Employee's Retirement System of the Government of the Commonwealth of Puerto Rico

(A Pension Trust Fund of the Commonwealth of Puerto Rico)

Basic Financial Statements 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

To the Board of Trustees of the
Employee's Retirement System of the Government of the
Commonwealth of Puerto Rico
San Juan, Puerto Rico

We have audited the accompanying statements of plan net assets of the Employee's Retirement System of the Government of the Commonwealth of Puerto Rico (the System) (a pension trust fund of the Commonwealth of Puerto Rico) 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 misstatements. 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 statements 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 as of 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 employers' contributions, funding progress and notes to supplementary schedules on pages 2 through 11, and 46 through 49 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 inquires 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.

Parissi, P.S.C.

April 27, 2009
San Juan, Puerto Rico

Stamp No. 2406734 was affixed
to the original of this report.
License No. 88 Exp. December 1, 2011

PARISSI P.S.C.
2406734
PUERTO RICO
CERTIFIED PUBLIC ACCOUNTANTS

Introduction

The Employee's Retirement System of the Government of the Commonwealth of Puerto Rico (the System) administers retirement and other plan member benefits, such as personal, cultural and mortgage loans, occupational and non-occupational disability annuities and death benefits. The System is a pension trust fund of the Commonwealth of Puerto Rico. Pension trust resources are only held in trust to pay retirement benefits to plan members. The System presents the annual basic financial statements and provides a narrative discussion and analysis of the financial activities for the fiscal years ended June 30, 2008 and 2007. The financial performance of the System is discussed and analyzed within the context of the accompanying basic financial statements and disclosures.

Overview of the Basic Financial Statements

The Management's Discussion and Analysis introduces the System's basic financial statements. The basic financial statements include: (1) Statements of Plan Net Assets, (2) Statements of Changes in Plan Net Assets, and (3) Notes to the Basic Financial Statements. The System also includes additional information 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 status of the System. The System uses accrual basis of accounting to prepare its financial statements.

The Statements of Plan Net Assets includes all of the System's assets and liabilities, with the difference reported as net assets held in trust for pension benefits. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the System as a whole is improving or deteriorating.

The Statements of Changes in Plan Net Assets reports changes in the System's net assets held in trust for pension benefits during the year. All current year additions and deductions are included regardless of when cash is received or paid.

Notes to Basic Financial Statements

The notes to the 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

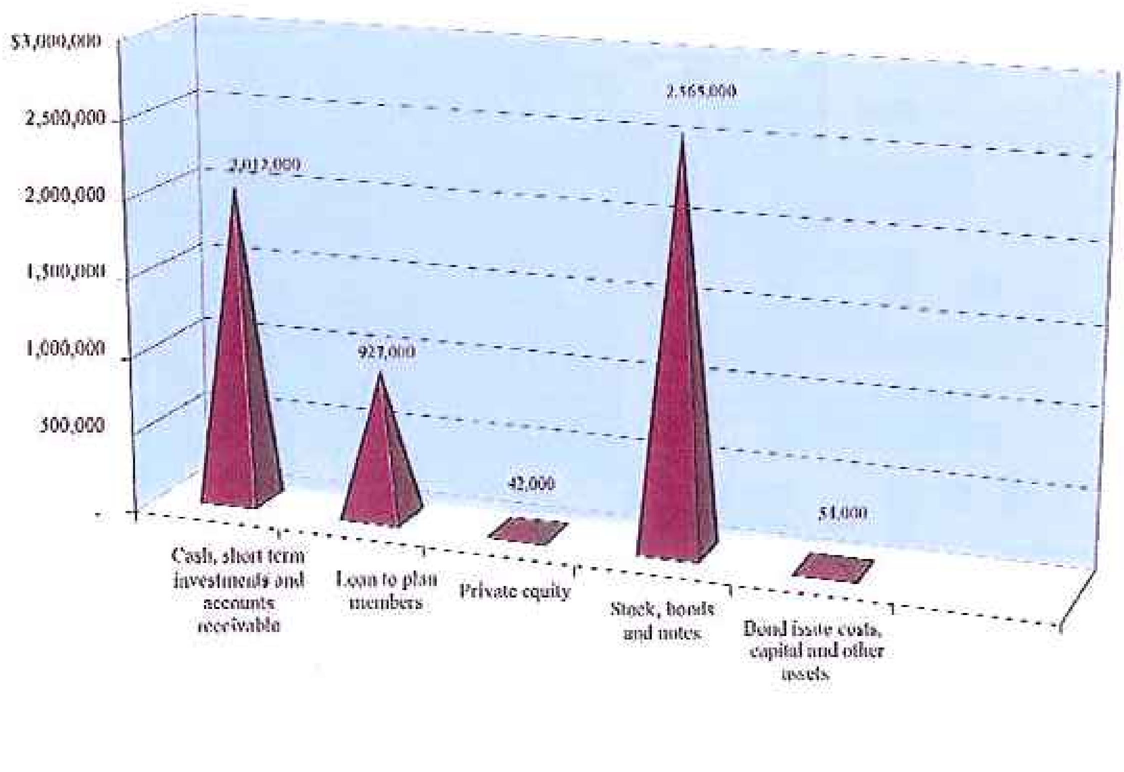
The required supplementary information consists of two schedules and related notes concerning the funded status of the pension plan administered by the System.

Financial Highlights

The System provides the retirement benefits to employees of the Commonwealth of Puerto Rico. The System has $5,600 and $2,931 million in total assets as of June 30, 2008 and 2007, respectively. This amount consists of the following:

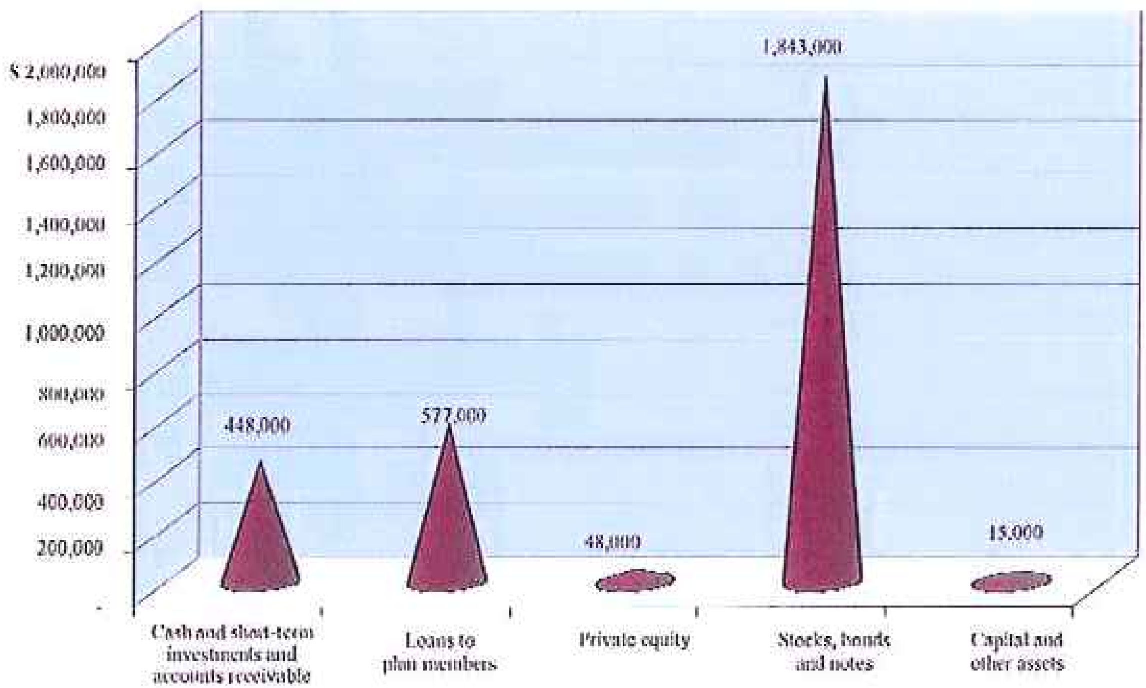
- $2,012 million in cash and short-term investments and accounts receivable
- $927 million in loans to plan members
- $42 million in private equity investments
- $2,565 million in stocks, bonds and notes
- $54 million in bond issue costs and capital and other assets

(In thousands)



For fiscal year ended June 30, 2007, consists of the following:

- $448 million in cash and short-term investments and accounts receivable
- $577 million in loans to plan members
- $48 million in private equity investments
- $1,843 million in stock, bonds and notes
- $15 million in capital and other assets



The following provides a comparison of certain items within the financial statements (amounts in thousands):

	2008	2007	Total Dollar Change	Total Percentage Change
Assets				
Cash and short-term investments and total accounts receivable	$ 2,012,042	447,572	1,564,470	349.5%
Investments	2,607,798	1,890,567	717,231	37.9%
Loans to plan members	926,831	577,314	349,517	60.5%
Bond issue costs, capital assets and other	53,595	15,847	37,748	238.2%
Total assets	5,600,266	2,931,300	2,668,966	91.1%
Liabilities				
Accounts payable and accrued liabilities	9,310	10,125	(815)	-8.0%
Insurance reserve for loans to plan members and investment purchases	16,559	11,086	5,473	49.4%
Bond payable	2,942,184	—	2,942,184	100.0%
Bond interest payable	12,181	—	12,181	100.0%
Other liabilities	12,946	18,588	(5,642)	-30.4%
Total liabilities	2,993,180	39,799	2,953,381	7420.7%
Total net assets held in trust for pension benefits	$ 2,607,086	2,891,501	(284,415)	-9.8%

	2007	2006	Total Dollar Change	Total Percentage Change
Assets				
Cash and short-term investments and total accounts receivable	$ 447,572	163,651	283,921	173.5%
Investments	1,890,567	2,068,653	(178,086)	-8.6%
Loans to plan members	577,314	528,552	48,762	9.2%
Capital assets and other	15,847	15,286	561	3.7%
Total assets	2,931,300	2,776,142	155,158	5.6%
Liabilities				
Accounts payable and accrued liabilities	10,125	9,246	879	9.5%
Insurance reserve for loans to plan members and investment purchases	11,086	148,686	(137,600)	-92.5%
Line of credit	—	60,000	(60,000)	-100.0%
Other liabilities	18,588	16,879	1,709	10.1%
Total liabilities	39,799	234,811	(195,012)	-83.1%
Total net assets held in trust for pension benefits	$ 2,891,501	2,541,331	350,170	13.8%

	2008	2007	Total Dollar Change	Total Percentage Change
Additions				
Contributions:				
Employers	$ 380,833	374,394	6,439	1.7%
Participating employees	345,614	338,791	6,823	2.0%
Other	141,724	69,097	72,627	105.1%
Net investment income (loss)	(93,910)	433,970	(527,880)	-121.6%
Other	47,796	36,872	10,924	29.6%
Total additions	822,057	1,253,124	(431,067)	-34.4%
Deductions				
Retirement and other benefits	968,202	824,755	143,447	17.4%
Refunds of contributions	40,366	33,305	7,061	21.2%
General and administrative	31,610	29,207	2,403	8.2%
Interest on Bond payable	46,996	---	46,996	100.0%
Other	19,298	15,687	3,611	23.0%
Total deductions	1,106,472	902,954	203,518	22.5%
Net increase (decrease) in net assets	$ (284,415)	350,170	(634,585)	-181.2%

	2007	2006	Total Dollar Change	Total Percentage Change
Additions				
Contributions:				
Employers	$ 374,394	382,877	(8,483)	-2.2%
Participating employees	338,791	342,697	(3,906)	-1.1%
Other	69,097	15,495	53,602	345.9%
Net investment income	433,970	292,816	141,154	48.2%
Other	36,872	39,954	(3,082)	-7.7%
Total additions	1,253,124	1,073,839	179,285	16.7%
Deductions				
Retirement and other benefits	831,658	804,315	27,343	3.4%
Refunds of contributions	33,305	22,373	10,932	48.9%
General and administrative	29,207	28,534	673	2.4%
Other	8,784	5,157	3,627	70.3%
Total deductions	902,954	860,379	42,575	4.9%
Net increase in net assets	$ 350,170	213,460	136,710	64.0%

- The System assets exceeded liabilities by $2,607 million (net assets) for the fiscal year reported compared to the prior year, for which assets exceeded liabilities by $2,891 million.
- Based on the last actuarial valuation at June 30, 2007, the System funding ratio of the actuarial accrued liability is 17.2%.
- Loans to plan members amounted to $927 million at June 30, 2008 compared to $577 million at June 30, 2007.

The basic financial statement of the System for the fiscal year ended June 30, 2008 presents a decrease in net assets held in trust for pension benefits of approximately $284 million. This was mostly the result of an increase in cash and short-term investments of $1,368 million and increase in the fair value of investments and bond issue cost of $753 million. Both increases were based on the proceeds received as a result of various bonds issuances during the current year. There was also a net increase in loans and interest receivable from plan members of $350 million as the loan upper limits were raised from $5 thousand to $15 thousand for the personal loans and from $5 thousand to $10 thousand for the cultural trip loans. The increase in accounts receivable of $198 million was mainly due to amounts receivable from various employers due to the implementation of early retirement programs as described in Note 2 to the basic financial statements. Finally, the net increase in total liabilities of $2,953 million was principally due to the issuance of senior pension funding bonds in the amount of $2,942 million.

The System's net assets held in trust for pension benefits include employer and employee contributions as well as investment income. For fiscal year 2008, the employer and plan member contributions increased by approximately $86 million, from $782 million during fiscal year 2007 to $868 million during fiscal 2008, which includes income received from early retirement contributions in the amount of $69 and $142 million, respectively. The System recognized a net depreciation in the fair value of investments of $213 million and a net appreciation of $364 million for fiscal year 2008 and 2007, respectively.

Also the financial statement of the System for the fiscal year ended June 30, 2007 presents an increase in net assets as compared to the fiscal year ended June 30, 2006 of approximately $350 million. This was mostly the result of an increase in the fair value of investments of $317 million, increase in loans portfolio of $49 million, increase in cash and short-term investments of $255 million, increase in accounts receivable of $29 million and an increase in liabilities of $195 million, offset by the sale of the PRTA Holdings Preferred Stock investment of $495 million..

For fiscal year 2007, the employer and employee contributions increased by approximately $41 million, from $741 during fiscal year 2006 to $782 million during fiscal year 2007, which includes income received from early retirement in the amount of $69 and $15 million, respectively. The System recognized a net appreciation in the fair value of investments of $364 and $189 million for fiscal year 2007 and 2006, respectively.

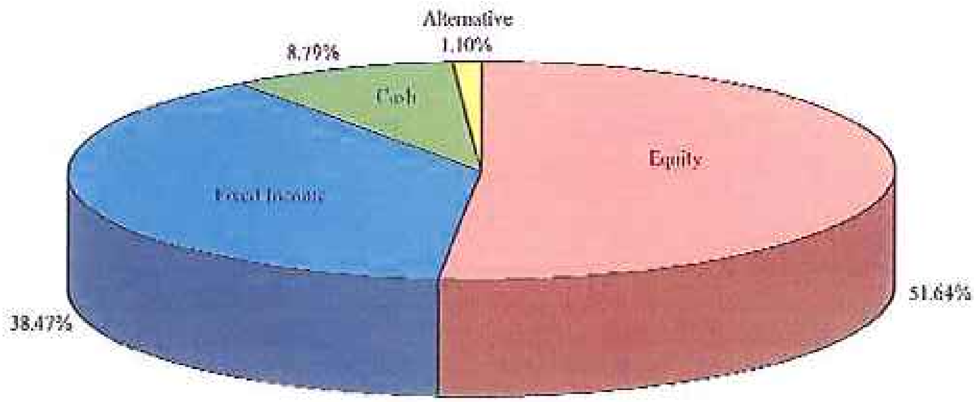
Issuance of Bonds

The Board of Trustees approved the issuance of bonds to increase the funds currently available to pay pension benefits to certain of its beneficiaries. The total amount of the bond payable amounted to $2,942 million as of June 30, 2008.

Financial Analysis of the System

Facing an unstable market, in 2001 management identified the need for a portfolio restructuring. The System's portfolio moved from a very aggressive allocation of 75% toward equities to a controlled allocation of a maximum of 65% in equities. To enhance the expected annual return, the strategy concentrated in the allocation of a 28% of the total portfolio to the plan members' loans program with only 7% assigned to a core fixed income strategy. Those loans actually provide a higher return and lower risk in comparison to bonds, mostly because the System has the ability to rise the interest rates charged, the repayment comes from payroll deductions and the loans are guaranteed by plan members' accumulated contributions.

The asset mix of the fund generated a fixed income of approximately 10.59% and 10.32% for the year ended June 30, 2008 and 2007, respectively. The new asset allocation is the one that fulfills the System's needs and since it is more adequately balanced, it provides protection in case of a market downturn. The asset allocation for Equity is 51.64%, Fixed Income 38.47%, Cash 8.79% and Alternative Investments 1.10% as shown in the following chart:



Other Investments and Transactions

At June 30, 2008 and 2007, the System held approximately $927 and $577 million, respectively, in loans and interest receivable from plan members which represent 26% and 23%, respectively of the total investment portfolio. As of June 30, 2008 these loans consist of $116 million in mortgage loans, $782 million in personal loans, $37 million in cultural loans, $18 million in accrued interest receivable, and $27 million in allowance for adjustment and losses in realization. For the fiscal year ended June 30, 2007 these loans consist of $108 million in mortgage loans, $440 million in personal loans, $27 million in cultural loans, $16 million in accrued interests receivable, and $14 million in allowance for adjustment and losses in realization.

As of June 30, 2008 and 2007, the System has participation in Limited Partnership Investments for an approximate value of $42.3 and $47.8 million, respectively which represents 2% of the investment portfolio for each year.

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 used the borrowed security to cover short sales and failed trades. The cash collateral received from the brokers is invested in order to earn interest. For financial statements purposes, the amount of securities as of June 30, 2008 that was involved in the securities lending transactions was presented with the required disclosures, according to the current government accounting pronouncements. For the fiscal year 2008 and 2007, income from the custodian securities lending activity amounted to approximately $349,000 and $144,000, respectively.

Funding Status

The System was created by Act 447 of May 15, 1951, and since its inception it lacked proper planning and the levels of contributions were relatively low (and still remains low in comparison to the level of benefits). Besides, all retirement systems in place before 1951 were merged into the System, which then had to absorb all their unfunded liabilities. Afterwards, in 1973, the benefits structure was enhanced however, without the appropriate increase in the contribution levels. As more people joined the government labor force and then retired under the new enhanced benefit structure, the gap between the assets available to pay benefits and the actuarial obligation started its steeping course.

In 1990, in an effort to withstand the increase in the unfunded liability, the benefit structure was modified, basically to decrease the benefits and to postpone the retirement age from 55 to 65 in order to provide a structure more affordable. Also, the level of contributions was raised and the Act 447 was amended to provide that any increase in benefits will require actuarial studies and must state the financing source.

Ten years later, the steeping course of the unfunded liability required further action. As a result, the defined benefit plan was closed to new plan members joining the System on or after January 1, 2000. To provide a retirement alternative, the Commonwealth created a defined contribution plan funded only by employee's contributions. The new plan is known as the Retirement Savings Account Program (System 2000). Under System 2000, the employers' contributions continue at the same level as the defined benefit plan, but are being used to fund the accrued actuarial liability of the defined benefit plan that was closed. Also under System 2000, the disability benefits are to be provided through a private insurance long term disability program to those plan members that voluntarily elect to enroll in such program. On September 15, 2004, Act 296 was enacted to amend the dispositions on Act 305 regarding disbursements and the disability benefits program. After the amendment, any plan member that leaves public service may request that the balance in his/her savings account be transferred to a qualified retirement vehicle such as an individual retirement account or a qualified retirement plan in Puerto Rico. Act 296 also provides flexibility on the establishment of the disability program; but still, the employees must finance the program.

Presently, the Employee's System consists of three different benefit structures, which are administrated according to their specifications in the Act. For all plan members in the defined benefit plan, the level of contributions established by law is 8.275% of the employee salary. Under System 2000, employee's contributions range from 8.275% to 10% of the salary, as specified by the employee. Under all structures, employers' contributions are stated by law at 9.275% of the employee salary.

On the other hand, the System's actuarial obligation continues its increasing trend as a result of the continuous increase in the pensioners' population and its longevity and the fact that incoming pensioners have higher salaries and consequently, they are entitled to even higher annuities. Since 1990, there have been no other increases in the employers or employees contributions to cope with those factors and therefore, the level of contributions remains low in comparison to the level of pension benefits.

Market events plus the continuous increase in the actuarial liability had a negative effect over the System's actuarial unfunded liability. Based on the last actuarial valuation at June 30, 2007, the System's funding ratio is 17.2%, the actuarial obligation is $16,769 million, total actuarial value of plan assets amounted to $2,891 million and the unfunded actuarial accrued liability is $13,878 million.

The bottom line is that the capital markets by themselves cannot solve the System's funding problem. Somehow capital contributions must be increased and/or the liabilities must be reduced. Management has come up with recommendations to improve the System's financial health. Among those stand out the possibility to increase in employee's and employer's contribution rates.

On February 27, 2007, the System's administration and the Government Development Bank for Puerto Rico, acting as the System's fiscal agent, presented to the Board of Trustees, a financial transaction for the issuance of pension funding bonds. The System has authorized the issuance of one or more series of bonds (the Bonds) in order to increase the funds currently available to pay pension benefits to certain of its beneficiaries. The System will pledge future Employer Contributions to the payment of the Bonds, invest the proceeds of the Bonds and use these investments and the earnings thereon to provide such pension benefits to its beneficiaries. On January 31, 2008, the System issued the first series of Bonds, which consisted of approximately $1,589 million aggregate principal amount of Senior Pension Funding Bonds, Series A (the Series A Bonds). On June 2, 2008, the System issued the second of such series of Bonds, which consisted of approximately $1,059 million aggregate principal amount of Senior Pension Funding Bonds, Series B (the Series B Bonds). Finally, on June 30, 2008, the System issued the third and final of such series of Bonds, which consisted of approximately $300 million aggregate principal amount of Senior Pension Funding Bonds, Series C (the Series C Bonds).

Increase in Benefits for Retirees Established for 2008 and 2007

For the years 2008 and 2007, the Government of Puerto Rico granted several benefits to the System's retirees to help them cope with the increase in the cost of living, which consisted of:

- Increase in the minimum monthly pension benefit from $300 to $400, effective July 1, 2007.
- Increases of 3% in all pensions effective on July 1, 2007, but computed retroactively to January 1, 2007.
- Increase from $500 to $550 and to $600 in the Christmas Bonus for the retiree, effective in December 2006 and 2007 respectively.

Following the requirements established by Act 1 of February 16, 1990, these benefits are financed through legislative appropriations from the Commonwealth with respect to Central Government retirees and financed by the municipalities and public corporations with respect to their corresponding retirees. There were no additional benefits for fiscal year 2008.

Capital Assets

The System's investment in capital assets as of June 30, 2008 and 2007 amounted to approximately $9.8 and $8.5 million, respectively, net of accumulated depreciation. Capital assets include land, building, construction in progress, equipment, furniture. The building consists in the facilities in which the System has its operations.

During the year ended June 30, 2007 the System invested approximately $1.4 million for construction and remodeling the building facilities. This construction activity was financed through the operational budget of the System.

Requests for Information

The financial report is designed to provide a general overview of the System's finances, 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 Commonwealth of Puerto Rico Government Employees and Judiciary Retirement Systems Administration, 437 Ponce de León Avenue, Hato Rey, Puerto Rico 00918.

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Employee's Retirement System of the Government of the Commonwealth of Puerto Rico

(A Pension Trust Fund of the Commonwealth of Puerto Rico)

Statements of Plan Net Assets
June 30, 2008 and 2007

Assets		2008	2007
		(In thousands)	
Cash and short-term investments:			
Deposits at commercial banks	$	84,439	41,365
Deposits with Treasury Department of the Commonwealth		23,099	
Deposits with Government Development Bank of Puerto Rico:			
Unrestricted		54,438	266,633
Restricted		1,320,224	2,310
Deposits with Bank of New York		194,819	—
Total cash and short-term investments		1,677,019	310,308
Investments:			
Bonds and notes		538,787	149,639
Stocks		2,026,717	1,693,144
Private equity investments		42,294	47,784
Total investments		2,607,798	1,890,567
Total cash and investments		4,284,817	2,200,875
Bond issue costs		35,462	
Loans and interest receivable from plan members, net of allowance for adjustments and losses in realization		926,831	577,314
Accounts receivable:			
Employers		246,167	117,420
Commonwealth of Puerto Rico		854	4,615
The Commonwealth of Puerto Rico Judiciary Retirement System		16,714	5,113
Investment sales		9,800	2,470
Accrued interest		3,278	3,119
Other		58,210	4,527
Total accounts receivable		335,023	137,264
Capital assets		9,840	8,476
Other assets		8,293	7,371
Total assets	$	5,600,266	2,931,300

See accompanying notes to basic financial statements. (Continued)

Employee's Retirement System of the Government of the Commonwealth of Puerto Rico

(A Pension Trust Fund of the Commonwealth of Puerto Rico)

Statements of Plan Net Assets

June 30, 2008 and 2007

		2008	2007
		(in thousands)	
Liabilities			
Deposits with Treasury Department of the Commonwealth	$	—	1,566
Funds of mortgage loans and guarantee insurance reserve for loans to plan members		3,863	8,914
Investment purchases		12,696	2,172
Accounts payable and accrued liabilities		9,310	10,125
Bonds payable		2,942,184	—
Bonds interest payable		12,181	
Other liabilities		12,946	17,022
Total liabilities		2,993,180	39,799
Net assets held in trust for pension benefits	$	2,607,086	2,891,501

(Concluded)

See accompanying notes to basic financial statements.

Employee's Retirement System of the Government of the Commonwealth of Puerto Rico

(A Pension Trust Fund of the Commonwealth of Puerto Rico)

Statements of Changes in Plan Net Assets

Years Ended June 30, 2008 and 2007

	2008	2007
	(in thousands)	
Additions:		
Contributions:		
Employers	$ 380,833	374,394
Participating employees	345,614	338,791
Early retirement	141,724	69,097
Other special laws	16,789	17,000
	884,960	799,282
Investment (loss) income:		
Net (depreciation) appreciation of investments	(213,356)	364,185
Dividend income	10,347	14,494
Interest income	115,763	68,231
	(87,246)	446,910
Less: Investment expense	6,664	12,940
Net Investment (loss) income	(93,910)	433,970
Insurance premiums on loans to plan members	6,197	2,441
Other Income	24,810	17,431
Total additions	822,057	1,253,124
Deductions:		
Annuities	932,701	793,883
Benefits under other special laws	16,789	17,000
Death benefits	18,712	13,872
Refunds of contributions:		
Employers	3,020	5,296
Participating employees	37,346	28,009
Insurance claims on loans to plan members	1,092	2,118
Interests on bonds payable	46,996	—
General and administrative	31,610	29,207
Other expenses	18,206	13,569
Total deductions	1,106,472	902,954
Net (decrease) increase	(284,415)	350,170
Net assets held in trust for pension benefits:		
Beginning of year	2,891,501	2,541,331
End of year	$ 2,607,086	2,891,501

See accompanying notes to basic financial statements.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Employee's Retirement System of the Government of the Commonwealth of Puerto Rico (the System) was created by Act No. 447 on May 15, 1951. The System began operations on January 1, 1952, at which date, contributions by employers and participating employees commenced. The System is a pension trust fund of the Commonwealth of Puerto Rico (the Commonwealth). 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 on the Board of Trustees, composed of two participating employees and one pensioner, who are appointed by the Governor of the Commonwealth. Also, there are four Commonwealth government agency representatives which are the Secretary of the Treasury, the President of the Government Development Bank for Puerto Rico, the Executive Director of the Commonwealth's Human Resources Office (ORHELA), and the Municipal Affairs Commissioner.

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

Basis of Presentation

The accompanying basic financial statements have been prepared on the accrual basis of accounting in accordance with the provisions of Governmental Accounting Standards Board No. 25 (GASB 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 employees and employer's contributions are recognized as additions in the period in which the employee services are rendered. Annuities and refunds are recognized as deductions when due and payable in accordance with the terms of the plan.

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

During the year ended June 30, 2008 the System adopted the provision of the Statement of Governmental Accounting Standards Board No. 45 (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. Also, the System adopted the provision of the Statement of Governmental Accounting Standards Board No. 48 (GASB No. 48), *Sales and Pledges of Receivable and Future Revenues and Intra-Equity Transfers of Assets and Future Revenues*, the objective of which is to establish uniform criteria for financial reporting by state and local governmental entities on whether to report these types of transactions as a sale or as a collateralized borrowings resulting in a liability.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted (GAAP) in the United States of America 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 Short-Term Investments

Cash and short-term investments consist of overnight deposits guaranteed by the custodian bank, and certificates of deposits in Government Development Bank for Puerto Rico (GDB) and a commercial bank. Restricted cash deposited with GDB consists of payments received from mortgage loan holders administered by the mortgage services in the servicing of loans (escrow accounts); expired checks not claimed by the plan members, restricted for repayments, and proceeds of the issuance of the Series A and B Bonds restricted for investment purchases.

Investments

Investments are carried at fair value, except for certain mortgage notes, which do not have readily determinable fair values. 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 data.

The alternative investments have as assets, securities whose values have been estimated by the corresponding general partner or fund manager. Market values are not available. The estimated values may differ significantly from the amounts that could be obtained from dispositions or formal active markets if were available.

Mortgage notes acquired from third parties are held to maturity and are not readily marketable. Consequently, these are carried at amortized cost.

Loans to Plan Members

Mortgage, personal and cultural trip loans to plan members are stated at their outstanding principal balance. Maximum amounts that may be granted to plan members for mortgage, personal and cultural trip loans are $100,000, $15,000 and $10,000, respectively.

The System services mortgage loans with aggregate principal balances of approximately $10.4 and $11.9 million at June 30, 2008 and 2007, respectively, related to certain mortgages loans sold to Federal National Mortgage Association (FNMA) for a fee of .25%. The income for 2008 and 2007 amounted to $21,672 and $30,622 respectively, and is recognized as interest income in the accompanying statement of changes in plan net assets.

In addition, as of June 30, 2008 and 2007, the System repurchased approximately $56,126 and $51,090, respectively, in mortgage loans that were sold during fiscal year 1998 to FNMA. The sale contract stipulates that the System must repurchase any loans with payments in arrears over 90 days.

Insurance Premiums, Claims and Reserve for Life Insurance on Loans to Plan Members

Premiums collected and benefits claimed are recorded as additions and deductions, respectively. The guarantee insurance reserve for life insurance on loans to plan members is revised each year and adjusted accordingly based on the annual higher claim amount of a five year period increased by a management determined percentage.

Capital Assets

Capital assets include building, furniture and equipment, capital leases and construction 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 equal to or in excess of four 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 construction in progress. The estimated useful lives of capital assets are as follows:

	Years
Building	50
Buildings improvements	10
Equipment, furniture, fixtures, and vehicles	5-10

During the year ended June 30, 2007, the System adopted the provisions of Statement on Governmental Accounting Standards (GASB) No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes that, generally, an asset is considered impaired when its service utility has declined significantly and unexpectedly, and the event or change in circumstances is outside the normal life cycle of the asset. Management is then required to determine whether impairment of an asset has occurred. Impaired capital assets that will no longer be used by the government should be reported at lower of carrying value or fair value. Impairment losses on capital assets that will continue to be used by the government should be measured using the method that best reflects the diminished service utility of the capital asset. Impairment of capital assets with physical damage generally should be measured using a restoration cost approach, an approach that use the estimated cost to restore the capital asset to identify the portion of the historical cost of the capital asset that should be written off. Management assessed and determined that no impairment adjustment was deemed necessary.

Future Adoption of Accounting Pronouncements

The GASB has issued the following accounting standards that have effective dates after June 30, 2008:

- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which is effective for fiscal years beginning after December 15, 2007
- GASB Statement No. 51, *Accounting and Reporting for Intangible Assets*, which is effective for fiscal years beginning after June 15, 2009.

- GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments,* which is effective for fiscal years beginning after June 15, 2008.
- GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments,* which is effective for fiscal years beginning after June 15, 2009.

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

2. PLAN DESCRIPTION

The System is a cost-sharing multi-employer defined benefit plan sponsored by the Commonwealth, public corporations and municipalities of Puerto Rico. Substantially all full-time employees of the Commonwealth and its Instrumentalities (Commonwealth Agencies, Municipalities and Public Corporations, including the System) are covered by the System under the terms of the Act No. 447 of 1951. All regular, appointed and temporary employees of the Commonwealth at the date of employment become plan members of the System. The System is optional for Commonwealth officers appointed by the Governor and Head of Agencies.

At June 30, 2008 and 2007, membership consisted of the following:

	2008	2007
Retirees and beneficiaries currently receiving benefits	102,614	99,851
Current participating employees	103,230	107,256
Total membership	205,844	207,107

The plan members of the System, other than those joining the System after March 31, 1990, are eligible for the benefits described below:

Retirement Annuity

Plan members are eligible for a retirement annuity upon reaching the following age:

Policemen and Firefighter:

50 with 25 years of credited service
58 with 10 years of credited service

Other Employees:

55 with 25 years of credited service
58 with 10 years of credited service

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.

Merit Annuity

Plan members are eligible for merit annuity with a minimum of 30 years or more of credited service. The annuity for which the plan member is eligible is limited to a minimum of 65% and a maximum of 75% of the average compensation.

Deferred Retirement Annuity

A participating employee who ceases to be an employee of the Commonwealth after having accumulated a minimum of ten years of credited service qualifies for retirement benefits provided his/her contributions to the System are left within the System until attainment of 58 years of age.

Coordinated Plan

On the Coordinated Plan the participating employee contributes a 5.775% of the monthly salary for the first $550 and 8.275% for the excess over $550. By the time the employee reaches 65 years old and begins to receive social security benefits, the pension benefits are reduced by the following:

- $165 per month if retired with 55 years of age and 30 years of credited service
- $110 per month if retired with less than 55 years of age and 30 years of credited service.
- All other between $82 and $100 per month
- Disability annuities under the coordinated plan are also adjusted at age 65 and in some cases can be reduced over $165 per month

Non-Coordinated Plan

On the Non-Coordinated plan the participating employee contributes an 8.275% of the monthly salary and does not have any change on the pension benefits upon receiving social security benefits.

Reversionary Annuity

A plan member, upon retirement, could elect to receive a reduced retirement annuity giving one or more benefit payments to his/her dependents. The life annuity payments would start after the death of the retiree for an amount not less than $240 yearly or greater than the annuity payments being received by the retiree.

Occupational Disability Annuity

A participating employee, who as a direct result of the performance of his/her occupation is totally and permanently disabled is eligible for a disability annuity of 50% of the compensation received at the time of the disability.

Non-occupational Disability Annuity

A participating employee totally and permanently disabled for causes not related to his/her occupation, and with no less than 10 years of credited service, is eligible for an annuity of 1.5% of the average compensation of the first 20 years of credited services increased by 2% for every additional year of credited service in excess of 20 years.

Death Benefits

Occupational:

- Surviving spouse - annuity equal to 50% of the participating employee's salary at the date of the death.
- Children - $10 per month for each child, minor or student, up to a maximum benefit per family of 100% of the participating employee's salary at the date of the death. If no spouse survives, or dies while receiving the annuity payments, each child, age 18 or under, is eligible to receive an annuity of $20 per month up to the attainment of 18 years of age or the completion of his/her studies.

Non-occupational:

- Beneficiary - the contributions and interest accumulated as of the date of the death plus an amount equal to the annual compensation at the time of the death.

Post-retirement:

- Beneficiary with surviving spouse age 60 or over and child, age 18 or under, up to 50% (60%, if not covered under Title II of the Social Security Act) of retiree's pension or 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 $750.

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 contributions to the System plus any interest earned thereon.

Amendments to Benefits Structure for Plan Members Who Joined the System on or After April 1, 1990:

Act No. 1 of February 16, 1990 made certain amendments applicable to new participating employees joining the System effective April 1, 1990. These changes consist principally of an increase in the retirement age from 55 to 65, a decrease in the benefit percentage of the average compensation in the occupational disability and occupational death benefits annuities from 50% to 40%, and the elimination of the Merit Annuity for participating employees (except policemen and firemen) who have completed 30 years of creditable service.

Cost of Living Adjustment for Pension Benefits

Act No. 10 of May 21, 1992 provided for increases of 3% every three years, of the pensions paid by the System to those plan members with three or more years of retirement. The Act requires further legislation to grant this increase every three years, subject to the presentation of actuarial studies regarding its costs and the source of financing. Since fiscal year 1992 to 2007 there have been other acts addressing the cost of living adjustment (COLA) as Act No. 207 of August 13, 1995, Act No. 221 of August 9, 1998, Act No. 40 of June 13, 2001, Act No. 157 of June 27, 2003, and Act No. 35 of April 24, 2007.

On April 24, 2007 the Governor signed the Act No. 35 to provide for an increase of 3% of the pension paid by the System to those plan members which monthly pension is less than $1,250, effective on July 1, 2008.

To protect the financial health of the System, the increases granted pursuant to the above laws are being financed through appropriations from the Commonwealth and contributions from municipalities and public corporations.

Other Benefits Granted

For fiscal years 2003 to 2007 the Commonwealth of Puerto Rico granted additional benefits to the System's retirees. As of June 30, 2008 these increases are being funded through special appropriations from the Commonwealth for the amount corresponding to the Commonwealth agencies and by contributions from the public corporations and municipalities.

Early Retirement Programs

During fiscal year 2001 the Commonwealth granted three additional retirement programs through Act No. 370, dated December 31st, 1999, Act No. 119 dated July 13th, 2000, and Act No. 174 dated August 12th, 2000. These acts applied to employees of the Municipality of San Juan, employees of the State Insurance Fund Corporation and the employees within the three branches of the of the Commonwealth of Puerto Rico, respectively. These early retirement programs ended in fiscal year 2006, time in which the total employees became fully beneficiaries of the System. To avoid any economic impact on the System, the employers were responsible for contributing to the System the amounts to cover the benefit payments and the employer and employee contributions with respect to the plan members covered until reaching the normal retirement age.

During fiscal year 2007 the Commonwealth issued the Act No. 273, dated December 21, 2006, to implement an early retirement program for the employees of the Puerto Rico Tourism Company (Tourism). Also the Municipality of San Juan issued the Resolution No. 41, dated November 17, 2006, which provided also, an early retirement program for the municipalities' employees. The actuarial cost of the implementation of the early retirement program of Tourism and the Municipality of San Juan would be paid by each entity prior to the implementation of the program.

As of June 30, 2008, there is $2.8 million as receivable balance from PRIDCO's early retirement program from the year 2005.

During fiscal year 2008 the Commonwealth issued the Act No. 70, dated July 13, 2007, to implement an early retirement program for the employees of the Puerto Rico Recreation Development. The Municipality of San Juan based on the Resolution No. 41, signed an agreement dated May 5, 2008, which provided an early retirement program for the municipalities' employees. Also, the Government Development Bank of Puerto Rico (GDB), including its subsidiaries, the Puerto Rico Infrastructure

Financing Authority and the Puerto Rico Housing Financing Authority, implemented an early retirement program for its employee's under the Act No. 188, dated December 12, 2007. The Recreation Development of PR already made two payments and would reimburse the remaining balance on annuities and other benefits paid by the System in three installments on each July 31 starting on 2009 through 2011. The actuarial cost of the implementation of the early retirement program of the Municipality of San Juan would be paid by the Municipality prior to the implementation of the program during a five year period. In addition, GDB would reimburse the annuities and other benefits paid by the System immediately upon invoiced.

Amendment to Act No. 447 Effective January 1, 2000 to create a Defined Contribution Plan:

On September 24, 1999, Law 305, an amendment to Act No. 447 of May 15, 1951, which created the System, was enacted to establish a defined contribution plan, known as System 2000 to cover employees joining the System on or after January 1, 2000.

Employees participating in the current system as of December 31, 1999, were allowed to elect either to stay in the defined benefit plan or transfer to System 2000. People joining the public sector on or after January 1, 2000, are only allowed to become members of System 2000. System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of plan assets, which will be invested by the System, together with those of the current defined benefit plan. The Commonwealth will not guarantee benefits at retirement age.

The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) will be invested as instructed by the employee in an account which either: (1) earns a fixed rate based on the two-year Constant Maturity Treasury Notes or, (2) earns a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (3) earns a combination of both alternatives. Plan members receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability benefits are not granted under System 2000 rather should be provided to those plan members that voluntarily elect to participate in a private insurance long-term disability program. The employers' contributions (9.275% of the employee's salary) with respect to employees under System 2000 will continue but will be used to fund the defined benefit plan. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after January 1, 2000.

At June 30, 2008 and 2007, System 2000 membership within the System's total membership consisted of the following:

	2008	2007
Current participating employees	69,440	69,581

3. FUNDING POLICY

The contribution requirement to the System is established by law and is not actuarially determined. Required employers' contributions consist of 9.275% of applicable payroll in the cases of municipalities, central government and public corporations. Required employee contribution consists of 5.775% of the first $550 of the monthly salary with the excess at 8.275% for the coordinated plan and 8.275% of the total monthly salary for participating employee's contributions for the non-coordinated plan. Commonwealth contributions should ultimately cover any deficiency between the participating employers' and employee's contributions and the System's pension benefit obligations and general and administrative deductions.

The System received from the Commonwealth $134.9 and $117.9 million in 2008 and 2007, respectively, to cover special laws. The additional contributions are accounted as reduction of benefits payments, except for approximately $16.8 million and $17 million in 2008 and 2007, respectively, which are received under the provisions of Law No. 127 of 1958 that covers the occupational disability of firefighter, policemen and other personnel disabled during high risk circumstances.

The System, besides the contributions received from plan members and employers, also receives legislative appropriations from special laws to cover additional benefits and the increase in benefits to retired employees. In the past years there have been laws that granted additional benefits; such as, summer and Christmas bonuses, medical plan contributions, and various increases in cost of living allowances (3%), among others. Most of the funds used to cover these benefits are budgeted by the Commonwealth through legislative appropriations.

Actuarial Information

Calculations of the present value of benefits under the System were made by consulting actuaries as of June 30, 2007, using the projected unit credit actuarial cost method, with straight proration based on service to decrement. The significant assumptions underlying the actuarial computations include (a) assumed rate of return on investments of 7.5%, (b) assumed projected salary increases of 3%, (no increases in 2009-10 and 2010-11) (c) assumed projected payroll growth of 2.5%, (d) assumed inflation rate of 2.5%, (e) assumed cost of living adjustments of .99% annual COLA to approximate 3% triennial increases (COLA is only applied to members covered under Act 127 who become disabled or die in the line of duty), and (e) assumed mortality as follows:

- Pre-Retirement Mortality – RP-2000 Employee Mortality Rates for males and females, projected on a generational basis using Scale AA.
- Post-Retirement Healthy Mortality gender specific rates based on a study of System mortality experience during the period from July 1, 2003 to June 30, 2007 projected on a generational basis using Scale AA.
- Post-Retirement Disabled Mortality – RP-2000 Disabled Annuitant Mortality Rates, without projection.

As of June 30, 2007 the actuarial accrued liability and the unfunded actuarial accrued liability were approximately $16,769 and $13,878 million, respectively.

The Legislature of the Commonwealth enacted Act No. 1 of February 16, 1990 to improve the solvency of the System for the next 50 years. Among other provisions, the legislation increased the level of contributions to the System, reduced the benefits for new participating employees and increased the retirement age from 55 to 65 years. Further, through Act 305 of September 24, 1999, the defined benefit plan was closed and a defined contribution plan was created (as described in Note 2) for all plan members who started working for the Commonwealth effective January 1, 2000 or after.

As an employer, the System has contributed $1,578,000 and $1,525,000 which represented its contractually required contribution for the years ended June 30, 2008 and 2007, respectively.

4. FUNDED STATUS AND FUNDING PROGRESS

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

Actuarial Valuation Date		Actuarial Value of Plan Assets	Actuarial Accrued Liability (AAL)	Unfunded Actuarial Accrued Liability (UAAL)	Funded Ratio	Annual Salary	UAAL as a Percentage of Annual Salary
June 30, 2007	$	2,891,501	16,769,512	13,878,011	17.2%	4,246,409	326.8%

The schedule of funding progress (see page 48), presented as required supplementary information (RSI) following the notes to the financial statements, present multilayer trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the AALs for benefits.

Additional information as of the latest actuarial valuation is as follows:

Valuation Date	June 30, 2007
Actuarial Cost Method	Projected unit credit actuarial cost method; with straight proration based on service to decrement
Amortization Method	30 years closed, level dollar
Remaining Amortization Period	30 years
Asset Valuation Method	Market value of assets
Actuarial Assumptions:	
Investment rate of return	7.50%
Projected salary increases	3.00% (no increases in 2009-10 and 2010-11)
Projected payroll growth	2.5%
Inflation	2.5%
Mortality rate	Pre-Retirement Mortality - RP-2000 Employee Mortality Rates, for males and females, projected on a generational basis using Scale AA.
	Post-Retirement Healthy Mortality - gender specific rates based on a study of System mortality experience during the period from July 1, 2003 to June 30, 2007, projected on a generational basis using Scale AA.
	Post-Retirement Disabled Mortality - RP-2000 Disabled Annuitant Mortality Rates, without projection.

Cost of living adjustment	.99% annual COLA to approximate 3% triennial increases (COLA is only applied to members covered under Act 127 who become disabled or die in the line of duty).

5. CASH AND INVESTMENTS

Custodial Credit Risk Related to Deposits

As of June 30, 2008 and 2007, the System's custodial credit risk was approximately $1.4 billion and $275.4 million, respectively, related to the bank balance of cash and short-term investments deposited in GDB. These deposits are exempt from the collateral requirement established by the Commonwealth.

Custodial credit risk is the risk that, in an event of a bank failure, the System's deposits might not be recovered. The Commonwealth requires that public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. Deposits at GDB for Puerto Rico are uninsured and uncollateralized, as these entities, which are component units of the Commonwealth, are exempt from compliance with the collateralization requirement.

Investments

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

	2008	2007
	(in thousands)	
US Government and agencies' securities	$ 288,840	96,879
US Corporate bonds	249,947	52,760
Total bonds	538,787	149,639
US Corporate stocks	1,436,291	1,137,987
Non-US Corporate stocks	590,426	555,157
Total stocks	2,026,717	1,693,144
Private equity investments	42,294	47,784
Total investments	$ 2,607,798	1,890,567

The System's investments are exposed to custodial credit risk, credit risk, concentration of credit risk, foreign currency risk and interest rate risk. Following is a description of these risks as of June 30, 2008.

Custodial Credit Risk Related to Investments

Custodial credit risk for investments is the risk that, in the event of 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 and 2007 securities investments were registered in the name of the System and were held in the possession of the System's custodian banks, State Street Bank and Trust, Citibank N.A., and Morgan Stanley.

Credit Risk

All fixed income securities at the time of purchase must be of investment grade quality. All issuances 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 Investor Service credit ratings. The following schedule presents the bonds Moody's ratings as of June 30, 2008 and 2007, respectively (in thousands):

		Fair Value	
Moody's Rating	Investment Type	2008	2007
AAA	US Government and Agencies Securities	$ 288,840	96,879
AAA	Corporate Bonds	62,937	990
AA1	Corporate Bonds	2,564	2,344
AA2	Corporate Bonds	20,985	—
AA3	Corporate Bonds	21,162	12,522
A1	Corporate Bonds	30,897	4,414
A2	Corporate Bonds	37,172	5,229
A3	Corporate Bonds	29,218	4,449
BAA1	Corporate Bonds	10,427	2,653
BAA2	Corporate Bonds	15,835	7,279
BAA3	Corporate Bonds	15,837	8,886
CAA1	Corporate Bonds	2,913	3,994
	Total bonds	$ 538,787	149,639

Concentration of Credit Risk

No investment in marketable securities in any organization represents 5% or more of the System's net assets held in trust for pension benefits.

Interest Rate Risk

In accordance with its investment policy, the System manages its exposure to declines in fair values by structuring the investment portfolio so that securities mature to meet cash requirement for benefit payments, thereby avoiding the need to sell securities on the open market prior to maturity. Investments in equity securities are not subject to the maximum maturity policy since they do not carry a maturity date. 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 following schedule summarizes the investments on debt securities of the System at June 30, 2008 (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	(2008-2038)	$ 288,840	5,951	35,682	27,796	219,411
Corporate bonds	(2009-2044)	249,947	7,451	84,876	65,008	92,612
Total bonds		$ 538,787	13,402	120,558	92,804	312,023

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

Maturity	Maximum Maturity
Less than one year	2%
One to five years	22%
More than five to ten years	17%
More than ten years	58%

Foreign Currency Risk

As of June 30, 2008 and 2007, the System owned approximately $519 and $555 million, respectively, in an international equity commingled fund under the custody of Morgan Stanley investment bank, which represented approximately 96.8% and 74.11%, respectively, of the total commingled fund. Also, for the year ended June 30, 2008 the System owned approximately $71 million in an international equity commingle fund under the custody of Invesco International Equity Trust, which represented approximately 8.67% of the total commingle fund. As of June 30, 2008 and 2007 these two pooled trusts had an asset mix and country allocation as shown in the following schedules:

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Morgan Stanley: Assets Mix			2008 Percent	2007 Percent
Cash and Equivalents			8.68	1.51
Future Contracts			8.77	12.14
Equity Securities			82.55	86.35
Total			100.00	100.00
Country Allocation	**Currency**	**Currency Code**	**Portfolio %**	**Portfolio %**
Poland	Zlotych	PLN	0.68	0.61
Russia	Rubles	RUB	0.94	0.99
Eastern Europe			1.62	1.60
Austria	Euro	EUR	0.00	1.00
Belgium	Euro	EUR	0.46	0.55
Finland	Euro	EUR	1.09	0.95
France	Euro	EUR	8.69	9.39
Germany	Euro	EUR	7.10	11.61
Greece	Euro	EUR	0.56	0.24
Ireland	Euro	EUR	0.00	0.05
Netherlands	Euro	EUR	1.88	2.47
Italy	Euro	EUR	0.00	0.99
Portugal	Euro	EUR	0.16	0.16
Spain	Euro	EUR	2.79	2.02
Euro Europe			22.73	29.43
Brazil	Real	BRL	1.24	1.93
Colombia	Pesos	COP	0.00	0.05
Mexico	Pesos	MXN	0.21	1.05
Latin America			1.45	3.03
Cyprus	Pounds	CYP	0.00	0.04
Turkey	Lira	TRY	0.02	0.22
Middle East			0.02	0.26
Denmark	Kroner	DKK	0.44	0.41
Norway	Kroner	NOK	1.76	1.32
Sweeden	Krona	SEK	1.85	2.61
Switzerland	Francs	CHF	5.56	4.72
United Kingdom	Pounds	GBP	16.32	17.85
Non-Euro Europe			25.93	26.91
Australia	Dollars	AUD	4.80	3.81
China	Yuan Renminbi	CNY	0.46	1.80
Hong Kong	Dollars	HKD	2.58	1.26
Indonesia	Rupiahs	IDR	0.18	0.48
Japan	Yen	JPY	23.38	24.72
Malasya	Ringgits	MYR	0.08	0.08
New Zealand	Dollars	NZD	0.01	0.01
Philippines	Pesos	PHP	0.02	0.00
Singapore	Dollars	SGD	2.53	2.14
South Korea	Won	KRW	0.02	0.56
Taiwan	New Dollars	TWD	0.70	0.14
Pacific			34.76	35.00
Emu	Euro	EUR	4.51	0.60
Africa	Rand	ZAR	0.08	0.14
India	Rupees	INR	0.22	1.52
Other			4.81	2.26
Cash			8.68	1.51
Total			100.00	100.00

Invesco: Assets Mix	2008 Percent
Short Term Investments	2.13
Foreign Stock	97.87
Total	100.00

Country Allocation	Currency	Currency Code	Portfolio %
Canada	Dollars	CAD	1.24
North America			1.24
Finland	Euro	EUR	3.96
France	Euro	EUR	9.27
Germany	Euro	EUR	4.46
Netherlands	Euro	EUR	9.97
Italy	Euro	EUR	1.83
Spain	Euro	EUR	1.48
Euro Europe			30.97
Denmark	Kroner	DKK	1.30
Norway	Kroner	NOK	1.32
Sweeden	Krona	SEK	3.81
Switzerland	Francs	CHF	9.38
United Kingdom	Pounds	GBP	18.57
Non-Euro Europe			34.38
Hong Kong	Dollars	HKD	2.91
Japan	Yen	JPY	24.26
Pacific			27.17
Invesco Emerging Markets Equity Trust			6.24
Other Countries			6.24
Total			100.00

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Investments in Limited Partnerships

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

	Date of Commitment	Total Commitment	FY 08 Contributions	Contributions to Date at Cost	Estimated Value
Grupo Guayacán, Inc.					
Guayacán Fund of Funds, LP	Sept. 1996	$ 25,000	67	23,570	5,801
Guayacán Fund of Funds II, LP	Aug. 1999	25,000	127	23,538	13,382
Advent-Morro Equity Partner, Inc.					
Guayacán Private Equity Fund, LP	Jan. 1997	5,000	—	4,407	4,432
Guayacán Private Equity Fund II, LP	Apr. 2007	15,000	4,365	5,565	4,907
Venture Capital Fund, Inc.	Nov. 1995	800	—	800	638
GF Capital Management & Advisors, LLC					
GF Capital Private Equity Fund LP	Dec. 2006	25,000	1,532	4,657	2,932
Chase Capital Partners Private Equity Fund of Funds Corporate Investors II, LTD	Jul. 2000	20,000	395	18,364	10,202
Martineau Bay Resort, s. en c. (s.e.)	Jul. 1998	1,796	—	1,796	—
Total private equity investments		$ 117,596	6,486	82,697	42,294

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

	Date of Commitment	Total Commitment	FY 07 Contributions	Contributions to Date at Cost	Estimated Value
Grupo Guayacán, Inc.					
Guayacán Fund of Funds, LP	Sept. 1996	$ 25,000	224	23,503	8,735
Guayacán Fund of Funds II, LP	Aug. 1999	25,000	3,772	23,411	16,859
Advent-Morro Equity Partner, Inc.					
Guayacán Private Equity Fund, LP	Jan. 1997	5,000		4,407	5,153
Guayacán Private Equity Fund II, LP	Apr. 2007	15,000	1,200	1,200	1,129
Venture Capital Fund, Inc.	Nov. 1995	800	—	800	633
GF Capital Management & Advisors, LLC					
GF Capital Private Equity Fund LP	Dec. 2006	25,000	3,125	3,125	2,754
Chase Capital Partners Private Equity Fund of Funds Corporate Investors II, LTD	Jul. 2000	20,000	1,068	17,969	12,521
Martineau Bay Resort, s. en c. (s.c.)	Jul. 1998	1,796	—	1,796	
Total private equity investments		$ 117,596	9,389	76,211	47,784

The fair value of investments in limited partnerships as of June 30, 2008 and 2007 amounted to approximately $42.3 and $47.8 million, respectively, and is presented within investments in the statements 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. The distributions for these investments were as follows:

- During fiscal year 2008, $67 thousand were invested 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 $25 million. The Fund has commitments to invest in fifteen (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. Total contributions for fiscal year 2007 amounted to approximately $224 thousand.

- During fiscal year 2008, $127 thousand were invested 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 nineteen (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. Total contributions for fiscal year 2007 amounted to approximately $3.8 million.

- During fiscal years 2008 and 2007 there were no additional contributions to the Guayacán Private Equity Fund, L.P., 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 fiscal year 2008, approximately $4.4 million were invested to Guayacán Private Equity Fund II, L.P., a limited partnership organized in April 2007, pursuant to the laws of the State of Delaware, in which the System has a total commitment of $15 million. The Partnership intends to seek out, invest in, and add value to companies, which will be based or operating in Puerto Rico or in companies whose products or services are targeted at the U.S.-Hispanic market, with specific interest in those companies where Advent-Morro's Equity Partners, Inc. Puerto Rico contact, know-how and track record can be leveraged to enhance investment selection and post-investment value-add. Guayacán Private Equity Fund II, L.P will strive to have a balanced mix of portfolio investments primarily focusing on later stage opportunities such as: expansion financing, leveraged buyouts, management buyouts and recapitalizations. The Partnership may invest in de-novo companies that are being set up to enter established industries via market consolidation opportunities and/or internal growth. Total contributions for fiscal year 2007 amounted to approximately $1.2 million.

- During fiscal years 2008 and 2007 there were no additional contributions to Venture Capital Fund, Inc., a Puerto Rico corporation organized pursuant to Act No. 3 of October 6, 1987, as amended, known as the Puerto Rico Capital Investment Funds Act that is managed by Advent-Morro Equity Partners (Advent-Morro), in which the System has a total commitment of $800 thousand. Advent-Morro is a Puerto Rico based private equity firm. The Fund was created to make private equity investments in operating companies which are based, or are operating, or a combination of both in Puerto Rico. Since inception, the Fund has invested in 25 companies some of which it continues to provide capital for their expansion.

- During fiscal year 2008, $1.5 million were invested in GF Capital Private Equity Fund, L.P., a limited partnership organized under the laws of the State of Delaware, in which the System has a total commitment of $25 million. The purpose of the partnership is to make private equity investments in a variety of industries including media and entertainment, branded consumer products, and software for media and telecommunications applications. The Partnership initiatives are focused on companies capitalized at between $20 to $400 million with a representation of buy-outs, growth capital and recapitalizations. Total contributions for fiscal year 2007 amounted to approximately $3.1 million.

- During fiscal year 2008, $395 thousand were invested in Chase Capital Partners Private Equity Fund of Funds Corporate Investors II, LTD a limited partnership, organized by Chase as General Partner in which the System has a total commitment of $20 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 and direct investments. Total contributions for fiscal year 2007 amounted to approximately $1.1 million.

The investment in Martineau Bay represents an investment in a hotel resort that filed under Chapter 11 of the United States Bankruptcy Code.

Valuation Method of Limited Partnerships

- *Grupo Guayacan* – The fair value of the Partnership's investments in limited partnerships is determined by the general partners of the limited partnerships. The Fund evaluates and analyzes these valuations to assess their appropriateness for inclusion in the financial statements at fair value. The value of the Partnership's investments in limited partnerships will change from time to time based on prevailing market conditions and operating performance of each of the underlying entities. Because of the inherent uncertainty of valuations, the valuation estimates may differ from the values that would have been used had a ready market for securities existed and such differences could be material.

  The Partnership's policy is to present its investments at fair value. Fair value is determined as follows:

  1. For freely tradable (as defined below) securities, the fair value is determined by taking the last reported sales price of the security on the valuation date of the national securities exchange where it is primarily traded.

  2. For securities not traded on a national securities exchange, the fair value is determined by taking the last reported sales price on the valuation date on the NASDAQ National Market.

  3. For securities not traded on the NASDAQ National Market, the fair value is determined by the closing bid price (or average of bid prices) last quoted on the valuation date as reported by an established quotation service for over- the counter-securities.

4. All other securities are valued initially at cost, with subsequent adjustments to fair values, which reflect meaningful third- party transactions in the private market or fair value as determined by the General Partner, who may consult with the Investment Fund Manager. The determination of the fair value is made by and shall be based upon all relevant factors, including, without limitation, such of the following factors as may be relevant in the circumstances: current financial position and current and historical operating results of the issuer; sales prices of recent public or private transactions in the same or similar securities, including transactions on any securities exchange on which such securities are listed or in the over- the- counter market; general level of interest rates; recent trading volume of the security; restrictions on transfer, including the Partnership's right, if any, to require registration of its securities by the issuer under the securities laws; significant recent events affecting the issuer, including pending mergers, acquisitions and sales of securities; the price paid by the Partnership to acquire the asset; the percentage of the issuer's outstanding securities that is owned by the Partnership; and all other factors affecting value.

For purposes of the Partnership's valuation of investments, a security shall be deemed to be "freely tradable" if (i) the portion of the Partnership's holding of such security to be valued or distributed can be immediately sold by the Partnership to the general public without the necessity of any U.S. federal, state or local government consent, approval or filing (other than any notice filings of the type required pursuant to Rule 144 (h) under the Securities Act of 1933, as amended (the Securities Act), and (ii) such security is either listed on a national securities exchange, any other recognized stock exchange or stock market for dealing in securities in the United Kingdom or Western Europe or carried on the NASDAQ National Market and market quotations are readily available therefore.

- *Advent Morro Equity Partners Inc.* – The Partnership's valuation methodologies used for investments measured at fair value:

1. The cost (excluding transaction costs) of an investment is deemed the "exit price" on the date of the investment and is therefore used as its initial fair value.

2. Listed securities which are not restricted as to saleability or transferability are valued at the closing price as of the valuation date. If any listed security was not traded on such date, the mean of the closing high bid and low asked prices as of the close of business on such date is used.

3. Unlisted securities which are readily marketable are valued at the mean of the closing bid and asked prices as of the valuation date.

4. Securities, whether listed or unlisted, for which market quotations are available, but which are restricted as to saleability or transferability, shall generally be valued as provided in (2) and (3) above, less a discount of generally five percent (5%) to thirty percent (30%) of the value thereof as determined in good faith by the General Partner. In determining the amount of such discount, the General Partner shall give consideration to the nature and length of such restrictions and the relative volatility of the market price of such security.

5. For securities which are not publicly traded, or unlisted securities which are not readily marketable, but do have a comparable company which fair value can be determined, the General Partner will utilize comparable company valuation techniques to determine fair value. These include existing similar securities performance valuation, sales prices of recent public or private transactions in the same or similar securities, including transactions on any securities exchange on which such securities are listed or in the over-the-counter market; general level of interest rates; recent trading volume of the security; restrictions on transfer including the partnerships right, if any, to require registration of its securities by the issuer under the securities laws, etc. The fair values derived from valuation methodologies described above may include significant adjustments based on unobservable inputs, as deemed necessary by the General Partner, under the circumstances of the particular security.

6. If the security does not have a comparable company which fair value could be derived, the general partner will see if the investee company has sustainable performance, for example recurring EBITDA. In such cases fair value may be determined as EBITDA times a reasonable marketplace multiple for the company.

7. If there is no comparable company which fair value could be derived, then the General Partner will determine if there is any material change in the results of the investee company compared to budget, plan, market for the company or its products or potential products, major change in the global economy or the economic environment in which the company operates, etc.

8. If none of the above scenarios are considered, the value of most recent round of financing will most likely be used as the best estimate of fair value.

9. If there is no recent round of financing the General Partner will analyze the investment and use a reasonable method to arrive to an estimated fair value.

- *GF Capital Management and Advisors, LLC* -- The Partnership adopted Financial Accounting Standards Board Statement of Financial Accounting Standards No. 157, Fair Value Measurements (FAS 157), effective January 1, 2008. In accordance with FAS 157, "fair value" is defined as the price that the Partnership would receive upon selling an investment in an orderly transaction to an independent buyer in the principal or most advantageous market for the investment.

- *Chase Capital Partners Private* -- Private equity investments are initially valued based upon transaction price, with subsequent adjustments to values which reflect the consideration of available market data, including primarily observations of the trading multiples of public companies considered comparable to the private companies being valued. Valuations are also adjusted to give consideration to the financial condition and operating results specific to the issuer, the lack of liquidity inherent in a non-public investment, credit markets and the fact that comparable public companies are not identical to the companies being valued. Such value may also be based on fair value as determined by JPMP and then adjusted as considered necessary by the Investment Manager due to the absence of quoted market values, inherent lack of liquidity and the long-term nature of such investments.

Investments in limited partnerships are presented in the accompanying financial statements at fair value, as determined by the Investment Manager. Such value generally represents the Fund's proportionate share of the net assets of the investment partnerships as reported by the general partners of the underlying partnerships. Accordingly, the value of the investment in the underlying partnerships is generally increased by additional contributions to the underlying partnerships and the Fund's share of net earnings from the underlying partnership investments and decreased by distributions from the underlying partnerships and the Fund's share of net losses from the underlying partnership investments.

The valuation of the underlying private companies require significant judgments and interpretations by the general partners of the underlying investment partnerships due to the absence of quoted market values, inherent lack of liquidity and the long-term nature of such investments. Private companies are initially valued based upon transaction price, with subsequent adjustments to values which reflect the consideration of available market data, including primarily observations of the trading multiples of public companies considered comparable to the private companies being valued. Valuations are also adjusted to give consideration to the financial condition and operating results specific to the issuer, the lack of liquidity inherent in a non-public investment, credit markets and the fact that comparable public companies are not identical to the companies being valued.

Securities Lending Transactions

The System entered into securities lending transactions. The System's securities custodian, as agent, manages the securities lending program and receives liquid collateral. At June 30, 2008 and 2007, the collateral received represents 102.93% and 103.88%, respectively, of the fair value of the securities lent.

Fair value of securities lending obligations for which collateral was received consisted of $166.7 million and $61.8 million in US equity securities at June 30, 2008 and 2007 respectively.

The underlying collateral for these securities had a market value of approximately $171.6 and $64.2 million as of June 30, 2008 and 2007, respectively, and was invested as follows (in thousands):

		2008		2007	
Asset Backed Commercial Paper	$	-	—	9,369	14.58%
Reverse Repo U.S. Agency Delivered		1,047	0.61%	6,154	9.58%
Reverse Repo Mortgage Backes Tri- Party		—	—	48,720	75.84%
Reverse Repo Corporate Tri-Party		170,553	99.39%	—	—
Total	$	171,600	100.00%	64,243	100.00%

The System has low credit risk exposure to borrowers. The System's rights to collateral are defined in the contractual agreement. There is collateral in excess of 100%. In case of borrower default, the System has immediate rights to collateral. Borrower's creditworthiness is also proactively reviewed by the Lending Agent.

6. LOANS AND INTEREST RECEIVABLE FROM PLAN MEMBERS

The loans receivable from plan members are guaranteed by the contributions of plan members and by other sources, including mortgage deeds and any unrestricted amount remaining in the escrow funds. In addition, collections on loans receivable are received through payroll withholdings. Effective September 2007, the System increased the maximum amounts that may be granted to plan members for personal and cultural trip loans from \$5,000 to \$15,000 and from \$5,000 to \$10,000, respectively.

The allowance for loan losses is considered a general allowance for all categories of loans and interest receivable except mortgage loans, and also a specific allowance for the special collection project loans balances.

The composition of loans and interest receivable from plan members is summarized as follows (in thousands):

	2008	2007
Loans receivable:		
Mortgage	$ 116,022	107,680
Personal	782,234	439,854
Cultural trips	37,379	27,813
Total loans to plan members	935,635	575,347
Accrued interest receivable	17,769	16,200
	953,404	591,547
Less: Allowance for adjustments and losses in realization	(26,573)	(14,233)
Total loans receivable, net	$ 926,831	577,314

7. ACCOUNTS RECEIVABLE FROM EMPLOYERS

During 2007 the System recorded approximately \$64.5 million as a reduction of annuities disbursements, regarding the amount billed for special laws that are the financial responsibility of the corresponding employers. The management of the System recorded all revenues during fiscal year 2007 since they believe that the information available in previous years was not sufficient and reliable to determine an accurate amount.

From the \$41 million of accounts receivable from employers as of June 30, 2007, 46% are supported by installment payment agreements signed by the counterparties, 37% accepted the amount billed by the System, but requested a term extension to sign the agreements after analysis by the governing bodies of the counterparties and 17% which have not accepted nor rejected the amount billed by the System.

The total amount included as receivable as of June 30, 2008, includes an allowance for doubtful accounts of approximately \$7 million mainly caused by the amount billed to the employers which as of end of fiscal year have not replied to the System either accepting or rejecting the amount billed to them. It is the management understanding that the remaining receivable balances do not need an allowance for doubtful accounts since these employers have consistently showed an acceptable payment history toward the System.

As of June 30, 2008 the balance of these accounts receivable amounted to $27 million as collections has been received during current year. For this outstanding balance there is still recorded an account receivable allowance of over $6 million, however the System has engaged in additional strategies toward a more aggressive collection effort to reach the highest collection rate possible. The System's management believes that these balances have a high probability of collection, moreover with the new collection strategies implemented and that any balance that remains uncollected has been already offset from their records as an adequate allowance has been established.

Accounts receivable from employers consist of contributions and loan repayments due from municipalities and public corporations. The employers, other than Commonwealth agencies, must pay directly to the System. According to Act 447, each employer must pay on a monthly basis, the amounts regarding contributions and loan repayments, on or before the fifteenth day of the following month. After that date, interests are charged, as established by the System. As of June 30, 2008 and 2007, the receivable from employers amounted to $241.3 and $117.4 million, respectively.

8. CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2008 was as follows (in thousands):

		Beginning Balance	Increases	Decreases	Ending Balance
Capital assets, not being depreciated:					
Land	$	969	—	—	969
Construction in progress		1,375	1,700	—	3,075
Total capital assets, not being depreciated		2,344	1,700	—	4,044
Capital assets, being depreciated:					
Building and improvements		7,631	-	—	7,631
Equipment		12,958	373	1,427	11,904
Total capital assets, being depreciated		20,589	373	1,427	19,535
Less accumulated depreciation for:					
Building and improvements		3,455	113	—	3,568
Equipment		11,002	592	1,423	10,171
Total accumulated depreciation		14,457	705	1,423	13,739
Total capital assets being depreciated, net		6,132	(332)	4	5,796
Total capital assets, net	$	8,476	1,368	4	9,840

Capital assets activity for the year ended June 30, 2007 was as follows (in thousands):

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets, not being depreciated:				
Land	$ 969	—	—	969
Construction in progress	—	1,375	—	1,375
Total capital assets, not being depreciated	969	1,375	—	2,344
Capital assets, being depreciated:				
Building and improvements	7,631	—		7,631
Equipment	12,780	295	117	12,958
Total capital assets, being depreciated	20,411	295	117	20,589
Less accumulated depreciation for:				
Building and improvements	3,342	113		3,455
Equipment	10,344	770	112	11,002
Total accumulated depreciation	13,686	883	112	14,457
Total capital assets being depreciated, net	6,725	(588)	5	6,132
Total capital assets, net	$ 7,694	787	5	8,476

9. OTHER ASSETS

At June 30, 2008 and 2007, other assets consisted of the following (in thousands):

	2008	2007
Repossessed and foreclosed properties	$ 3,594	2,672
Executed land	4,699	4,699
Total	$ 8,293	7,371

Repossessed and foreclosed properties consist mainly of properties acquired through foreclosure proceedings related to delinquent mortgage loans. Foreclosed properties are valued at the outstanding principal balance of the related mortgage loan upon foreclosure. These properties will be sold under a bidding process intended to recover the outstanding principal balance of the related mortgage loan. Gain or loss is recognized at the time of sale.

Differences resulting from recognition of losses at the point of sale rather than upon foreclosure, as required by accounting principles generally accepted in the United States of America, are not material. Management believes that the carrying value of these properties approximates its fair value.

As of June 30, 2008 and 2007, a total of 14,618 square meters of land remained under the possession of the System. According to an independent appraisal as of June 8, 2005, the estimated market value of this land approximates $22.8 million.

10. BONDS PAYABLE

Senior Pension Funding Bonds

On February 27, 2007, the System's administration and the Government Development Bank for Puerto Rico, acting as the System's fiscal agent, presented to the Board of Trustees, a financial transaction for the issuance of pension funding bonds in order to reduce the System's unfunded actuarial accrued liability. The System has authorized the issuance of one or more series of bonds (the Bonds) in order to increase the funds currently available to pay pension benefits to certain of its beneficiaries and reduce its unfunded accrued actuarial pension liability. The System will pledge future Employer Contributions to the payment of the Bonds, invest the proceeds of the Bonds and use these investments and the earnings thereon to provide such pension benefits to its beneficiaries.

On January 31, 2008, the System issued the first series of Bonds, which consisted of approximately $1,589 million aggregate principal amount of Senior Pension Funding Bonds, Series A (the Series A Bonds). On June 2, 2008, the System issued the second of such series of Bonds, which consisted of approximately $1,059 million aggregate principal amount of Senior Pension Funding Bonds, Series B (the Series B Bonds). Finally, on June 30, 2008, the System issued the third and final of such series of Bonds, which consisted of approximately $300 million aggregate principal amount of Senior Pension Funding Bonds, Series C (the Series C Bonds).

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The outstanding balance of the Employee's Retirement System Senior Pension Funding Bonds is comprised of the following obligations (in thousands):

Description		2008
Serie A -		
Capital Appreciation Bonds, maturing through 2028, with interest rate of 6.20%	$	46,197
Term Bonds, maturing through 2023, with interest rate of 5.85%		200,000
Term Bonds, maturing from 2031 through 2038, with interest rate of 6.15%		679,000
Term Bonds, maturing from 2039 through 2042, with interest rate of 6.20%		332,770
Term Bonds, maturing from 2055 through 2058, with interest rate of 6.45%		332,000
		1,589,967
Serie B -		
Capital Appreciation Bonds, maturing from 2028 through 2030, with interest rate of 6.40%		141,787
Capital Appreciation Bonds, maturing from 2031 through 2034, with interest rate of 6.45%		101,984
Term Bonds, maturing through 2031, with interest rate of 6.25%		117,100
Term Bonds, maturing from 2036 through 2039, with interest rate of 6.30%		270,000
Term Bonds, maturing from 2055 through 2058, with interest rate of 6.55%		429,000
		1,059,871
Serie C -		
Capital Appreciation Bonds, maturing through 2030, with interest rate of 6.50%		2,203
Term Bonds, maturing through 2028, with interest rate of 6.15%		110,000
Term Bonds, maturing through 2038, with interest rate of 6.25%		45,000
Term Bonds, maturing through 2043, with interest rate of 6.30%		143,000
		300,203
Total bonds outstanding		2,950,041
Less: Bonds discounts		(7,857)
Net bonds payable	$	2,942,184

Series A The Series A Bonds issued on January 31, 2008 in the aggregate principal amount of approximately $1,589 million as term bonds (the Term Bonds) and as capital appreciation bonds (the Capital Appreciation Bonds), in the principal amounts of $1,544 million and $45 million, respectively, bearing interest rates from 5.85% to 6.45% and maturing from 2023 through 2058. Interest on the Series A Bonds accrued, or compound (in the case of Capital Appreciation Bonds), from their date of delivery. Interest in the Term Bonds are payable monthly on the first day of each month, commencing on March 1, 2008. Interest on the Capital Appreciation Bonds are not payable on a current basis, but are added to the principal of the Capital Appreciation Bonds on each January 1 and July 1, commencing on July 1, 2008 (each, a Compounding Date), and are treated as if accruing in equal daily amounts between Compounding Dates, until paid at maturity or upon redemption. Interest shall be computed on the basis of a 360-day year consisting of twelve 30-day months. The Series A Bonds are subject to redemption at the option of the System from any source, in whole or in part at any time on or after July 1, 2018, at a redemption price equal to the principal amount (in the case of Capital Appreciation Bonds, the Accreted Amount) of the Series A Bonds, plus accrued interest to the redemption date, and without premium. The Series A Bond has the following debt service requirements (in thousands):

Year ending June 30,	Principal	Interest
2009	$ —	40,059
2010	—	95,504
2011	—	95,504
2012	—	95,504
2013	-	95,504
2014-2018	-	477,522
2019-2023	120,000	474,596
2024-2028	80,000	423,702
2029-2033	52,541	530,476
2034-2038	538,000	366,469
2039-2043	466,270	173,749
2044-2048	—	107,070
2049-2053	—	107,070
2054-2058	251,150	90,476
2059	80,850	5,215
Principal outstanding and interest	1,588,811	3,178,420
Add (deduct): Accreted value on bonds outstanding	1,156	(1,156)
	$ 1,589,967	3,177,264

Series B -- The Series B Bonds issued on June 2, 2008 in the aggregate principal amount of approximately $1,059 million as term bonds (the Term Bonds) and as capital appreciation bonds (the Capital Appreciation Bonds), in the principal amounts of $816 million and $243 million, respectively, bearing interest rates from 6.25% to 6.55% and maturing from 2028 through 2058. Interest on the Series B Bonds accrued, or compound (in the case of Capital Appreciation Bonds), from their date of delivery. Interest in the Term Bonds are payable monthly on the first day of each month, commencing on July 1, 2008. Interest on the Capital Appreciation Bonds are not payable on a current basis, but are added to the principal of the Capital Appreciation Bonds on each January 1 and July 1, commencing on July 1, 2008 (each, a Compounding Date), and are treated as if accruing in equal daily amounts between Compounding Dates, until paid at maturity or upon redemption. Interest shall be computed on the basis of a 360-day year consisting of twelve 30-day months. The Series B Bonds are subject to redemption at the option of the System from any source, in whole or in part at any time on or after July 1, 2018, at a redemption price equal to the principal amount (in the case of Capital Appreciation Bonds, the Accreted Amount) of the Series B Bonds, plus accrued interest to the redemption date, and without premium. The Series B Bond has the following debt service requirements (in thousands):

Year ending June 30,		Principal	Interest
2009	$	—	4,223
2010		—	52,428
2011		—	52,428
2012			52,428
2013		—	52,428
2014-2018		—	262,141
2019-2023		—	262,141
2024-2028			262,141
2029-2033		308,171	819,866
2034-2038		186,464	431,277
2039-2043		135,000	153,255
2044-2048		—	140,498
2049-2053		—	140,498
2054-2058		288,750	121,585
2059		140,250	9,186
Principal outstanding and interest		1,058,635	2,816,523
Add (deduct): Accreted value on bonds outstanding		1,236	(1,236)
	$	1,059,871	2,815,287

Series C -- The Series C Bonds issued on June 30, 2008 in the aggregate principal amount of approximately $300 million as term bonds (the Term Bonds) and as capital appreciation bonds (the Capital Appreciation Bonds), in the principal amounts of $298 million and $2 million, respectively, bearing interest rates from 6.15% to 6.50% and maturing from 2028 through 2043. Interest on the Series C Bonds accrued, or compound (in the case of Capital Appreciation Bonds), from their date of delivery. Interest in the Term Bonds are payable monthly on the first day of each month, commencing on August 1, 2008. Interest on the Capital Appreciation Bonds are not payable on a current basis, but are added to the principal of the Capital Appreciation Bonds on each January 1 and July 1, commencing on July 1, 2009 (each, a Compounding Date), and are treated as if accruing in equal daily amounts between Compounding Dates, until paid at maturity or upon redemption. Interest shall be computed on the basis of a 360-day year consisting of twelve 30-day months. The Series C Bonds are subject to redemption at the option of the System from any source, in whole or in part at any time on or after July 1, 2018, at a redemption price equal to the principal amount (in the case of Capital Appreciation Bonds, the Accreted Amount) of the Series C Bonds, plus accrued interest to the redemption date, and without premium. The Series C Bond has the following debt service requirements (in thousands):

Year ending June 30,		Principal	Interest
2010		—	18,638
2011		—	18,587
2012		—	18,587
2013		—	18,587
2014		—	18,587
2015-2019		—	92,935
2020-2024		—	92,935
2025-2029		110,000	78,455
2030-2034		10,683	65,553
2035-2039		36,520	53,430
2040-2044		143,000	27,026
Principal outstanding and interest	$	300,203	503,320
Total Series	$	2,950,041	6,495,871

Activity of bonds payable during the year ended June 30, 2008 is as follows:

		June 30, 2008					
		2007	Issuances	Accretion	Payments	2008	Current Portion
Serie A -	$						
Capital Appreciation Bonds		—	45,041	1,156	—	46,197	—
Term Bonds		—	1,543,770	—	—	1,543,770	—
			1,588,811	1,156	—	1,589,967	—
Serie B -							
Capital Appreciation Bonds		—	242,535	1,236	—	243,771	—
Term Bonds		—	816,100		—	816,100	—
		—	1,058,635	1,236	—	1,059,871	—
Serie C -							
Capital Appreciation Bonds		—	2,203	—		2,203	
Term Bonds		—	298,000	—		298,000	
		—	300,203	—	—	300,203	—
Total bonds outstanding			2,947,649	2,392	—	2,950,041	—
Less: Bonds discounts		—	(7,857)	—	—	(7,857)	—
Total bonds payable, net	$	—	2,939,792	2,392	—	2,942,184	—

Pledge of Employer Contributions Pursuant to Security Agreement

The System entered into a Security Agreement with the Fiscal Agent for the benefit of the Bondholders, pursuant to which the System pledged to the Fiscal Agent, and granted to the Fiscal Agent a security interest in, Employer Contributions made after January 31, 2008, which was the date of issuance of the first series of Bonds, and the funds on deposit with the Fiscal Agent under the various account established under the Pension Funding Bond Resolution (the Resolution).

The Resolution and the Security Agreement constitute a contract between the System and the Fiscal Agent, on behalf of the owners of the Bonds. The pledge, covenants and agreements of the System set forth in the Resolution and the Security Agreement shall be for the equal benefit, protection an security of the owners of the Bonds, regardless of time or times of their issuance or maturity, and shall be of equal rank, without preference, priority or distinction of any of the Bonds over any other Bond, except as expressly provided in or permitted by the Resolution. The pledge by the System of the Pledged Funds, which consist of all Employer Contributions that are made after January 31, 2008, which was the date of issuance of the first series of Bonds, in accordance with the Act and amounts on deposit in the different accounts created pursuant to the Resolution for the benefits of the owners of the Bonds, is irrevocable so long as any Bonds are outstanding under the terms of the Resolution.

11. 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. The plan members who obtained these loans from the System pay the coverage in its entirety. The life insurance rates are actuarially determined and do not vary by age, sex or health status.

12. REIMBURSEMENT CLAIM

The System, besides receiving contributions from plan members and the plan sponsor, also receives legislative appropriations from special laws to cover the increase in benefits to retirees. There have been several acts which established an increase of 3% in pension annuities every three years for those members who meet the requirements outlined by these acts (Act No. 10 of May 21, 1992, Act No. 207 of August 13, 1995, Act No. 221 of August 9, 1998, Act No. 40 of June 13, 2001, and Act No. 157 of June 27, 2003). Also there have been other laws that granted additional benefits, such as, summer and Christmas bonuses, and medical plan contributions, among others. Most of the funds needed to cover these benefits are budgeted by the Commonwealth through legislative appropriations. Nevertheless, the System believes that the costs of pension benefits from 1992 to June 30, 2004 pursuant to the above laws were not received in full by the System from legislative appropriations. The System had to cover approximately $34.7 million from its resources that the System believes should have been received through special laws appropriations. From these costs, as of June 30, 2008 and 2007 there were $319 thousands and $3 million, respectively, included in the financial statements as receivables from the Commonwealth of Puerto Rico.

In June 30, 2007, the System had filed a reimbursement claim with the Office of Management and Budget of the Commonwealth to collect this amount. The final outcome of this claim cannot be presently determined, therefore no accruals has been made in the System's financial statements.

13. COMMITMENTS AND CONTINGENT LIABILITIES

Loss Contingency

The System is defendant or co-defendant in various lawsuits resulting from the ordinary conduct of its operations. Based on the advice of legal counsel and considering insurance coverage, management is of the opinion that the ultimate liability, if any, will not have a significant effect on the financial status of the System.

Construction Commitments

The System has entered into various contracts with outside contractors for construction and remodeling the building facilities. The System records the liability for these contracts as progress billings are received, based on completed work. The uncompleted portion of these contracts approximated $2 million as of June 30, 2008.

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Required Supplementary Schedules of Employers' Contributions and Funding Progress

Employee's Retirement System of the Government of the Commonwealth of Puerto Rico

(A Pension Trust Fund of the Commonwealth of Puerto Rico)
Schedule of Employer's Contribution
June 30, 2008
(In Thousands)

Year Ended June 30,		Actual Employer Contributions	Annual Required Contributions	Percentage Contributed
2008 *	$	581,285	1,191,275	48.80%
2007 **		566,524	816,472	69.39%
2006 **		559,198	816,472	68.49%
2005		374,823	578,387	64.80%
2004		330,336	578,387	57.11%
2003		330,404	802,536	41.17%
2002		308,228	802,536	38.41%

* Actual Employer Contribution for the year ended June 30, 2008 assumes:

- o contribution of 9.275% of expected payroll for the Basic System Benefits, plus
- o contribution of $139.9 million for Special Law Pension Benefits, plus
- o contribution of $47.5 million for early retirement incentives.

* In the development of the Fiscal Year 2007-2008 Annual Required Contribution the System has adopted a level dollar amortization method with 30-year period to reflect the closing of the defined benefit plan to new entrants under System 2000 (the Retirement Savings Account Program).

** Annual Required Contributions for the years ended June 30, 2007 and June 30, 2006 is restated to remove the offset of employer contributions on behalf of System 2000 members that was applied to the normal cost, and to include the Special Law Benefits. Actual Employer Contributions are restated to include receipts for Special Law pension benefits and early retirement incentives. Those adjustments were made to allow for better comparability between the results of the current and the prior valuation.

The above liabilities are for Basic System Benefits and selected System Administered Benefits.

See notes to supplementary schedule of employers' contributions and funding progress.

Employee's Retirement System of the Government of the Commonwealth of Puerto Rico

(A Pension Trust Fund of the Commonwealth of Puerto Rico)
Schedule of Funding Progress
June 30, 2008
(In Thousands)

Actuarial Valuation Date		Actuarial Value of Plan Assets	Actuarial Accrued Liability - Unit Credit (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Annual Covered Payroll	UAAL as a Percentage Covered Payroll
June 30, 2007	$	2,891,501	16,769,512	13,878,011	17.2%	4,246,409	326.8%
June 30, 2006		2,541,331	Not determined	Not determined	Not determined	Not determined	Not determined
June 30, 2005 *		2,327,871	13,969,000	11,641,129	16.7%	4,125,866	282.2%
June 30, 2004		2,141,442	Not determined	Not determined	Not determined	Not determined	Not determined
June 30, 2003		1,947,402	11,191,357	9,243,955	17.4%	3,334,441	277.2%
June 30, 2002		1,979,677	Not determined	Not determined	Not determined	Not determined	Not determined

*Accrued liability for June 30, 2005 is restated to include the Special Law benefits. These adjustments were made to allow for better comparability between the results of the current and the prior valuation.

The above liabilities are for Basic System Benefits and Selected System Administered Benefits.

See notes to supplementary schedule of employers' contributions and funding progress.

1. SCHEDULE OF CONTRIBUTIONS

The Schedule of 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 in accordance with certain parameters, which include actuarial methods and assumptions.

The System's Schedule of Contributions is based on total benefits and administration costs, net of member contribution; it includes both Commonwealth's and participating employer's contributions. The Commonwealth's and participating employer's contributions, ultimately, should cover any deficiency between pension benefits and the System's administration costs.

The information was obtained from last actuarial report as of June 30, 2007.

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 sufficient assets to pay benefits when due. The information was obtained from the last actuarial report as of June 30, 2007.

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