Puerto Rico System of Annuities and Pensions for Teachers

Audited Financial Statements and Independent Auditors' Report

June 30, 2005

Puerto Rico System of Annuities and Pensions for Teachers

Audited Financial Statements

June 30, 2005

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Rodríguez-Parissi, Vázquez & Co. 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

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, 2005 and 2004 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, 2005 and 2004 and the changes in its net assets for the years then ended in conformity with accounting principles generally accepted in the United States America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Management's Discussion and Analysis presented on pages 3 through 7 and the supplemental schedules of employer contributions and funding progress presented on pages 32 and 33 are supplementary information required by the Governmental Accounting Standards Board, and are not a required part of the basic financial statements. We have applied certain limited procedures, which consisted principally of

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inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information presented in the Management's Discussion and Analysis and supplemental schedules and, therefore, express no opinion on them.

Rodríguez-Parissi, Vázquez & Co. PSC

San Juan, Puerto Rico
September 29, 2005

Stamp No. 2084018 was affixed to
the original copy of this report

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 assets for the fiscal year ended June 30, 2005 and 2004. 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) Statement of Plan Net Assets, 2) Statement of Changes in Plan Net Assets, and 3) Notes to the Financial Statements. Additional information is also presented to supplement the basic financial statements.

Statement of Plan Net Assets and Statement of Changes in Plan Net Assets

Both these statements provide information about the overall financial status of the System. The Statement of Plan Net Assets includes all of the System's assets and liabilities, with a difference reported as net assets. The Statement of Changes in Plan Net Assets discloses changes in the System's assets during the fiscal year. Comparative information for the years ended June 30, 2005 and 2004 is presented.

Notes to the Basic Financial Statements

The notes to the 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.

Supplementary Information

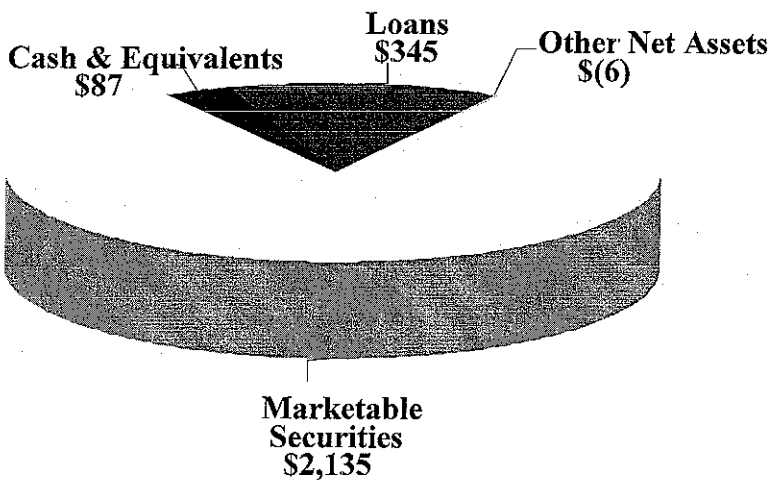
The required supplementary information consists of two schedules and related notes concerning the funded status of the pension plan administered by the System.

Financial Highlights

The System's net assets as of June 30, 2004 increased from approximately $2,403 million to $2,561 million as of June 30, 2005. The increase was primarily due to the net appreciation in the fair value of the System's investment portfolio. The amount of $2,561 in total net assets consists of the following:

- $2,135 million in marketable securities
- $345 million in loans to participants
- $87 million in net cash and equivalents
- ($6) million in other net assets (liabilities)

Total net assets table (in millions):



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

- The System's assets exceeded liabilities by $2,561 million (net assets) for the fiscal year ended June 30, 2005 when compared to the prior year which assets exceeded liabilities by $2,403 million.
- The fair value of the System's investments at June 30, 2005 amounted to $2,135 million, compared to $2,003 million at June 30, 2004.
- Administrative expenses increased from approximately $22.6 million for the year ended June 30, 2004 to approximately $25.8 million for the year ended June 30, 2005.
- The System's funded ratio of the actuarial accrued liability at June 30, 2004 and 2003 was 51% and 47%, respectively.

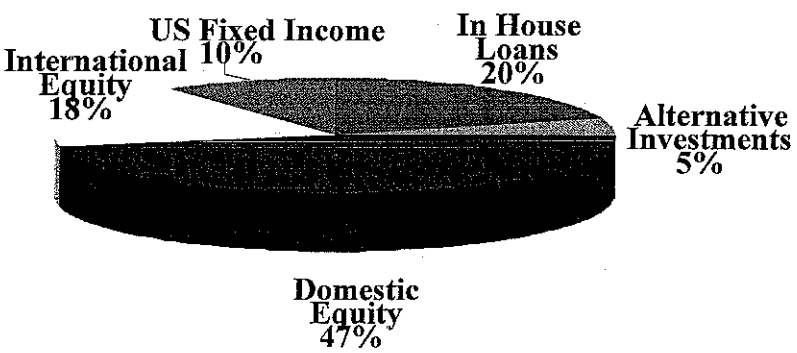
Financial Analysis of the System

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, 2005 amounted to approximately $2,561 million, an increase of approximately $158 million from approximately $2,403 million at June 30, 2004. 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 2005, employer and member contributions increased by approximately $23 million, from approximately $229 million during fiscal year 2004 to approximately $252 million during fiscal 2005. The System recognized a net appreciation in the fair value of investments of approximately $162 million for fiscal year 2005.

In fiscal year 2004, the System started a re-engineering and mechanization project that involves different areas; such as Pensions, Loans and Finance. As of June 30, 2005, $4.4 million was capitalized as a result of the project in progress.

As of June 30, 2005, the long-term debt related with Bonds Payable (see Note 9 in Financial Statements) amounted to $21.3 million. In fiscal year 2005, there were payments of principal and interest related to Series A and payments of interest related to Series B.

During the fiscal year ended June 30, 2004, the System went through a re-structuring of its investment portfolio after having selected a new target asset mix and investment managers for the different asset classes. The investment strategy implemented contemplated a reduction in the number of investment managers and investing 65% of the domestic equity asset class in an S&P 500 Index Fund. Both of these actions contributed to a significant reduction in management fees. The asset mix of the fund generated a positive gross return of 9.82% for the year ended June 30, 2005. The target asset mix is as follows:



Domestic Equity Overview

The System's investment portfolio is well diversified within this segment having passive and active management. Within the active management there is exposure to Large and Small Capitalization levels and to Growth and Value styles. During fiscal year 2005, the ups and downs of this asset class were mainly due to investors' concerns over rising oil prices and energy costs, inflation and interest rates.

At June 30, 2005, the System held approximately $1,270 million in U.S. equity securities which represents 51% of the total investment portfolio. During fiscal year ended June 30, 2005, investments in U.S. equity securities earned gross returns of approximately 7.59%.

International Equity Overview

The international portfolio's goal is to provide a strategic allocation to the Europe, Australia and Far East (EAFE) segment of the International Equity market. During fiscal year 2005, the changes in returns across all regions of international equity were also the result of how investors reacted to oil and energy prices, and earnings.

As of June 30, 2005, the System held approximately $563 million in foreign equity securities which represents 23% of the total investment portfolio. During fiscal year ended June 30, 2005, these securities earned a gross return of 16.10%.

Fixed Income Overview

The performance shown under the Domestic Fixed Income was the result of several factors, such as: inflation concerns and the Fed raising interest rates 25 basis points during its March meeting. However, during fiscal year 2005, there were periods that posted solid returns due to the stable interest-rate environment and steady foreign demand, particularly from Asian central banks.

As of June 30, 2005, the System held approximately $257 million in domestic fixed income securities which represents 10% of the total investment portfolio. The System's fixed income money managers had a gross return of 7.17 % for the fiscal year ended June 30, 2005.

Other Investments and Transactions

At June 30, 2005 and 2004, the System held approximately $345.3 million and $344.8 million in loans to participants, respectively, which represents 14% of the total investment portfolio. As of June 30, 2005 these loans consist of $110 million in mortgage loans, $234 million in personal loans and $1 million in cultural trip loans.

Other Investments and Transactions (continued)

As of June 30, 2005 the System has participation in Limited Partnerships of Private Equity Investments for an approximate value of $45 million which represents approximately 2% of the investment portfolio. These investments had a gross return of 15.42% for the fiscal year ended June 30, 2005.

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 2005, income from securities lending activity amounted to approximately $722,000. In addition, the System invests in a commingled fund, which engages in securities lending transactions that resulted in approximate earnings of $36,000 as securities lending income.

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, 2004. According to such valuation, the System's unfunded liability amounted to approximately $2.3 billion with a capitalization level of 51%.

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, PR 00919-1879.

Puerto Rico System of Annuities and Pensions for Teachers
Statements of Plan Net Assets

	June 30, 2005	June 30, 2004
	(In Thousands)	
ASSETS		
Cash:		
Cash and cash equivalents	$ 79 017	$ 67,113
Cash with fiscal agent	2 853	
Cash restricted	1 595	2,396
Cash deposited with Government Development Bank for Puerto Rico	3,536	3,717
Total cash	87,001	73,226
Investments, at fair value:		
Bonds and notes	257,030	280,747
Stocks	1,833,168	1,678,679
Total investments at fair value	2,090,198	1,959,426
Other investments:		
Private equity investments	44,747	43,660
Total investments	2,134,945	2,003,086
Loans to plan members:		
Mortgage	109 605	110,293
Personal	234,335	233,342
Cultural trips	1,338	1,148
Total loans to plan members	345,278	344,783
Total Investments and loans	2 567 224	2 421,095
Accounts receivable:		
Receivable for investments sold	10,516	5 535
Accrued interest and dividends receivable	4 449	5,380
Other	2,593	2,500
Total accounts receivable	17,558	13,415
Property and equipment, net	26 206	24,332
Other assets	600	619
TOTAL ASSETS	2,611,588	2,459,461
LIABILITIES		
Investments purchased	14,262	10,567
Cash overdraft in cash with fiscal agent	-	7,812
Accounts payable	3 768	2,570
Obligation under capital lease	78	96
Accrued expenses	4,314	3,071
Line of credit	4	240
Escrow funds of mortgage loans and guarantee insurance reserve for loans to plan members	6,069	9,911
Bonds payable	21,285	22,090
Other liabilities	669	109
Total liabilities	50,449	56,466
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	$ 2,561,139	$ 2,402,995

Puerto Rico System of Annuities and Pensions for Teachers
Statements of Changes in Plan Net Assets

	June 30, 2005	June 30, 2004
	(In Thousands)	
Additions:		
Contributions:		
Participating employees	$ 131,481	$ 118,743
Employer	120,887	110,548
Special	60,853	40,409
Total contributions	313,221	269,700
Investment income:		
Interest income	47,577	55,878
Dividends income	20,339	17,264
Net appreciation in fair value of investments	161,685	240,732
	229,601	313,874
Less investment expense	4,986	4,958
Net investment income	224,615	308,916
Other income	1,167	32,397
Total additions	539,003	611,013
Deductions:		
Benefits paid to participants:		
Annuities and death benefits	313,551	292,401
Special benefits	38,592	32,210
Refunds of contributions	2,912	3,432
Administrative expenses	25,804	22,637
Total deductions	380,859	350,680
Net increase in net assets held in trust for pension benefits	158,144	260,333
Net assets held in trust for pension benefits		
Beginning of year	2,402,995	2,142,662
End of year	$ 2,561,139	$ 2,402,995

See accompanying notes

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: the Secretary of the Treasury, the Secretary of Education, the President of the Government Development Bank for Puerto Rico (GDB), two active teachers (one of them a representative of the Teachers Organization according to Act No. 45 of February 25, 1998), two retiree teachers, one representative of the teachers organizations, and one representative of the public interest. The last two trustees are appointed by the Governor of the Commonwealth

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.

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.

1. Organization and Summary of Significant Accounting Policies (continued)

Cash and Cash equivalents

Cash and cash equivalents consist of "overnight deposits" with the custodian bank. Cash with fiscal agent represents a fund account the System has at the Department of Treasury for the payment of operational and administrative expenses. Restricted cash deposited with GDB consists of payments received from in-house loans holders to service the loans; and the restricted cash deposited with a commercial bank represents an escrow account for purposes of the bonds payable (See Note 9).

Investments

Marketable securities 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 paid by 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.

1. Organization and Summary of Significant Accounting Policies (continued)

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 recorded for projects in progress. The estimated useful lives of capital assets are as follows:

	Years
Building	40
Buildings improvements	10
Equipment, 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.

Reserve for Life Insurance on 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, 2005:

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which is effective for fiscal years beginning after December 15, 2004.
- GASB Statement No. 43, *Financial Reporting for Post-employment Benefit Plans Other Than Pension Plans,* which is effective for fiscal years beginning after December 15, 2004.

- GASB Statement No 44, *Economic Condition Reporting. The Statistical Section—an amendment of NCGA Statement 1*, which is effective for statistical sections of Comprehensive Annual Financial Reports prepared for periods beginning after June 15, 2005.
- 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. 46, *Net Assets Restricted by Legislation, an Amendment of GASB Statement No 34*, which is effective for periods beginning after June 15, 2005.
- GASB Statement No. 47, *Accounting for Termination Benefits*, which is effective for periods beginning after June 15, 2005.

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

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, 2005 the membership consisted of approximately:

Retirees and beneficiaries currently receiving benefits	27,000
Current participating employees	50,000
Total membership	77,000

2. Plan Description (continued)

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:

Age	Years of Creditable Services	Retirement Annuity Compensation
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
Forty-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 $300 per month.

2. Plan Description (continued)

Non-occupational Disability Annuity

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

Death Benefits

Pre-retirement

- Beneficiary – the contributions and 2% interest accumulated as of the date of death after discounting debts with the System, plus an amount equal to the annual compensation at the time of death.

Post –retirement

- Surviving spouse - 50% of retiree's pension.
- Children – 50% of the retiree's pension to the children of age under 22 or disabled.
- Otherwise 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 are refunded to the beneficiaries.

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 and 2004 the Legislature has replicated the benefit granted per Act No. 62. This benefit is funded by the General Fund of the Commonwealth.

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.

2. Plan Description (continued)

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 service 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 36 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 will last 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 $60,853,000 and $40,409,000 in 2005 and 2004, 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, 2004 and 2003, using the entry age normal actuarial cost method. Significant assumptions underlying the actuarial computations include: (a) assumed rate of return of investments of 8%, net of investment expense; (b) assumed compound rate of wage increases of 5% per year; and (c) assumed mortality rate based on the Group Annuity Table for 1983.

The actuarial accrued liability as of June 30, 2004 and 2003 was approximately $4,702,000,000 and $4,540,000,000, respectively. As of June 30, 2004 and 2003, the unfunded actuarial accrued liability was approximately $2,299,000,000 and $2,397,000,000, respectively.

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.

This year the System adopted GASB Statement No. 40 "Deposit and Investment Risk Disclosures" an amendment of GASB Statement No. 3.

Deposits

Cash with fiscal agent has a surplus and overdraft of approximately $2,853,000 and ($7,812,000) as of June 30, 2005 and 2004, respectively.

Restricted cash of approximately $1,595,000 and $2,396,000 as of June 30, 2005 and 2004, respectively, is held in escrow by a commercial bank, as trustee (the Trustee), for purposes of servicing the bonds payable (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 $3,536,000 and $3,717,000 as of June 30, 2005 and 2004, respectively.

Investments

The following table shows the market value of the investments in marketable securities held by the System as of June 30, 2005 and 2004 (in thousands):

	2005	2004
US Government and agencies' securities	$ 140,807	$ 10,321
US Corporate bonds	116,223	270,426
Total Bonds	257,030	280,747
US Corporate stocks	1,270,255	1,205,498
Non-US Corporate stocks	562,913	473,181
Total Stocks	1,833,168	1,678,679
Private equity investments	44,747	43,660
Total Investments	$ 2,134,945	$ 2,003,086

4. Deposits and Investments (Continued)

Cash and equivalents and marketable securities include approximately $59,132,000 and $55,249,000 as of June 30, 2005 and 2004, respectively, held as pledge collateral by a 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, and interest rate risk. Following is a description of these risks as of June 30, 2005.

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, 2005 securities investments were registered in the name of the System and were held in the possession of the System's custodian bank, States Street Bank and Trust.

Credit Risk

The System's investment guidelines prohibit the investments in securities with maturity dates beyond 30 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 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 Standard and Poor's or Moody's credit ratings.

4. Deposits and Investments (continued)

Credit Risk

Moody's Rating	Investment Type	Fair Value June 30, 2005
AAA	US Government Bonds	$ 107,291,776
AAA	Mortgage Backed Securities	29,764,673
AAA	Corporate Bonds	4,479,542
AAA	Asset Back Securities	1,502,955
		143,038,946
A1	Corporate Bonds	19,759,900
A2	Corporate Bonds	2,350,192
A2	Mortgage Backed Securities	100,241
		2,450,433
A3	Corporate Bonds	14,925,428
A3	Convertible Bonds	37,406
		14,962,834
AA1	Corporate Bonds	3,040,810
AA2	Corporate Bonds	3,085,048
AA3	Corporate Bonds	12,430,869
BA1	Corporate Bonds	45,544
BAA1	Corporate Bonds	15,877,484
BAA1	US Government Bonds	104,338
		15,981,822
BAA2	Corporate Bonds	24,421,793
BAA3	Corporate Bonds	15,802,553
CAA1	Mortgage Backed Securities	45,066
NA	Mortgage Backed Securities	742,913
NR	Mortgage Backed Securities	1,221,066
Total Bonds and Notes		**$ 257,029,597**

4. Deposits and Investments (continued)

Concentration of Credit Risk

There are no investments in any one issuer that represent 5% or more of total investments as of June 30, 2005. 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 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 30 years are prohibited.

The following table summarizes the investments on debt securities of the System at June 30, 2005 (in thousands):

			Investment Maturities (In Years)			
	Maturity from	Fair Value	Less than 1	1-5	More than 5-10	More than 10
U.S. Government and agencies securities	(2005-2030)	$140,807	$31,370	$74,417	$11,269	$23,751
Corporate Bonds	(2005-2035)	116,223	112	26,339	49,134	40,637
Total Bonds and Notes		$257,030	$31,482	$100,756	$60,403	$64,388

As of June 30, 2005, investments maturities are as follows:

Maturity	Maximum Maturity
Less than one year	12%
One to five years	39%
More than five to ten years	24%
More than ten years	25%

4. Deposits and Investments (continued)

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

Investments exposed to foreign currency risk as of June 30, 2005 are as follows:

Investment Type	Local Currency	Market Value
Foreign Currency	Pound Sterling	$2,201,798
Foreign Currency	Japanese Yen	167,855
Foreign Currency	Euro Currency	150,908
Foreign Currency	New Turkish Lira	1,685
Total Cash exposed to foreign currency risk		$2,522,246

Investment Type	Local Currency	Market Value
Common Stock	Euro Currency	$176,833,540
Common Stock	Pound Sterling	116,439,565
Common Stock	Japanese Yen	111,007,723
Common Stock	Swedish Krona	35,366,284
Common Stock	Swiss Franc	24,215,346
Common Stock	Australian Dollar	23,006,949
Common Stock	Hong Kong Dollar	19,306,549
Common Stock	Danish Krone	12,803,447
Mutual Funds	Pound Sterling	6,172,447
Depository Receipts	Euro Currency	5,298,240
Common Stock	South African Rand	4,288,604
Common Stock	Singapore Dollar	4,207,610
Common Stock	New Zealand Dollar	2,168,241
Total Securities exposed to foreign currency risk		$541,114,545
Common Stock	US Dollar	21,798,720
Total Securities		$562,913,265

4. Deposits and Investments (continued)

Investments in Limited Partnerships

The System invested approximately $4,330,793 in limited partnerships during the fiscal year ended June 30, 2005. The investments were as follows:

- During fiscal year 2005 there were no contributions to 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 familiarizes the local pension funds with the private equity asset class without the risks inherent in geographically constrained investments.

- $1,975,806 was invested in 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 fiscal year 2005 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.

- $ 752,295 was 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 $6 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 fiscal year 2005 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.

4. Deposits and Investments (continued)

- During fiscal year 2005 there were no contributions to 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 $4.5 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

- $ 1,602,692 was 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, 2005 amounted to $ 44.7 million and is presented within other investments in the statements 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.

As of June 30, 2005, the System had capital commitments and contributions as follows (in thousands):

	Total Commitments	Fiscal year Contributions	Cumulative Contributions	Fair Value
Guayacán Fund of Funds	$ 20,000	$ -	$ 18,623	$ 9,515
Guayacán Fund of Funds II	25,000	1,976	19,639	14,820
Guayacán Private Equity Fund	5,000	-	3,930	3,902
Invesco Venture Partnership Fund III, LP	6,000	752	2,926	2,435
Invesco Non-US Partnership Fund III, LP	4,500	-	3,264	3,793
Invesco US Buyout & Expansion Capital Partnership Fund III, LP	4,500	-	1,568	2,110
Chase Capital Partners Private Equity Fund of Funds II, LTD	15,000	1,603	12,817	8,172
	$ 80,000	$ 4,331	$ 62,767	$ 44,747

4. Deposits and Investments (continued)

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 custodial 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, 2005, the collateral received represented 101.73% of the fair value of the domestic securities lent and 105.21% of the fair value of the international securities lent.

The securities on loan for which collateral was received at June 30, 2005 consisted of the following (in thousands):

Securities Lent	Fair Value 2005
US Corporate Bonds	$9,370,834
US Government	25,136,737
US Equity	49,872,492
Non-US Equity	115,189,597
Total	$199,569,660

The underlying collateral for these securities had a market value of approximately $207,023,619 as of June 30, 2005. It represented cash collateral and was invested in the lending agent's short-term investment fund. As of June 30, 2005 the short-term investment fund's distribution by sector was as follows:

Asset-Backed	25.40%	Repo	9.74%
CD	21.48%	ABCP	2.54%
Corporate	17.40%	Deposit Note	1.49%
TD	10.68%	CP	0.59%
Bank Note	10.54%	US Agency	0.14%

4. Deposits and Investments (continued)

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. Property and Equipment, Net

Property and equipment additions are recorded at cost. Depreciation is provided using the straight-line method over the useful life of the asset. As of June 30, 2005 and 2004, changes in property and equipment consisted of the following (in thousands):

	Estimated Useful Life (in years)	Balance June 30, 2004	Additions	Retirements	Adjustments	Balance June 30, 2005
Depreciable						
Building	40	$ 26,008				$ 26,008
Furniture and equipment	4-10	4,656	$ 694	$ (341)	$ 29	5,038
Capital leases	5	106				106
Improvements	10		39			39
Vehicles	5		21			21
		30,770	754	(341)	29	31 212
Accumulated depreciation and amortization		(8,318)	(1,056)			(9,374)
Non-depreciable						
Project in-progress		1,880	2,488			4,368
		$ 24,332	$ 2,186	$ (341)	$ 29	$ 26,206

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, 2005 and 2004, other assets consisted of repossessed and in-substance foreclosed properties amounting to approximately $600,000 and $619,000, 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. Losses are recognized based on impairment of the asset, and are measured by Statement of Financial Accounting Standard No 144, Accounting for the Impairment or Disposal of Long-Lived Assets Management believes that the carrying value of these properties approximates their fair value.

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, 2005.

Following is a summary of equipment under capital lease and accumulated amortization as of June 30, 2005 (in thousands):

Equipment under capital lease	$	106
Accumulated amortization		42
Book value	$	64

7. Obligation under Capital Leases (continued)

The future minimum lease payments under capital leases and the net present value of the future minimum lease payments as of June 30, 2005 for each of the next four years are (in thousands):

Year ending June 30,	Amount
2006	23
2007	23
2008	23
2009	12
Total minimum lease payments	81
Less amount representing interest	3
Present value of minimum lease payments	$ 78

8. Line of Credit

The System has a line of credit with the Governmental Development Bank (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, 2005 and 2004, the outstanding balance of the line of credit was approximately $4,000 and $240,000, respectively, 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.

9. Bonds Payable (continued)

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

	Balance June 30, 2004	Additions	Deductions	Balance June 30, 2005
Series A				
6 50% Term Bonds due July 1, 2006	$ 1,660,000	$ -	$ 805,000	$ 855,000
6 65% Term Bonds due July 1, 2011	5,220,000	-	-	5,220,000
	6,880,000	-	805,000	6,075,000
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
Total Bonds Payable	$ 22,090,000	$ -	$ 805,000	$ 21,285,000

Interest on the Series A Bonds is payable on a monthly basis and for the Series B Bonds semiannually on each July and January Future minimum mandatory principal and interest requirements follow:

	Series A			Series B		
Fiscal Year	Principal	Interest	Total	Principal	Interest	Total
2006	855,000	402,705	1,257,705	-	836,550	836,550
2007	915,000	347,130	1,262,130	-	836,550	836,550
2008	975,000	286,283	1,261,283	-	836,550	836,550
2009	1,040,000	221,445	1,261,445	-	836,550	836,550
2010	1,110,000	152,285	1,262,285	-	836,550	836,550
2011-2015	1,180,000	78,470	1,258,470	5,110,000	3,780,425	8,890,425
2016-2020	-	-	-	8,180,000	1,926,375	10,106,375
2021-2022	-	-	-	1,920,000	105,600	2,025,600
	$6,075,000	$1,488,318	$7,563,318	$15,210,000	$9,995,150	$25,205,150

9. Bonds Payable (continued)

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 on July 2006, or any date thereafter at the determined redemption prices as follows:

July 1, 2006 through June 30, 2007	102%
July 1, 2007 through June 30, 2008	101%
July 1, 2008 and thereafter	100%

10. Insurance Reserve for Life Insurance on 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 2005 through 2009. The future revenue under the existing operating leases is as follows (in thousands):

Fiscal Year Ending	Amount
2006	$ 400
2007	411
2008	420
2009	42
	$ 1,273

12. Commitments

The System leases offices for the operation of its regional offices (Ponce, Mayagüez, Arecibo, Humacao) and maintains four contracts for this purpose that expire between the years 2006 through 2008.

The minimum future payments under the existing operating leases are as follows (in thousands):

Year	Amount
2006	61
2007	61
2008	9
	$ 131

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 received 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, 2005 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 "Comisión para resolver Controversias sobre Pagos y Deudas entre Agencias Gubernamentales" the amount claimed has not been accrued in the System's financial statements.

Supplemental and Required Supplementary Information

Puerto Rico System of Annuities and Pensions for Teachers

Schedule of Employer Contributions
(In Thousands)

June 30, 2005

Year ended June 30	Annual Required Contributions	Contributions	Percentage Contributed
2004	$ 217,000	$ 159,200	73.36%
2003	172,300	140,300	81.42%
2002	172,300	124,200	72.08%
2001	103,200	116,100	112.50%
2000	112,800	86,200	76.42%
1999	120,600	91,200	75.62%

Puerto Rico System of Annuities and Pensions for Teachers
Schedule of Funding Progress (In Thousands)
June 30, 2005

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
6/30/2004	$ 2,403,000	$ 4,702,000	$ 2,298,000	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%
6/30/2001	2,284,000	3,683,000	1,400,000	62%	871,000	161%
6/30/2000	2,509,000	3,205,000	695,000	78%	1,006,000	69%
6/30/1999	2,314,000	2,904,000	590,000	80%	996,000	59%

Puerto Rico System of Annuities and Pensions for Teachers

Notes to Schedules of Trend Information

June 30, 2005

1. 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

2. 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

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, 2004
Actuarial Cost Method	Entry age normal
Amortization	Level percentage closed
Remaining Amortization Period	16 years
Asset Valuation Method	Market value of assets
Actuarial Assumptions:	
Investment rate of return*	8.00%
Projected salary increases*	5.00%
Inflation	3.50%
Cost of living adjustment	None

* Includes inflation at 3.5%