	76,904
Common Stock	Pound Sterling	73,097	59,339
Common Stock	Japanese Yen	59,090	58,214
Common Stock	Swiss Franc	30,065	13,965
Common Stock	Swedish Krona	23,667	18,715
Common Stock	Australian Dollar	18,210	15,113
Common Stock	Norwegian Krone	9,821	—
Common Stock	Danish Krone	8,619	7,729
Mutual Funds	Pound Sterling	6,844	5,650
Common Stock	Hong Kong Dollar	6,235	5,053
Preferred Stock	Swiss Franc	3,517	2,740
Common Stock	Singapore Dollar	1,651	1,162
Rights	Euro Currency	47	—
Depository Receipts	Euro Currency	—	3,107
Common Stock	New Zealand Dollar	—	366
Total securities exposed to foreign currency risk		667,884	546,552
Common Stock	US Dollar	12,619	9,654
Total Investment		\$ <u>680,503</u>	<u>556,206</u>

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

The System owns shares in an international equity commingled fund. As of June 30, 2007, the System owned approximately 8,462,314 shares that represent 28.54% of the total commingled fund which had the following countries weightings.

<u>Europe</u>	<u>Currency</u>	<u>Percent</u>	<u>Pacific Basin</u>	<u>Currency</u>	<u>Percent</u>
Denmark	Danish Krone	1.1%	Hong Kong	Hong Kong Dollar	2.9%
Finland	Euro (Various)	5.7%	Japan	Japanese Yen	20.4%
France	Euro (Various)	8.6%	Total Pacific		23.3%
Germany	Euro (Various)	3.1%	Emerging Markets	Various	3.9%
Italy	Euro (Various)	1.3%	Canada	Canadian Dollar	2.1%
Netherlands	Euro (Various)	10.2%	Total Equities		99.2%
Norway	Norwegian Krone	1.2%	Cash	Various	0.8%
Spain	Euro	0.9%	Total		100.0%
Sweden	Swedish Krona	3.9%			
Switzerland	Swiss Frank	8.8%			
United Kingdom	Sterling Pound	25.1%			
Total Europe		69.9%			

Investments in Limited Partnerships

The System invested approximately \$5,091,000 in limited partnerships during the fiscal year ended June 30, 2007. The investments were as follows:

- During fiscal year 2007, \$180,000 were invested in Guayacán Fund of Funds, L.P. a Delaware limited partnership created by Grupo Guayacán, Inc. as General Partner in which the System has a total commitment of \$20 million. The Fund has commitments to invest in 15 US based and international venture partnerships and ties local pension funds with the private equity asset class without the risks inherent in geographically constrained investments.
- During fiscal year 2007, \$3,772,000 were invested in contributions to Guayacán Fund of Funds II, L.P. a Delaware limited partnership created by Grupo Guayacán, Inc. as General Partner in which the System has a total commitment of \$25 million. The Fund seeks to provide investors with a superior investment return and extensive diversification by investing in 19 Private Equity investment partnerships in the United States and Europe. The Fund also invests a portion of its assets in a Puerto Rico based Private Equity investment entity.
- During the fiscal year 2007, there were no contributions to Guayacán Private Equity Fund, a limited partnership organized pursuant to the laws of the state of Delaware and authorized to engage in business in the Commonwealth of Puerto Rico, in which the System has a total commitment of \$5 million. The purpose of the Partnership is to make equity investments in privately held companies as established in its charter.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

- During the fiscal year 2007, \$251,000 were invested in Invesco Venture Partnership Fund III, L.P. a Delaware limited partnership, organized by IPC Partnership Associates III, LLC as General Partner in which the System has a total commitment of approximately \$5.5 million. The Partnership was organized to invest in other collective investments funds investing in alternative assets, including primarily United States and international funds that focus on both early and later-stage venture capital investments.
- During the fiscal year 2007, there were no contributions to Invesco Non-U.S. Partnership Fund III, L.P. a Delaware limited partnership, organized by IPC Partnership Associates III, LLC as General Partner in which the System has a total commitment of \$4.5 million. The Partnership was organized to invest in other collective investments funds investing in alternative assets, including primarily investments focusing on non U.S. buyouts, expansion capital, turnaround, mezzanine, and distressed investment partnerships.
- During the fiscal year 2007, \$354,000 were invested in Invesco U.S. Buyout & Expansion Capital Partnership Fund III, L.P. a Delaware limited partnership, organized by IPC Partnership Associates III, LLC as General Partner in which the System has a total commitment of approximately \$3.7 million. The Partnership was organized to invest in other collective investments funds investing in alternative assets, including primarily investments focusing on small, mid-size and large domestic buyout transactions.
- During the fiscal year 2007, \$534,000 were invested in Chase Capital Partners Private Equity Fund of Funds II, LTD a limited partnership, organized by Chase as General Partner in which the System has a total commitment of \$15 million. The Fund's investment strategy is to capitalize on a globally diversified portfolio of private equity investment opportunities across various sectors including buyouts, growth equity, venture capital and other special situations through partnership investments and direct investments.

The fair value of these investments at June 30, 2007 amounted to \$46.7 million and is presented within other investments in the statement of net assets. The allocations of net gain and net loss to limited partners are based on certain percentages, as established in the limited partnership agreements.

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Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

As of June 30, 2007, the System had capital commitments and contributions as follows (in thousands):

	<u>Total</u>	<u>Fiscal year</u>	<u>Cumulative</u>	<u>Market</u>
	<u>Commitments</u>	<u>Contributions</u>	<u>Contribution</u>	<u>Value</u>
Guayacán Fund of Funds	\$ 20,000	180	18,803	6,989
Guayacán Fund of Funds II	25,000	3,772	23,411	16,859
Guayacán Private Equity Fund	5,000	—	4,407	5,153
Invesco Venture Partnership Fund III, LP	5,498	251	3,929	3,872
Invesco Non-US Partnership Fund III, LP	4,500	—	3,941	3,555
Invesco US Buyout & Expansion Capital Partnership Fund III, LP	3,716	354	2,832	2,982
Chase Capital Partners Private Equity Fund of Funds II, LTD	15,000	534	13,985	7,276
Total	\$ 78,714	5,091	71,308	46,686

Securities Lending Transactions

The System participates in a security lending program whereby securities are transferred to an independent broker or dealer in exchange for collateral in the form of cash, government securities and irrevocable bank letters of credit equal to approximately 102% of the market value of the domestic securities on loan and 105% of the market value of the international securities on loan, with a simultaneous agreement to return the collateral for the same securities in the future. Collateral is marked to market daily and the agent places a request for additional collateral from brokers if needed. The custodian bank is the agent for the securities lending program.

At year end there was no credit risk exposure to borrowers because the amounts the System owes the borrowers (the collateral) exceeded the amounts the borrowers owe the System (the loaned securities). At June 30, 2007, the collateral received represented 102.42% of the fair value of the domestic securities lent and 105.22% of the fair value of the international securities lent.

The securities on loan for which collateral was received at June 30, 2007 consisted of the following:

Securities Lent	Fair Value
	<u>2007</u>
US Equity	\$ 132,745,589
US Government	25,144,793
Non US Equity	57,914,918
US Corporate Bonds	17,370,411
Total	\$ 233,175,711

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

The underlying collateral for these securities had a market value of approximately \$240,439,664 as of June 30, 2007. It represented cash collateral and was invested in the lending agent's short-term investment fund. As of June 30, 2007 the short-term investment fund's distribution by sector was as follows:

Asset-Backed	43.39%
CD	27.04%
Corporate	18.52%
TD	4.30%
Repo	3.21%
Bank Note	1.94%
CP	0.93%
ABCP	0.67%

Under the terms of the securities lending agreement, the System is fully indemnified against failure of the borrowers to return the loan securities (to the extent the collateral is inadequate to replace the loaned securities) or failure to pay the System for income distributions by the securities' issuers while the securities are on loan. In addition, the System is indemnified against loss should the lending agent fail to demand adequate and appropriate collateral on a timely basis.

5. Capital Assets

Capital assets additions are recorded at cost. Depreciation is provided using the straight-line method over the useful life of the asset. As of June 30, 2007 and 2006, changes in capital assets consisted of the following (in thousands):

Depreciable	Estimated Useful Life (in years)	Balance June 30, 2006	Additions	Retirements	Balance June 30, 2007
Building	40	\$ 26,008	—	—	26,008
Furniture & Equipment	4-10	3,812	52	(1,871)	1,993
Computers & Software	4	246	2,076	(200)	2,122
Capital Leases	5	106	—	—	106
Improvements	10	39	—	—	39
Vehicles	5	42	—	—	42
		<u>30,253</u>	<u>2,128</u>	<u>(2,071)</u>	<u>30,310</u>
Accumulated Depreciation and Amortization		(9,355)	(2,182)	1,294	(10,243)
Not Depreciable					
Project in-progress		4,767	1,056	—	5,823
		<u>\$ 25,665</u>	<u>1,002</u>	<u>(777)</u>	<u>25,890</u>

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

On August 1, 1996, the System acquired the North Tower of Capital Center (the Building) located in Hato Rey to serve as the System's main office facilities and to lease the additional space to third parties. Approximately one-half of the Building is being used for its operations and the other half for rental. The Building was financed with Industrial Revenue Bonds (see Note 9).

6. Other Assets

At June 30, 2007 and 2006, other assets consisted of repossessed and in-substance foreclosed properties amounting to approximately \$700,000 and \$691,000, respectively. Repossessed and in-substance foreclosed properties consist mainly of properties acquired or to be acquired upon foreclosure proceedings as collateral from delinquent mortgage loans. Foreclosed properties are valued at the outstanding principal balance of the related mortgage upon foreclosure. These will be sold under a bidding process intended to recover the outstanding principal balance.

7. Obligation under Capital Leases

During the fiscal year ended June 30, 2004, the System acquired office equipment under capital leases in the total amount of \$105,709, that expire in January 2009 and the annual interest rate is 3.75%. The assets and liabilities under capital leases are recorded at the lower of the present value of the minimum lease payments or the fair value of the asset. The assets are amortized over the lesser of their related lease terms or their estimated productive lives. Amortization of assets under capital leases is included in the depreciation expense for fiscal year ended June 30, 2007.

Following is a summary of equipment under capital lease and accumulated amortization as of June 30, 2007 (in thousands):

Equipment under capital lease	\$ 106
Accumulated amortization	<u>85</u>
Book value	<u><u>\$ 21</u></u>

The future minimum lease payments under capital leases and the net present value of the future minimum lease payments as of June 30, 2007 for each of the next years are (in thousands):

<u>Year ending June 30,</u>	<u>Amount</u>
2008	\$ 23
2009	<u>14</u>
Total minimum lease payments	37
Less amount representing interest	<u>2</u>
Present value of minimum lease payments	<u><u>\$ 35</u></u>

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements
Years Ended June 30, 2007 and 2006

8. Line of Credit

The System has a line of credit with the GDB of \$15,000,000, which is due on October 31, 2010 and is guaranteed by a pool of investments of the System. As of June 30, 2007 and 2006, the outstanding balance of the line of credit was approximately \$4,000 at a variable rate subject to LIBOR, but not less than an annual interest rate of 5%.

9. Bonds Payable

On August 1, 1996, the System entered into a loan agreement with the Puerto Rico Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority (the Authority), which secured the Authority's issuance of \$26,945,000 of Industrial Revenue Bonds (the Bonds). The Bonds were issued under a trust agreement (the Trust Agreement) dated August 1, 1996, between the Authority and the Trustee. The Bonds are secured by a pledge of certain marketable securities of the System.

The proceeds from the sale of the bonds were loaned by the Authority to the System to (i) finance the acquisition of the Building; a sixteen story mixed use office and commercial building and a portion of the adjoining seven story parking facility and (ii) pay certain expenses incurred in connection with the issuance and sale of the Bonds.

The following is a summary of changes in the bonds payable principal balance:

	Balance			Balance
	June 30, 2006	Additions	Deductions	June 30, 2007
Series A				
6.65% Term Bonds due July 1, 2011	\$ 5,220,000	—	5,220,000	—
	5,220,000	—	5,220,000	—
Series B				
5.50% Term Bonds due July 1, 2016	6,575,000	—	6,575,000	—
5.50% Term Bonds due July 1, 2021	8,635,000	—	8,635,000	—
	15,210,000	—	15,210,000	—
	<u>\$ 20,430,000</u>	<u>—</u>	<u>20,430,000</u>	<u>—</u>

The Series A and B Bonds at the time outstanding, maturing on or after July 1, 2006 and July 1, 2016, respectively, are subject to redemption, at the option of the System, in whole or in part in July 2006, or any date thereafter at the determined redemption price stipulated in the Trust Agreement. In January 2007 the System decided to exercise its option to redeem the bonds in whole effective March 15, 2007 at the applicable redemption price (102%) plus interest accrued to the date fixed for

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

redemption. On March 15, 2007 the bonds were paid in full from the System's assets (\$20,248,639) and from the System's account with the Trustee (\$804,345). Once the bonds were paid in full, the pledged collateral was released and contributed to the System's investment portfolio.

	<u>Series A</u>	<u>Series B</u>	<u>Total</u>
Principal outstanding	\$ 5,220,000	15,210,000	20,430,000
2% Premium	104,400	304,200	408,600
Accrued Interest	42,427	171,957	214,384
Total	<u>\$ 5,366,827</u>	<u>15,686,157</u>	<u>21,052,984</u>

10. Guarantee Insurance Reserve for Loans to Plan Members

The System provides life insurance that guarantees the payment of the outstanding principal balance of mortgage, personal and cultural trip loans in case of death of a plan member. This coverage is paid in its entirety by the plan members who obtain these loans from the System. The life insurance rates are determined by the actuary.

11. Rent Income

The System is the lessor of an office building for which it has lease contracts that expire between the years 2007 through 2009. The future revenue under the existing operating leases is as follows (in thousands):

<u>Fiscal Year Ending</u>	<u>Amount</u>
2008	\$ 353
2009	46
	<u>\$ 399</u>

12. Commitments

The System leases offices for the operation of its regional offices (Ponce, Mayagüez, Arecibo, Humacao and Caguas) and maintains five contracts for these purposes that expire between the years 2007 through 2008.

The minimum future payment under the existing operating leases is as follows (in thousands):

<u>Fiscal Year Ending</u>	<u>Amount</u>
2008	\$ 79
	<u>\$ 79</u>

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

13. Contingencies

Loss Contingencies

The System is a defendant or co-defendant in various lawsuits resulting from the ordinary conduct of its operations. Management and legal counsel believe that there are no contingent matters that would have a material adverse effect on the System's financial status.

Gain Contingency

The System, besides receiving contributions from participants and the plan sponsor, also receives legislative appropriations from special laws to cover the increase in benefits to retired teachers. Law No. 62 of September 4, 1992, as amended, establishes an increase of 3% in pension annuities every three years for those members who meet the requirements. In addition, there have been other laws that granted benefits; such as, Summer and Christmas bonuses, and medical plan contributions, among others. Most of the funds used to cover these benefits are budgeted by the Commonwealth through legislature appropriations. Nevertheless, the costs of pension benefits that increased from 1992 to June 30, 2004 were not received in full by the System from legislative appropriations. The System had to cover \$119,575,193 from its resources that should have been received through special laws. As of June 30, 2007 the System has a claim with the Office of Management and Budget to collect this amount as per a resolution approved by the Board of Trustees on May 31, 2004. Since the parties involved in this claim are under a decisions committee the amount claimed has not been accrued in the System's financial statements.

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REQUIRED SUPPLEMENTARY INFORMATION

Puerto Rico System of Annuities and Pensions for Teachers

Schedule of Employer Contributions

June 30, 2007

(In Thousands)

<u>Year Ended June 30</u>	<u>Annual Required Contribution</u>	<u>Actual Employer Contribution</u>	<u>Percentage Contribution</u>
2007	\$ 341,160	147,597	43.26%
2006	220,821	150,215	68.03%
2005	220,821	151,690	68.69%
2004	217,002	132,403	61.01%
2003	172,338	118,303	68.65%
2002	150,883	112,956	74.86%

See notes to schedules.

The annual required contribution, actual employer contributions, and percentage contributed for the years ended June 30, 2004, 2003, and 2002 have been revised and were obtained from the amounts presented in the 2007 report. The revisions were made based on our current actuary firm interpretation of the reporting requirements of the schedule.

Puerto Rico System of Annuities and Pensions for Teachers

Schedule of Funding Progress

June 30, 2007

(In Thousands)

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Plan Assets</u>	<u>Actuarial Accrued Liability (AAL)</u>	<u>Unfunded AAL (UAAL)</u>	<u>Funded Ratio</u>	<u>Annual Covered Payroll</u>	<u>UAAL Percentage of Annual Covered Payroll</u>
6/30/2007	\$ 3,163,000	7,756,000	4,593,000	41%	1,370,000	335%
6/30/2006		Not Determined			Not Determined	
6/30/2005		Not Determined			Not Determined	
6/30/2004	2,403,000	4,702,000	2,299,000	51%	1,294,000	178%
6/30/2003	2,143,000	4,540,000	2,397,000	47%	1,195,000	201%
6/30/2002	2,167,000	4,155,000	1,988,000	52%	991,000	201%

See notes to schedules.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Schedules

June 30, 2007

(In Thousands)

1. Schedule of Employer Contributions

The Schedule of Employer Contributions provides information about the annual required contributions (ARC) and the extent to which contributions made cover the ARC. The ARC is the annual required contribution for the year calculated with certain parameters, which include actuarial methods and assumptions.

2. Schedule of Funding Progress

The Schedule of Funding Progress provides information about the funded status of the System and the progress being made in accumulating assets to pay benefits when due.

3. Actuarial Data

The information presented in the schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows:

Valuation Date	June 30, 2007
Actuarial Cost Method	Entry age normal
Amortization	30 years closed, level percent of payroll
Remaining Amortization Period	30 years
Asset Valuation Method	Market value of assets
Actuarial Assumptions:	
Investment rate of return	8.00%
Projected salary increases	3.5% general wage inflation plus a service based merit increase
Inflation	2.50%
Cost of living adjustment	None

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