

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

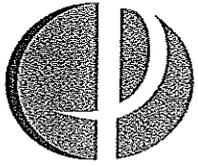
*Basic Financial Statements and
Required Supplementary Information for
the Years Ended June 30, 2008 and 2007;
and Independent Auditors' Report*

Puerto Rico System of Annuities and Pensions for Teachers

***Basic Financial Statements, and Required Supplementary Information for the
Years Ended June 30, 2008 and 2007 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, 2008 and 2007 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.

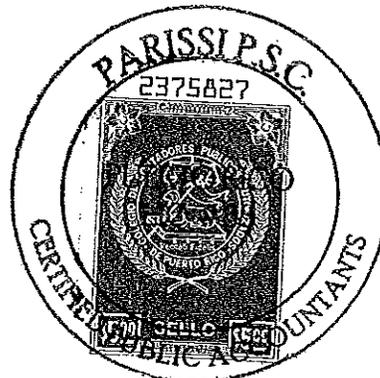
We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, 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, 2008 and 2007 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 and the schedules of employer contributions, funding progress and notes to schedules on pages 2 through 9 and 31 through 33 are not a required part of the basic financial statements but are 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.

December 9, 2008
San Juan, Puerto Rico

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Puerto Rico System of Annuities and Pensions for Teachers

Management's Discussion and Analysis

Years Ended June 30, 2008 and 2007

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, 2008 and 2007. 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, 2008 and 2007 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.

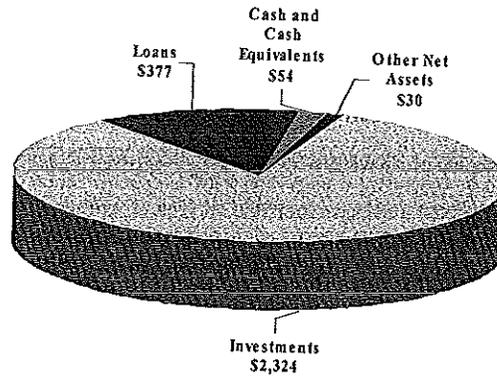
Financial Highlights

The System's net assets decreased from approximately \$3,163 million as of June 30, 2007 to \$2,785 million as of June 30, 2008. This reduction was primarily due to the net depreciation in the fair value of the System's investment portfolio. The amount of \$2,785 million in total net assets consists of the following:

- \$2,324 million in investments
- \$377 million in loans to plan members
- \$54 million in net cash and cash equivalents
- \$30 million in other net assets (liabilities)

Puerto Rico System of Annuities and Pensions for Teachers
Management's Discussion and Analysis
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Total net assets as of June 30, 2008 are presented in the following pie chart (in millions):



The following schedules present comparative summary financial statements of the System's net assets and changes in net assets for fiscal years 2008 and 2007:

Summary Comparative Statements of Plan Net Assets:

Assets	2008	2007	Amount of Change	Percentage Change
	(In Thousands)			
Cash and short term investments	\$ 54,026	36,665	17,361	47%
Investments, at fair value and loans	2,701,078	3,097,292	(396,214)	(13)%
Accounts receivable	26,229	33,194	(6,965)	(21)%
Capital assets	26,223	25,890	333	1%
Other assets	451	700	(249)	(36)%
Total Assets	2,808,007	3,193,741	(385,734)	(12)%
Liabilities				
Accounts payable and accrued liabilities	9,061	14,276	(5,215)	(37)%
Insurance reserve for loans to plan members and investment settlements	12,593	16,174	(3,581)	(22)%
Other liabilities	1,007	571	436	76%
Total liabilities	22,661	31,021	(8,360)	(27)%
Net assets held in trust for pension benefits	\$ 2,785,346	3,162,720	(377,374)	(12)%

Puerto Rico System of Annuities and Pensions for Teachers
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Summary Comparable Statements of Plan Net Assets Analysis:

The increase in cash and short-term investments is primarily attributable to normal fluctuations in the short-term investments. This amount mainly represents the amount of short-term investments held by investment managers at a point in time. The decrease in accounts receivables is mainly attributable to a decrease in receivables for investments sold due to market conditions and investment managers' decisions as of fiscal year end.

The decrease in fair value of investments is primarily attributable to the generally unfavorable market conditions experienced during fiscal year 2008 as evidenced in Teachers Retirement System Fund total investment return from a positive 17.44% in 2007 to a negative 6.52% in 2008. Detailed information regarding the investment portfolio is included in the Investment Portfolio and Capital Markets Overview section of this report.

The decrease in other assets is due to the sale of repossessed houses with respect to the Mortgage Loans Program to participants.

The decrease in accounts payable and accrued liabilities is primarily due to a decrease in investments purchased as a result of market conditions and investment managers' decisions as of fiscal year end. It is also related with a positive balance of cash in the System account at the Treasury Department of the Commonwealth of Puerto Rico compared to a negative balance at the end of fiscal year 2007.

Summary Comparative Statements of Changes in Plan Net Assets

	Years Ended		Amount of Change	Percentage Change
	2008	June 30, 2007		
	(In Thousands)			
Additions:				
Contributions	\$ 316,897	314,485	2,412	1%
Investment (loss) income	(199,966)	478,935	(678,901)	(142)%
Other income	1,735	1,299	436	34%
Total additions	<u>118,666</u>	<u>794,719</u>	<u>(676,053)</u>	<u>(85)%</u>
Deductions:				
Benefits paid to participants:				
Administrative expenses	470,503	416,009	54,494	13%
Total deductions	<u>25,537</u>	<u>22,877</u>	<u>2,660</u>	<u>12%</u>
Net (decrease) increase in net assets held in trust for pension benefits	<u>496,040</u>	<u>438,886</u>	<u>57,154</u>	<u>13%</u>
	<u>(377,374)</u>	<u>355,833</u>	<u>(733,207)</u>	<u>(206)%</u>
Net assets held in trust for pension benefits				
Beginning of year	<u>3,162,720</u>	<u>2,806,887</u>	<u>355,833</u>	<u>13%</u>
End of year	<u>\$ 2,785,346</u>	<u>3,162,720</u>	<u>(377,374)</u>	<u>(12)%</u>

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Summary Comparable Statements of Changes in Plan Net Assets Analysis

During fiscal year 2008, employers and employees' contributions do not reflect significant change with respect to the prior fiscal year. During the period the Government contribution for Special Laws benefits increased by approximately \$10.1 million. The increase was intended to mainly cover an additional cost of living adjustment granted by the Government to qualified System retirees that were paid since July 2007, retroactively to January 1, 2007. During fiscal years 2007 and 2008, the System received employee contributions related to the employees working at the System who elected to transfer from the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (ERS) benefit structure to the System's benefit structure. The transfers from the ERS amounted to approximately \$8.1 million for the period ended on June 30, 2007 and \$2.4 million for the period ended on June 30, 2008. The decrease in member's contributions transfers partially offsets the increase in Special Law contributions.

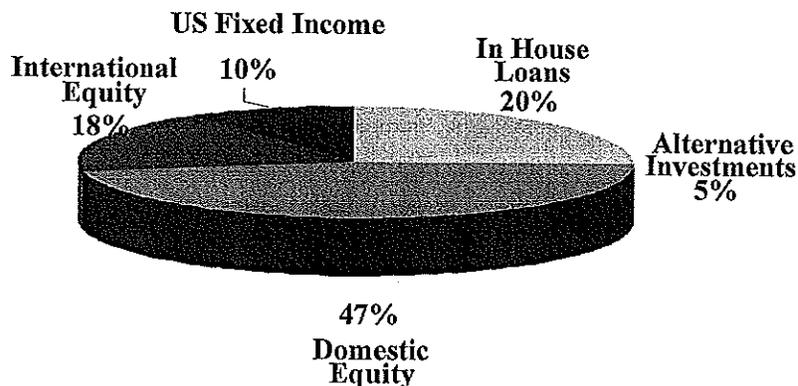
The investment loss that resulted in fiscal year 2008 is attributable to generally unfavorable market conditions that adversely affected the fair market value of the System's assets. The System recognized a net devaluation in the fair value of investments of approximately \$277 million for fiscal year 2008.

The increase in the benefits paid by the System exceeded the norm with respect to the prior fiscal years. Benefit payments increased due to an incentive retirement program to qualified teachers granted by the Puerto Rico Department of Education. To be eligible for the incentive payment, the teachers must have had accrued the minimum retirement requirements of age and years of services. The increase is attributable also to the cost of living adjustment granted to retirees by a Special Law.

The increase in administrative expenses is mainly related with an increase in employees' payroll due to collective bargain commitments and the organizational changes intended to strengthen the retirement service component. Since fiscal year 2004 the System has been involved in a re-engineering and mechanization project that involves different areas; such as Pensions and Finance. As of June 30, 2008, \$5.2 million was capitalized as a result of the project in progress.

Investment Portfolio and Capital Markets Overview

During the fiscal year ended June 30, 2008, there were no changes in the System's asset allocation and manager structure, except for the termination of a fixed income manager which assets were assigned to one of the existing fixed income managers. The asset mix of the fund generated a negative gross return of 6.52% for the year ended June 30, 2008. The target asset mix is as follows:



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Management's Discussion and Analysis

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Following is a general description of how the markets behaved during fiscal year 2008 in general, by asset class, and how it impacted the Fund's performance.

Economy and Market Overview

Fiscal 2008 was a tumultuous year for the economy and the financial markets. Subprime, housing bubble, credit crunch, liquidity crisis and recession are words that were used on a daily basis by the media and general public during this time period. It all started in July 2007 when the subprime market started to show signs of cracking and in August 2007 turned into a credit crisis. The Federal Reserve stepped in and cut rates by 50 basis points at the September 2007 meeting which spurred a rebound in the stock markets. The collapse of two large hedge funds from Bear Stearns and Goldman Sachs also marked the third quarter of 2007. The rebound in the financial markets did not last very long and in November 2007 equity markets took a nose dive. The continuing issues resulting from the subprime debacle resulted in a full blown credit crunch and liquidity crisis which carried over to 2008. Financial markets took an even bigger punch in January of 2008 and the Federal Reserve embarked on an aggressive rate cutting campaign to try and pump liquidity back into the markets. By the end of fiscal 2008, the Federal Reserve had cut the fed funds rate by 325 basis points, from 5.25% to 2.0%. On March 14, 2008, the Federal Reserve stepped in and brokered a deal with JP Morgan to prevent the collapse of Bear Stearns, a major investment bank and primary dealer. In addition, the Federal Reserve expanded the Term Auction Facility¹, created the Term Securities Lending Facility, and opened up the discount window to non-depository institutions in order to stimulate the economy and financial markets. By the end of the first quarter of 2008, the Fed actions appeared to have worked and equity markets rebounded in April and May of 2008. The government's rebate program helped with consumer spending. But investors concerns over the spike in oil prices and other commodities, the continuing decline in home values and rising foreclosure rates, consecutive months of rising unemployment claims and huge write-offs by financial institutions, brought anxiety back into the market during the final month of the fiscal year 2008 and plummeting financial markets as a result.

During the fiscal year, the consumer was pretty resilient in the beginning, but has become increasingly worried as indicated by the consumer confidence index about the economy. Rising oil prices (oil rose from around \$90 during the third quarter of 2007 to over \$140 in the second quarter of 2008) and other commodity prices have started to trickle down and inflation is a major concern for the Federal Reserve and the consumer. Despite all the issues facing the economy, Gross Domestic Product (GDP) growth has been remarkably strong. Over the course of fiscal 2008, GDP growth was mixed, cycling down from the robust 4.9% in the third quarter of 2007 to -0.2% in the fourth quarter of 2007 and 0.9% and 1.9% in the first and second quarters of 2008, respectively.

¹ In view of the pressures evident in short-term funding markets, the Board of Governors of the Federal Reserve System (the "Board") has approved the establishment of a temporary Term Auction Facility ("TAF") program in which the Federal Reserve will auction term funds to depository institutions. The TAF is a credit facility that allows a depository institution to place a bid for an advance from its local Federal Reserve Bank at an interest rate that is determined as the result of an auction. By allowing the Federal Reserve to inject term funds through a broader range of counterparties and against a broader range of collateral than open market operations, this facility could help ensure that liquidity provisions can be disseminated efficiently even when the unsecured interbank markets are under stress.

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Global markets were also affected by rising oil and food prices, failing housing markets, and credit/liquidity issues within their financial markets. Equity markets in the developed nations were impacted in a similar fashion as the domestic equity markets, with the low dollar somewhat aiding US investors' returns. Emerging Markets were also impacted albeit not as severe as developed markets and mostly in those countries that are export depended.

During fiscal 2008, the yield curve steepened significantly with lower yields across the board. The overall investment themes for fiscal year 2008 were that bonds outperformed equities, mid cap beat both large and small cap, growth beat value, and non-US equities outperformed US equities.

Domestic Equity Overview

The US Equity markets started off the fiscal year on a somewhat positive note, with the broader market showing a positive return. However, the next three quarters were negative across the board for US Equity markets, with the first quarter of 2008 experiencing the biggest decline. The broad US equity market as measured by the Russell 3000 posted a negative 12.69% return for the fiscal year ending 6/30/08, its worst showing since fiscal 2002. Based on the Russell indices, mid cap stocks led the way, followed by large stocks. Growth equities outperformed value equities for the entire period regardless of capitalization. Within the Russell 3000, energy (+28.32%) was the best performing sector and one of only three sectors with a positive return for the period. The other positive sectors were materials (+8.22%) and utilities (+4.82%). The worst performing sector was financials (-39.23%), followed by consumer discretionary (-28.54%) and telecommunications (-20.46%).

At June 30, 2008, the System held \$1,275 million in U.S. equity securities which represents approximately 47% of the total investment portfolio. During fiscal year ended June 30, 2008, investments in U.S. equity securities posted negative gross returns of approximately 13.09%.

Domestic Fixed Income Overview

The first three quarters of the fiscal year were very strong for the fixed-income markets as now risk-averse investors were looking for safety and quality. Spread sectors, however, experienced some of the worst months in bond market history during the period. Treasuries and agencies were the place to be and investors holding a significant allocation in anything else suffered dearly. Many active managers underperformed the broad market index for the fiscal year as spread sector securities were pummeled regardless of quality. A repricing of risk and lack of liquidity aided in the severe relative underperformance of spread sectors. The actions undertaken by the Federal Reserve during the first three quarters of the fiscal year did lead to a narrowing of spreads in April and May, but in June fear and volatility made a comeback amid inflation concerns and rising oil prices. The bond market as measured by the Lehman Brothers Aggregate Index returned 7.12% for the fiscal year ending 6/30/08. The Government sector showed the best performance as measured by the LB Government index (+9.68%) while High Yield and Asset Backed Securities had the worst performance as measured by the LB High Yield Index (-2.26%) and the LB ABS Index (-2.08%).

As of June 30, 2008, the System held \$490 million in domestic fixed income securities which represents approximately 18% of the total investment portfolio. The System's fixed income money managers had a positive gross return of 3.35% for the fiscal year ended June 30, 2008.

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Management's Discussion and Analysis

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International Equity Overview

Non-US equity markets were not spared from the credit crunch and liquidity crisis that was going on in the US. The rest of the world faced some of the same issues as the U.S. such as rising fuel and food prices, large write-offs at major investment banks, softening real estate markets and inflation. The MSCI EAFE Index returned -10.61% for the period, helped in part by a weaker dollar. Continental Europe (-11.34%) suffered the most followed by the Pacific region (-9.0%). Japan (-12.04%) lagged the broader market for most of the period. Emerging Markets were once again the best performing area ending the fiscal year up 4.89% as measured by the MSCI Emerging Markets Index.

As of June 30, 2008, the System held \$522 million in foreign equity securities which represents approximately 19% of the total investment portfolio. During fiscal year ended June 30, 2008, these securities posted a negative gross return of 8.34%.

	1-Year Returns as of 6/30/2008
S&P 500	-13.12
Dow Jones	-13.27
NASDAQ	-11.18
S&P 500 Citi Growth	-5.38
S&P 500 Citi Value	-20.25
Russell 2000	-16.19
Russell 2000 Growth	-10.83
Russell 2000 Value	-21.63
MSCI EAFE	-10.61
MSCI Emerging	4.89
Lehman Aggregate	7.12

Total Fund Performance

During the fiscal year 2008, the System posted a negative return mostly as a result of the negative performance of the US and Non-US equity markets. However, all equity asset class returns exceeded their benchmarks. Under performance in US fixed income by one the investment managers caused the overall fund to trail its composite benchmark for the period. Loans & Mortgages was the best performing area posting a positive 9.98% return for the year ended June 30, 2008.

Other Investments and Transactions

At June 30, 2008 and 2007, the System held \$376.6 million and \$364.1 million in loans to participants, respectively, which represents approximately 14% of the total investment portfolio. As of June 30, 2008 these loans consist of \$104 million in mortgage loans, \$272 million in personal loans and \$1 million in cultural trip loans. The loans to participants had a gross return of positive 9.98% for the fiscal year ended June 30, 2008.

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Management's Discussion and Analysis

Years Ended June 30, 2008 and 2007

As of June 30, 2008 the System has participation in Limited Partnerships of Private Equity Investments for an approximate value of \$37.6 million which represents approximately 1% of the investment portfolio. These investments had a gross return of positive 7.84% (time-weighted calculation, or 10.93% under internal rate of return calculation) for the fiscal year ended June 30, 2008.

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 2008, income from the custodian's securities lending activity amounted to approximately \$2 million.

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, Act No. 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, 2008 and 2007

	<u>2008</u>	<u>2007</u>
	(In Thousands)	
Assets		
Cash:		
Cash and cash equivalents	\$ 50,474	33,542
Cash with fiscal agent	297	—
Cash deposited with Government Development Bank for Puerto Rico	3,255	3,123
Total cash	<u>54,026</u>	<u>36,665</u>
Investments, at fair value:		
Bonds	490,007	468,452
Stocks	1,796,817	2,218,033
Total investments, at fair value	<u>2,286,824</u>	<u>2,686,485</u>
Other investments:		
Private equity investments	37,630	46,686
Total investments	<u>2,324,454</u>	<u>2,733,171</u>
Loans to plan members:		
Mortgage	103,759	102,684
Personal	271,510	260,066
Cultural trips	1,355	1,371
Total loans to plan members	<u>376,624</u>	<u>364,121</u>
Total investments and loans	<u>2,755,104</u>	<u>3,133,957</u>
Accounts receivable:		
Receivable for investments sold	4,693	12,242
Accrued interest and dividends receivable	6,395	6,312
Other	15,141	14,640
Total accounts receivable	<u>26,229</u>	<u>33,194</u>
Capital assets	26,223	25,890
Other assets	451	700
Total assets	<u>2,808,007</u>	<u>3,193,741</u>
Liabilities		
Investments purchased	7,952	11,258
Cash overdraft in cash with fiscal agent	—	5,619
Accounts payable	3,688	4,152
Obligation under capital lease	12	35
Accrued expenses	5,361	4,470
Line of credit	—	4
Escrow funds of mortgage loans and guarantee insurance reserve for loans to plan members	4,641	4,916
Other liabilities	1,007	567
Total liabilities	<u>22,661</u>	<u>31,021</u>
Net assets held in trust for pension benefits	<u>\$ 2,785,346</u>	<u>3,162,720</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, 2008 and 2007

	Years Ended June 30,	
	2008	2007
(In Thousands)		
Additions:		
Contributions:		
Participating employees	\$ 127,566	127,809
Employer	117,065	116,320
Contributions transferred from other systems	4,181	12,396
Special	68,085	57,960
Total contributions	<u>316,897</u>	<u>314,485</u>
Investment income:		
Interest income	67,825	65,367
Dividends income	15,629	13,654
Net (devaluation) appreciation in fair value of investments	(276,573)	406,131
	<u>(193,119)</u>	<u>485,152</u>
Less investment expense	6,847	6,217
Net investment (loss) income	<u>(199,966)</u>	<u>478,935</u>
Other income	1,735	1,299
Total additions	<u>118,666</u>	<u>794,719</u>
Deductions:		
Benefits paid to participants:		
Annuities and death benefits	414,334	364,998
Special benefits	49,742	45,564
Refunds of contributions	6,427	5,447
Administrative expenses	25,537	22,877
Total deductions	<u>496,040</u>	<u>438,886</u>
Net (decrease) increase in net assets held in trust for pension benefits	<u>(377,374)</u>	<u>355,833</u>
Net assets held in trust for pension benefits		
Beginning of year	<u>3,162,720</u>	<u>2,806,887</u>
End of year	<u>\$ 2,785,346</u>	<u>3,162,720</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, 2008 and 2007

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-Officio members which are the Secretary of the Puerto Rico Treasury Department, the Secretary of Puerto Rico Department 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 System 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* as amended by GASB Statement No. 50, *Pension Disclosures*. 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 Statement 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

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Notes to Basic Financial Statements

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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.

During the year ended June 30, 2008, the Government adopted the provision of the Statement of Governmental Accounting Standards Board (GASB) No. 45, *Accounting and Financial Reporting by Employers for Post-employment Benefits Other than Pensions*, the objective of which is to establish standards for the measurement, recognition, and display of other post employment benefits (OPEB) expenditures and related assets and liabilities, note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local governmental employers.

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 and Cash with Fiscal Agent

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 Puerto Rico Treasury Department for the payment of pension and payroll expenses for the years ended June 30, 2008 and 2007. Cash deposited with the Government Development Bank for Puerto Rico (GDB) consists of life insurance premium payments received from in-house loans' holders.

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 as investment income (loss).

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 lent 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, both subject to certain restrictions established by the System.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2008 and 2007

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.

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

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

Long-Lived Assets

The System adopted the provisions of GASB No. 42, *Accounting and Financial Reporting for impairment of Capital Assets and Insurance Recoveries*. 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 amounts 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, 2008:

- GASB Statement No. 51, *Intangible Assets*, which is effective for periods beginning after June 15, 2009.
- GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is effective for periods beginning after June 15, 2009.

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, 2008 and 2007

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 act 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 Puerto Rico 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, 2008 the membership consisted of approximately:

Retirees and beneficiaries currently receiving benefits	30,712
Current participating employees	<u>47,250</u>
Total membership	<u><u>77,962</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 \$400 per month and a maximum of 75% of the average compensation.

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Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2008 and 2007

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

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 \$400 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 \$400 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.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2008 and 2007

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 of Puerto Rico.

Refunds

A participating employee who ceases his/her employment with the Commonwealth of Puerto Rico 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.

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 \$68,085,000 and \$57,960,000 in 2008 and 2007, respectively, represent the contribution from the General Fund of the Commonwealth of Puerto Rico 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.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2008 and 2007

4. FUNDED STATUS AND FUNDING PROGRESS

The funded status of the plan as of June 30, 2007, the most recent actuarial valuation date, is as follows (dollar amount in thousands):

Actuarial Valuation Date	Actuarial Value of Plan Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Annual Covered Payroll	UAAL Percentage of Annual Covered Payroll
6/30/2007	\$ 3,163,000	7,756,000	4,593,000	41%	1,370,000	335%

The schedule of funding progress (see page 32), included as required supplementary information (RSI) following the notes to the financial statements, presents multilayer trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the AAL's for benefits.

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

5. 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 a positive balance of \$297,000 as of June 30, 2008 and an overdraft of approximately \$5,619,000 as of June 30, 2007.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2008 and 2007

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 \$3,255,000 and \$3,123,000 as of June 30, 2008 and 2007, respectively.

Investments

The following table shows the market value of the investments in marketable securities held by the System as of June 30, 2008 and 2007 (in thousands):

	<u>2008</u>	<u>2007</u>
US Government and agencies' securities	\$ 274,270	294,767
US Corporate bonds	<u>215,737</u>	<u>173,685</u>
Total bonds	490,007	468,452
US Corporate stocks	1,274,793	1,537,530
Non-US Corporate stocks	<u>522,024</u>	<u>680,503</u>
Total stocks	<u>1,796,817</u>	<u>2,218,033</u>
Private equity investments	<u>37,630</u>	<u>46,686</u>
Total Investments	<u>\$ 2,324,454</u>	<u>2,733,171</u>

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, 2008.

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, 2008 securities investments were registered in the name of the System and were held in the possession of the System's custodian bank.

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.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2008 and 2007

<u>Moody's Rating</u>	<u>Investment Type</u>	<u>Market Value (In Thousands)</u>	
		<u>2008</u>	<u>2007</u>
Aaa	Mortgage Backed Securities	\$ 195,948	137,326
Aaa	US Government Issues	73,457	147,226
Aaa	Corporate Bonds	1,605	3,172
Aaa	Asset Backed Securities	510	4,614
Aaa	Other Asset Backed Securities	339	—
		<u>271,859</u>	<u>292,338</u>
Aa1	Mortgage Backed Securities	458	307
Aa1	Corporate Bonds	—	3,123
Aa1	Asset Backed Securities	—	480
		<u>458</u>	<u>3,910</u>
Aa2	Corporate Bonds	19,805	11,480
Aa2	Mortgage Backed Securities	108	—
		<u>19,913</u>	<u>11,480</u>
Aa3	Corporate Bonds	23,129	26,543
Aa3	Asset Backed Securities	232	—
		<u>23,361</u>	<u>26,543</u>
Aa3e	Corporate Bonds	4,708	—
A1	Corporate Bonds	40,000	25,705
A2	Corporate Bonds	26,593	17,775
A2	Asset Backed Securities	334	—
A2	Other Asset Backed Securities	—	475
A2	Mortgage Backed Securities	—	100
		<u>26,927</u>	<u>18,350</u>
A3	Corporate Bonds	14,315	18,278
A3	Asset Backed Securities	11	—
A3	Mortgage Backed Securities	—	498
		<u>14,326</u>	<u>18,776</u>
Baa1	Corporate Bonds	<u>18,885</u>	<u>18,727</u>
	Sub Total	\$ 420,437	415,829

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2008 and 2007

<u>Moody's Rating</u>	<u>Investment Type</u>	<u>Market Value (In Thousands)</u>	
		<u>2008</u>	<u>2007</u>
	Balance Forward	\$ 420,437	415,829
Baa2	Corporate Bonds	34,895	25,472
Baa2	Mortgage Backed Securities	205	469
Baa2	Asset Backed Securities	28	—
		35,128	25,941
Baa3	Corporate Bonds	31,098	18,551
Baa3	Other Asset Backed Securities	43	—
		31,141	18,551
Ba1	Corporate Bonds	418	3,378
Ba1	Asset Backed Securities	73	—
		491	3,378
Ba3	Asset Backed Securities	20	—
B1	Asset Backed Securities	105	—
B1	Corporate Bonds	—	255
		105	255
B3	Asset Backed Securities	61	—
Caa2	Corporate Bonds	23	—
Caa3	Asset Backed Securities	92	—
Caa3	Corporate Bonds	35	—
		127	—
NA	Mortgage Backed Securities	1,546	66
NA	Other Asset Backed Securities	—	1,317
NA	Corporate Bonds	—	996
		1,546	2,379
NR	Mortgage Backed Securities	331	1,889
WR	Corporate Bonds	230	230
P-1	Asset Backed Securities	367	—
	Total Bonds and Notes	\$ 490,007	468,452

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2008 and 2007

Concentration of Credit Risk

There are no investments in any one issuer that represent 5% or more of total investments as of June 30, 2008. 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.

The following table summarizes the investments on debt securities of the System at June 30, 2008 (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	(2008-2051)	\$ 274,270	840	21,999	10,737	240,694
Corporate Bonds	(2008-2049)	<u>215,737</u>	<u>3,628</u>	<u>45,731</u>	<u>54,903</u>	<u>111,475</u>
Total Bonds		<u>\$ 490,007</u>	<u>4,468</u>	<u>67,730</u>	<u>65,640</u>	<u>352,169</u>

As of June 30, 2008, investments maturities are as follows:

<u>Maturity</u>	<u>Maximum Maturity</u>
Less than one year	1%
One to five years	14%
More than five to ten years	13%
More than ten years	72%

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.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2008 and 2007

Investments exposed to foreign currency risk as of June 30, 2008 and 2007 are as follows:

<u>Investment Type</u>	<u>Local Currency</u>	<u>Market Value</u> (In Thousands)	
		<u>2008</u>	<u>2007</u>
Foreign Currency	Euro	\$ 2,446	916
Foreign Currency	Norwegian Krone	1,985	—
Foreign Currency	Pound Sterling	560	79
Foreign Currency	Japanese Yen	102	75
Foreign Currency	Hong Kong Dollar	6	—
Foreign Currency	Singapore Dollar	—	5
Foreign Currency	Australian Dollar	—	39
Foreign Currency	Danish Krone	—	507
Total cash exposed to foreign currency risk		\$ 5,099	1,621
Shares in a Commingled Fund	Various (Refer to countries below)	\$ 258,636	340,523
Common Stock	Euro	61,160	86,498
Common Stock	Pound Sterling	52,477	73,097
Common Stock	Japanese Yen	39,926	59,090
Common Stock	Swiss Franc	25,771	30,065
Common Stock	Swedish Krona	17,977	23,667
Common Stock	Norwegian Krone	13,826	9,821
Common Stock	Australian Dollar	13,041	18,210
Common Stock	Hong Kong Dollar	8,113	6,235
Common Stock	Danish Krone	5,720	8,619
Mutual Funds	Pound Sterling	5,273	6,844
Preferred Stock	Swiss Franc	3,462	3,517
Common Stock	Singapore Dollar	2,642	1,651
Rights	Euro	—	47
Total securities exposed to foreign currency risk		508,024	667,884
Common Stock	U.S. Dollar	14,000	12,619
Total Investment		\$ <u>522,024</u>	<u>680,503</u>

The System owns shares in an international equity commingled fund. As of June 30, 2008, the System owned approximately 7,379,072 shares that represent 31.53% of the total commingled fund which had the following countries weightings.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2008 and 2007

<u>Europe</u>	<u>Currency</u>	<u>Percent</u>	<u>Pacific Basin</u>	<u>Currency</u>	<u>Percent</u>
Denmark	Danish Krone	1.3%	Hong Kong	Hong Kong Dollar	2.9%
Finland	Euro (Various)	4.0%	Japan	Japanese Yen	24.5%
France	Euro (Various)	9.2%	Total Pacific		27.4%
Germany	Euro (Various)	4.5%	Emerging Markets	Various	6.2%
Italy	Euro (Various)	1.8%	Canada	Canadian Dollar	1.2%
Netherlands	Euro (Various)	9.9%	Total Equities		100.0%
Norway	Norwegian Krone	1.3%			
Spain	Euro	1.5%			
Sweden	Swedish Krona	3.8%			
Switzerland	Swiss Frank	9.4%			
United Kingdom	Sterling Pound	18.5%			
Total Europe		65.2%			

Investments in Limited Partnerships

The System invested approximately \$1,476,469 in limited partnerships during the fiscal year ended June 30, 2008. The investments were as follows:

- During fiscal year 2008, \$53,820 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 2008, \$127,688 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 2008, 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.
- During the fiscal year 2008, \$802,448 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.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2008 and 2007

- During the fiscal year 2008, \$92,378 were invested in 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 2008, \$202,272 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 2008, \$197,863 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, 2008 amounted to \$37.6 million and is presented within other investments in the statement of plan 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.

As of June 30, 2008, the System had capital commitments and contributions as follows (in thousands):

	<u>Total Commitments</u>	<u>Fiscal year Contributions</u>	<u>Cumulative Contributions</u>	<u>Fair Value</u>
Guayacán Fund of Funds	\$ 20,000	54	18,857	4,641
Guayacán Fund of Funds II	25,000	128	23,539	13,382
Guayacán Private Equity Fund	5,000	—	4,407	4,432
Invesco Venture Partnership Fund III, LP	5,498	802	4,731	3,936
Invesco Non US Partnership Fund III, LP	4,500	92	4,034	2,150
Invesco US Buyout & Expansion Capital Partnership Fund III, LP	3,716	202	3,034	2,803
Chase Capital Partners Private Equity Fund of Funds II, LTD	15,000	198	14,182	6,286
Total	<u>\$ 78,714</u>	<u>1,476</u>	<u>72,784</u>	<u>37,630</u>

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2008 and 2007

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 lent securities). At June 30, 2008, the collateral received represents 102.78% of the fair value of the domestic securities lent and 106.07% of the fair value of the international securities lent.

The securities on loan for which collateral was received at June 30, 2008 consisted of the following:

Securities Lent	Fair Value 2008
US Equity	\$ 143,507,498
US Government	51,046,649
Non US Equity	44,628,167
US Corporate Bonds	<u>26,336,439</u>
Total	\$ <u>265,518,753</u>

The underlying collateral for these securities had a fair value of approximately \$274,372,007 as of June 30, 2008 consisting of non-cash collateral and cash collateral for \$1,190,656 and \$273,181,351, respectively. The non-cash collateral consisted of securities issued by the US Government and its agencies. The cash collateral was invested in the lending agent's short-term investment fund. As of June 30, 2008 the short-term investment fund's distribution by sector was as follows:

Asset-Backed	48.91%
CD	21.00%
Bank Note	14.76%
Corporate	6.15%
ABCP	4.90%
Repo	2.39%
TD	1.89%
<u>Total</u>	<u>100.00%</u>

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements
Years Ended June 30, 2008 and 2007

Under the terms of the securities lending agreement, the System is fully indemnified against failure of the borrowers to return the lent 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.

6. 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, 2008 and 2007, changes in capital assets consisted of the following (in thousands):

<u>Depreciable</u>	<u>Estimated Useful Life (in years)</u>	<u>Balance June 30, 2007</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2008</u>
Building	40	\$ 26,008	—	—	26,008
Furniture & equipment	4-10	1,993	44	(76)	1,961
Computers & software	4-5	2,122	2,599	(88)	4,633
Capital leases	5	106	—	—	106
Improvements	10	39	—	—	39
Vehicles	5	42	—	—	42
		<u>30,310</u>	<u>2,643</u>	<u>(164)</u>	<u>32,789</u>
Accumulated depreciation and amortization		(10,243)	(1,639)	141	(11,741)
Not depreciable					
Project in-progress		5,823	999	(1,647)	5,175
		<u>\$ 25,890</u>	<u>2,003</u>	<u>(1,670)</u>	<u>26,223</u>

7. OTHER ASSETS

At June 30, 2008 and 2007, other assets of \$475,450 and \$700,000, respectively, consisted primarily of repossessed and in-substance foreclosed properties. 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.

8. 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, 2008.

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Basic Financial Statements

Years Ended June 30, 2008 and 2007

Following is a summary of equipment under capital lease and accumulated amortization as of June 30, 2008 (in thousands):

Equipment under capital lease	\$ 106
Accumulated amortization	<u>(92)</u>
Book value	<u>\$ 14</u>

The future minimum lease payments under capital leases and the net present value of the future minimum lease payments as of June 30, 2008 for the next year is (in thousands):

<u>Year ending June 30,</u>	<u>Amount</u>
2009	\$ <u>14</u>
Total minimum lease payments	14
Less amount representing interest	<u>2</u>
Present value of minimum lease payments	<u>\$ 12</u>

9. 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, 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%. At June 30, 2008, there were no outstanding balance of the line of credit.

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 reserve is determined by the actuary.

11. RENT INCOME

The System is the lessor of an office building for which it has lease contracts that expire in 2009. The future revenue under the existing operating leases for the period ending June 30, 2009 is \$675,886.

Puerto Rico System of Annuities and Pensions for Teachers

*Notes to Basic Financial Statements
Years Ended June 30, 2008 and 2007*

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 2009 through 2012.

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

<u>Fiscal Year</u> <u>Ending</u>	<u>Amount</u>
2009	\$ 321
2010	147
2011	86
2012	36
	<u>\$ 590</u>

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. Act 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 approximately \$120 million from its resources that should have been received through special laws. As of June 30, 2008 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.

14. SUBSEQUENT EVENTS

Effective October 1, 2008 the plan sponsor appointed a new custodian bank for the Plan.

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REQUIRED SUPPLEMENTARY INFORMATION

Puerto Rico System of Annuities and Pensions for Teachers

Schedule of Employer Contributions

June 30, 2008

(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, 2008

(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, 2008

(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.

The information presented in the schedules was determined as part of the actuarial valuations at the dates indicated.

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